The Moral and Legal Adequacy (or otherwise) of Exclusion Clauses and their General Application in the Insurance Process with Special Reference to the Liberian Experience

Being a Paper Presented by

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The insurance business, like every other financial services business, is controlled by the insurance contract and general principles of contract process. However, while most constitutions, including the Liberian Constitution,[1] have a freedom to contract clause, the insurance contract and its process is very highly regulated by the state. The rationale is that the insurance business affects a great many people and is stamped with public interest[2], and therefore constitutionally may be subjected to governmental regulations not applicable to other business enterprises.[3] It is a generally accepted principle of law that the state, in exercise of its police power, has the power or duty to approve or disapprove insurance policies in accordance with statutes which prescribe in substance what shall be the provisions of insurance policies issued within the state; this power is not limited to purely formal matters, such as the print, type or make-up of the insurance policy, but extends to substantive matters of conformity with statutory provisions of the jurisdiction relating to clauses and stipulations which must, may, or may not be included in insurance contracts.[4]

The moral and legal adequacy of the exclusion clauses of insurance contracts and their general practical application in the insurance business with special reference to the Liberian experience must therefore be viewed in the context of the state's regulatory powers over the insurance business, as discussed above, which regulatory power oftentimes underpins court decisions on such matters.

Another generally accepted principle which must be taken into account in discussng this topic is the applicability of the rule of liberal construction of a

[1] Liberian Constitution, Art. 25
[2] *Eckenrode v Life of America Inc. Co.,* 470 **F**2d 1.
[3] 43 Am Jur 2d, Insurance, §17
[4] Ibid, §24

contract against the party who drafted it; the law simply provides that ambiguities, uncertainties and doubts in an insurance contract shall be construed strictly and most strongly against the insurer, and liberally in favor of the insured, so as to effect the dominant purpose of indemnity or payment to the insured. [5] For example, where the provisions of an insurance policy are reasonably susceptible of two constructions consistent with the object of the obligation, one favorable to the insured and the other favorable to the insurer, the former will be adopted.[6] In one case, the court held that:

> *"Insurance is, in its nature, complex and difficult for the layman to understand. Policies are prepared by experts, who know and can anticipate the bearing and possible complications of every contingency. So long as insurance companies insist upon the use of ambiguous, intricate, and technical provisions which conceal, rather than frankly disclose, their own intentions, the courts must, in fairness to those who purchase insurance construe every ambiguity in favor of the insured."*[7]

Another reason advanced for the application of the rule of liberal construction of the insurance contract in favor of the insured and most strongly against the insurer is that a liberal construction in favor of the insured is most conducive to trade and business and, moreover, probably most consonant with the intentions of the parties, and that in accord with the presumed intention of the parties, the construction should be such that as not to defeat, without a plain necessity, the insured's claim to the indemnity which

[5] 43 Am Jur 2d, Insurance §283.
[6] *Aetna Casualty & Surety Co. v. Stover,* 327 **F**2d 288, 7 ALR3d 655.
[7] *Buchanan v. Massachusetts Protective Asso.,* 223 **F**2d 609, 53 ALR2d 548, 350 US 833.

it was his object to secure and for which he paid a premium.[8] Consistent with this general principle, another court has held that:

> *"Contracts of insurance are not to be construed to relieve insurance companies that write them from coverages broader than they intended and from coverages they would not advisedly have taken, if to do so is to leave one without protection who might reasonably be held to be within the policy's provision."*[9]

In still another case, the court held that *"In general, the object and purpose of insurance is to indemnify the insured in case of loss, and to that end, the law makes every rational intendment in order to give full protection to the interests of the insured.*[10]

In the context of the rules elaborated on above, a general principle of law that is well-established is that forfeitures of an insurance policy are looked upon with disfavor both by the law; and courts are generally disposed to avoid forfeiture if by reasonable interpretation they can do so.[11] Under that same parity of reasoning, the additional rule, which is also very well-established, is that if exceptions, exclusions, and exemptions from, or limitations of, the liability of an insurer are not expressed plainly and without ambiguity, they will be construed strictly against the insurer, and liberally against the insured, in order that the purpose of insurance shall not be defeated.[12] (Emphasis Mine).

