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ARTICLES

The Seventh Circuit's Improper Dicta Regarding the "Sophistication" of Indiana Policyholders

Policyholder-sophistication issues are most often addressed in the context of determining whether to construe ambiguous policy provisions against the insurer without an evidentiary inquiry into the parties' intent.

By Gregory Gotwald

A policyholder's "sophistication" has long been an issue in insurance-coverage litigation. *See generally*, Beh, Hazel Glenn, *Reassessing the Sophisticated Insured Exception* 39 Tort & Ins. L.J. 85, 85 86 (2003). Policyholder-sophistication issues are most often addressed in the context of *contra proferentem*: determining whether to construe ambiguous policy provisions against the insurer without an evidentiary inquiry into the parties' intent. Beh, 39 Tort & Ins. L.J. at 108 09. This is not the only circumstance though. *E.g.*, *Landmark Am. Ins. Co. v. Deerfield Constr., Inc.*, 933 F.3d 806, 811 (7th Cir. 2019) ("The Supreme Court of Illinois has identified five non-dispositive factors to aid in [determining late notice]... '(2) the insured's sophistication in commerce and insurance matters...'"), quoting *W. Am. Ins. Co. v. Yorkville Nat. Bank*, 939 N.E.2d 288 (Ill. 2010).

States have treated the issue in different ways. *Compare In re Molten Metal Tech., Inc.*, 271 B.R. 711, 724 (Bankr. D. Mass. 2002) ("In order to establish that [the sophisticated-policyholder exception] applies, the Insurers must show not only that the party procuring the insurance coverage . . . was a sophisticated commercial entity and equal in bargaining power to the Insurers, but also that the specific language at issue was a result of bargaining between the Insurer and [the policyholder]."), *with* *Eli Lilly & Co. v. Home Ins. Co.*, 794 F.2d 710, 716 (D.C. Cir. 1986) (construing *Eli Lilly & Co. v. Home Ins. Co.*, 482 N.E.2d 467 (Ind. 1985) and stating: "the only factual predicate of the rule that insurance contracts should be construed against the insurer is the requirement that the contract be ambiguous. Once that factual predicate was satisfied, no quantum of evidence on the issues of authorship, intent, or etiolo y should have defeated a motion for summary judgment."). *See also* The Restatement of the Law of Liability Insurance 4 cmt. h. ("This Section does not endorse the idea of a sophisticated-policyholder exception to the *contra proferentem* doctrine. By placing the responsibility for residual ambiguity on the party that is most in control of the language of the policy, the contra proferentem

rule provides an important incentive to draft terms clearly regardless of the sophistication of the policyholder."). *But see id.* cmt. g (noting that reasonable person in this policyholder's position could account for the sophistication of policyholder).

Indiana law has long been clear that a policyholders' sophistication has no bearing on the application of construing ambiguous terms against the insurer. *Lilly,* 794 F.2d at 715–16; *Lilly*, 482 N.E.2d at 470; *See, e.g., Nat'l Union Fire Ins. Co. v. Std. Fusee Corp.*, 917 N.E.2d 170, 184 (Ind. Ct. App. 2009), *vacated, rev'd on other grounds*. Despite this, the Seventh Circuit has recently failed to recognize this controlling law multiple times. *USA Gymnastics v. Liberty Ins. Underwriters, Inc.*, 27 F.4th 499, 520, 533, 537 (7th Cir. 2022). *See also Emmis Communs. Corp. v. Ill. Nat'l Ins. Co.*, 937 F.3d 836, 853 (7th Cir. 2019) (adopting the district court's opinion as its own). These statements—dicta—by the Seventh Circuit should not be considered good law.

Indiana's Supreme Court Has Expressly Rejected the Sophisticated Policyholder Exception Argument

When construing ambiguous terms against the insurer, policyholder-sophistication references are legally irrelevant and improper under controlling Indiana Supreme Court precedent. *Eli Lilly & Co. v. Home Ins. Co.*, 482 N.E.2d 467 (Ind. 1985) expressly held that any ambiguous, insurance-policy terms should be construed in favor of coverage—without consideration of extrinsic evidence.

Lilly made its way to the Indiana Supreme Court via a certified question from the U.S. Court of Appeals for the District of Columbia Circuit. 482 N.E.2d at 468. The Indiana Supreme Court first addressed "whether under Indiana law the insurers' extrinsic evidence should be used to interpret Lilly's policies." 482 N.E.2d at 470. The insurers "contend[ed] the extrinsic evidence '[was relevant[, in part,] to…Eli Lilly's sophistication and strength as a bargaining partner….'" 482 N.E.2d at 470.