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[8] 43 Am Jur 2d, Insurance, §284.
[9] *Johnson v. Maryland Casualty Co.,* 125 **F**2d 337.
[10] *Glickman v. New York Life Inc. Co.,* 16 **Cal** 2d 626, 107 P2d 252.
[11] 43 Am Jur 2d, Insurance, §290.
[12] Ibid, § 291

Now, these qualifications and observations on the regulation of the insurance contract and the insurance business by the state and the attitude of the law and the courts to ambiguities and exclusion clauses of the insurance policy are counter-balanced by another well-established principle of law that the parties to an insurance contract may make the contract in the legal form they desire, and that insurance companies have, in the absence of statutory provisions to the contrary, the same right as individuals to limit their liability and to impose whatever conditions they please upon their obligations, not inconsistent with public policy. If exceptions, exclusions and limitations are plainly expressed, insurers are entitled to have them construed and enforced as expressed.[13]

This means that the issue regarding exclusion clauses is not necessarily that they are moral or not; the issue is their legal adequacy. The issue is whether exclusion clauses are so clearly stated in the insurance contract, as to infer, with certainty, that the insured knew about them and understood their implications, imports and effects. To ensure legal adequacy, some insurers place the exclusion clauses in typed-letters that are bolder than other provisions of the insurance contract; and in addition to the bolder-typed letters, some insurers have the insured initial exclusion clauses of the insurance contract. Still other insurers put the exclusion clauses as separate riders to the insurance contract and have the insured sign on to or otherwise acknowledge in writing the separate rider; and the rider is incorporated into the insurance contract as an attachment, referred to in the body of the insurance contract.

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[13] *Fidelity & Casualty Co. v. Reece,* 223 **F**2d 114; *Phillips v. Government Employees Inc. Co.,* 395 **F**2d 166; *American Casualty Co. v. Myrick,* 304 **F**2d 179, 96 ALR2d 1352; *Standard Acc. Ins. Co. v. Winget,* 197 **F**2d 97, 34 ALR2d 250; *Schultz v. Commercial Standard Inc. Co.,* 308 **F** Supp 202.

Obviously, the insured must get what he has contracted for and paid for; but it is extremely important from the onset of the relationship that the insured fully understand what the insurance policy covers and what is not covered. The insured should not expect to get what he did not contract for and pay premium for; on the other hand, the insurer should not be allowed to deny coverage where it was not clear that a particular risk or peril was contracted for and premium paid for. In the latter case, it is fair that the overall intention of the insurance contract, to provide indemnity or compensation to the insured, must be honored; and this does not present a moral dilemma; it presents a legal issue.

What is more perilous for insurance companies in some jurisdictions, especially jurisdictions of developing countries or emerging economies is the legal interpretation and application of exclusion clauses. This peril is stated in the context of the fact that in the event of a dispute on an exclusion clause (its interpretation or applicability or both), which dispute eventually ends up in courts, a trial is conducted by a jury. Perhaps because of the absence of sophistication of the people or lack of experience with insurance products, jurors of ordinary people look with strong disfavor on exclusion clauses. The attitude to an exclusion clause is that the insurer is simply attempting to avoid the obligations of the insurance contract after having benefitted from the premiums paid by the insured. Regrettably, this attitude is sometimes assumed by even the sophisticated and well-educated, including lawyers and judges, who assume the additional attitude that their job is to protect the insured, which is presumed to be the weaker of the two parties (the party who is now in distress and needs relief). They consider themselves guardian angels of the weak and distressed party; and this is a social perception; not a moral issue.

These attitudinal characteristics find themselves in the opinions and judgments which courts render from jurisdiction to jurisdiction in our part of the world (West Africa). That is, if an insurer finds itself in a jurisdiction which is favorable to the insurer, exclusion clauses in insurance contracts are likely to be construed and interpreted with maximum objectivity, using the premise that the insured must get only what he has contracted for and paid premium for. In those jurisdictions, which are favorable to the insured, exclusion clauses are construed and interpreted on the premise that the overriding object of indemnity and compensation must be given high marks and exclusion clauses must be honored only where it is clear that the insurer understood the implications, imports and effects of the exclusion clauses and knew that he did not pay premium for the excluded risk or peril. This therefore presents what I would call the *social context of the legal process*; it is not a moral issue.

Let me tell you about my personal experience with exclusion clauses of insurance policies in three (3) different jurisdictions, where some were more favorable to the insurer and others more favorable to the insured. These matters grew out of Liberia's civil war; the insurance policies were the same in terms of general provisions, issued by one foreign company, which only maintained an agent in Liberia in the 1980s. The insured properties were damaged during the years of the war (1990 - 1991. One or more of my clients elected to sue the insurer in the State of Pennsylvania, United States of America where the insurer had its headquarters; and for those cases, I served merely as a consulting counsel to the Pennsylvania attorneys who handled the cases. Well, because Pennsylvania is a jurisdiction more favorable to the insurer, my clients eventually lost their cases; the courts relied on the war risk

exclusion clause of the insurance policies and held that there was war in Liberia and all properties destroyed during the time of the war were not covered by the insurance policy.[14] There are some of my clients, who took their cases to the State of Texas, United States of America, where again I served as consultants to their American lawyers; but Texas has a legal regime that is more favorable to the insured, including treble damages, where the insurer is deemed to have unwarrantedly denied recovery. Even with the same war risk exclusion clause, the same insurer gladly settled with my client in the Texas case.[15] The insurer also invited me to negotiations for settlement with those clients for whom I had instituted legal actions in Liberia, apparently on the theory that I would invoke principles of Texas law, in the absence of governing Liberian law on the matter, to get favorable judgments in my Liberian cases.

Obviously, the issue with my three sets of cases was not one of the morality of the war risk exclusion clause; the issue was the favorableness of the legal regime to the war risk exclusion clause; and the matter should be looked at within the *social context of the legal process*.

I had an additional experience with the war risk exclusion clause; and that additional experience is that after settlement with my clients in the Liberian case, the same insurer refused to settle other claims filed in Liberian courts by other insureds. Why was that?

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[14] *Abi Jaoudi & Azar Trading Corporation and Younis Brothers Company v. Cigna Worldwide Insurance Company,* Civil Case No. _____, Federal District Court for the Southern District of Pennsylvania. (Citation incomplete).

[15] *Bridgestone/Firestone, Inc. v. Cigna Worldwide Insurance Company,* Civil Case No. _____, Federal District Court of Texas. (Citation incomplete).

The first reported case in Liberia on the exclusion clause of an insurance contract involved the war risk exclusion clause; and in that case, the Supreme Court held generally that when hostilities attain dimensions which interfere with the exercise of the jurisdiction of the existing government over parts of its territory, a state of war exists and properties destroyed in those territories during the time of the state of war are excluded from coverage under the war risk exclusion clause of the insurance policy.[16] This was a Supreme Court that was favorable to the insurer; but the membership of that Supreme Court was changed by the time the same matter came up for re-argument. On re-argument of the identical case, the Supreme Court held that the fact that violent hostilities, including war, may have been engaged in or conducted in the city in which the insured properties are located is not enough for the insurer to disclaim liability for the loss or destruction of properties insured by it for reason for the war risk exclusion clause of the insurance policy. The Supreme Court went on to say that a disclaimer of liability for an insurance claim for reason of the war risk exclusion clause of the insurance policy must show that the losses which occurred were a direct result of a war, and that war was not just a remote cause of the war. It further says that actual military offensive and defensive operation must be the direct cause of the loss or destruction of property insured by an insurer in order for the insurer to successfully disclaim liability. It is not enough, the Supreme Court concluded, for the insurer to merely show that violent hostilities, including military operations, took place at the time of the loss or destruction.[17]

In my opinion, in the second opinion of the Supreme Court, the burden of proof placed on the insurer to benefit from the war risk exclusion clause is

[16] *Mano Insurance Corporation v. Picasso Cafeteria and Spanish Gallery,* 38 LLR 37 (1995).
[17] *Picasso Cafeteria and Spanish Gallery v. Mano Insurance Corporation v.,* 38 LLR 297 (1996)

so awesome as to make the war risk insurance clause virtually meaningless. But this is possible where the law of the jurisdiction is not so clear on exclusion clauses and where the insurer did not recognize that in the absence of expressed provision of law or extensive experience of the jurisdiction with exclusion clauses of an insurance policy, the insurer's exclusion clauses should be exhaustive, including provisions covering who carries the burden of proof and the quantum of proof is necessary for recovery.

The Liberian experience with the war risk exclusion clause continues to be one of fluidity and uncertainty; which again makes it necessary for insurers in Liberia, and perhaps countries with similar level of sophistication with the insurance industry, to *put more meat* on exclusion clauses which they adopt from more sophisticated countries of Europe and Northern America. And the *meat* should relate to who (insured or insurer) carries the burden of proof and what should be the quantum of proof for exclusion clause disputes.

In a more recent case decided by the Liberian Supreme Court, it opined that the war risk exclusion clause of an insurance policy is a substantive and binding provision of the insurance contract; and in order for the insured to recover under the policy, the insured would have to show by preponderance of the evidence that the loss it suffered was not caused by any of the perils excluded from coverage under the policy and that the loss was not a direct result of any of the perils.[18] This 2004 decision of the Supreme Court is clearly contrary to the 1996 decision of the Supreme Court in the *Picasso Cafeteria and Spanish Gallery* case; but then in 2007, a new uncertainty in the law on exclusion clauses of insurance policies surfaced.

[18] *Super Cold Services v. Liberian American Insurance Corporation,* March 2004 Term Supreme Court Opinions, decided August 17, 2004.

In 2007, the Supreme Court opined that the fact that a country is at war does not necessarily mean that every loss of property is attributable to the war.[19] But in that same opinion, the Supreme Court went on to say that the loss of property through burglary, having nothing to do with the war, could occur while the country is at war. The Supreme Court further said that forcible entry into a building and removal of properties from that building by men in military uniforms and with guns under the cover of darkness even in times of war could very well be the criminal act of burglary instead of an act of war, such as looting.[20] How's that?

The clear contradiction of the Supreme Court's opinion in the *Sun Pharmacy* case illustrates the dilemma which the courts in our part of the world grapple with insofar as the exclusion clause of insurance policies is concerned. As much as these courts want to apply the law of contract to insurance policies, they are still concerned that a loss has occurred through no fault of the insured and that a strict application of the exclusion clause would frustrate the reasonable expectation of the insured for indemnity or compensation. Depending on the orientation of the jurisdiction (a legal regime favorable to either the insured or the insurer), a determination will be made of the effect of the exclusion clause. So, until exhaustive statutes are enacted on the subject of exclusion clause of an insurance policy, insurers in our part of the world can make it easier for the courts and themselves by providing exclusion clause which are more exhaustive, including provisions on who carries the burden of proof and the quantum of proof for recovery. More than

[19] *Sun Pharmacy v. The United Security Insurance Company,* March 2007 Term Supreme Court Opinions, decided May 11, 2007.
[20] *Sun Pharmacy v. The United Security Insurance Company,* March 2007 Term Supreme Court Opinions, decided May 11, 2007.

this, the exclusion clause should be in plain and unambiguous language, easily understandable by the insured. With this the influence of the *social context of the legal process* in the interpretation and application of exclusion clause of an insurance policy would be minimized. Judges would be constrained to apply the plain language of the insurance contracts.

The problem of exclusion clause of an insurance policy is not a moral dilemma; it is a legal dilemma, underpinned by social concerns and attitudes.

Sources

1. Liberian Constitution, Art. 25
2. *Eckenrode v Life of America Inc. Co.,* 470 **F**2d 1.
3. 43 Am Jur 2d, Insurance, §§17, 283, 284, 290, 291
4. *Aetna Casualty & Surety Co. v. Stover,* 327 **F**2d 288, 7 ALR3d 655.
5. *Buchanan v. Massachusetts Protective Asso.,* 223 **F**2d 609, 53 ALR2d 548, 350 US 833.
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