The Indiana Supreme Court acknowledged that "[t]he insurance policies at issue [were] 'manuscript' policies written specifically for Lilly." 482 N.E.2d at 469. Despite this—and Lilly's sophistication—it concluded that "consideration of the extrinsic evidence [wa]s unnecessary to the interpretation of the policies [and held that] the insurers' proffered evidence would not be considered." 482 N.E.2d at 470. The court grounded this decision on the principal that ambiguous language should be strictly construed against the insurer "to further the policy's purpose of indemnity." 482 N.E.2d at 471. Because this was a manuscript policy, the additional (and often cited) justification for this strict construal—the insurer is in the best position to eliminate the ambiguous language—did not matter. *See e.g.,* The Restatement of the Law of Liability Insurance 4 cmt. h.

On remand from the Indiana Supreme Court, the insurers again raised to the D.C. Circuit that Lilly was a sophisticated policyholder, that it had bargaining power, and that the policies were not drafted exclusively by the insurers. 794 F.2d at 715. The D.C. Circuit Court of Appeals rejected the insurers' arguments:

> [W]e read the Indiana Court to have based the general rule that insurance contracts are to be construed against the insurer on three policies: assuring indemnification, fulfilling the reasonable expectations of the insured, and *contra proferentem*. Nonetheless the Indiana opinion does not suggest that *each* of these rationales is a necessary predicate of the rule that a court should construe ambiguities against the insurer. The Indiana court's passing reference to the issue of authorship is therefore mere dicta. *Lilly,* 794 F.2d at 715

It continued:

> [T]he only factual predicate of the rule that insurance contracts should be construed against the insurer is the requirement that the contract be ambiguous. Once that factual predicate was satisfied, no quantum of evidence on the issues of authorship, intent, or etiology should have defeated a motion for summary judgment. *Lilly,* 794 F.2d at 716.

Lilly has never been overturned. No Indiana case has expressly adopted a "sophisticated policyholder" defense for insurers in Indiana since. To the contrary, such arguments have been rejected. *See, e.g., Std. Fusee,* 917 N.E.2d at 184 (vacated, reversed on other grounds) ("We agree with the trial court's conclusion that Indiana law does not recognize a distinction in the level of a policyholder's sophistication. 'Policy terms are interpreted from the perspective of an ordinary policyholder of average intelligence. Consequently, the Insurers' argument about whether [Standard Fusee Corporation] was a sophisticated policyholder need not be decided" (citations omitted.)

The Seventh Circuit's Improper Dicta about Policyholder Sophistication

Despite *Lilly*'s clear mandate against it, the Seventh Circuit has made "policyholder sophistication" references in multiple Indiana-law opinions in the past few years.

In *USA Gymnastics*, the Seventh Circuit (in a *per curium* decision) referenced the policyholder as "sophisticated" multiple times in deciding key coverage issues. *USA Gymnastics*, 27 F.4th at 520, 533, 537. At the outset, a few things are noteworthy about this case. The insurer never advocated a sophisticated-insured exception to *contra proferentem*. Additionally, there were no factual findings concerning USA Gymnastics' "sophistication" or its negotiation of actual policy words or phrases. The

only evidence in the record was that the broker and the insurer discussed whether a certain coverage (Third Party EPL) would be included in the policy.

As to the decision, the Seventh Circuit first stated that the phrase "any insured" had been "negotiated by sophisticated parties" when it agreed with the insurer on the scope of this phrase. *USA Gymnastics,* 27 F.4th at 520. But this phrase was never negotiated. There was zero evidence that USA Gymnastics, the insurer, or the broker ever mentioned—let alone "negotiated"—the use of the words "any insured" or some other phrase. This was the insurers' standard policy language on the form it drafted.

Additionally, it appears the only evidence the decision relied upon to justify calling the non-profit a sophisticated purchaser of insurance was that an insurance broker was involved. The mere involvement of a broker does not even satisfy the standards of those supporting the exception. *See e.g.,* Beh, 39 Tort & Ins. L.J. at 86 (noting that commentators supporting sophisticated- policyholder-exception rules call for it when there is equal bargaining power). All, or virtually all, business insurance policies are purchased through brokers. This is the avenue that insurers have chosen to use to sell their products. Others note a policyholder's wealth and power should not matter because such factors "ignore[] the unique reality of insurance marketing . . ." and that "when it comes to insurers and insureds, equality is a fiction." Beh, 39 Tort & Ins. L.J. at 86 (citing Eugene R. Anderson & James J. Fournier, Why Courts Enforce Insurance Policyholders' Objectively Reasonable Expectations of Insurance Coverage, 5 Conn. Ins. L.J. 335, 369–71 (1998)).

On a separate issue (the available limits), the Seventh Circuit again referred to USA Gymnastics as "a sophisticated insured that was able to negotiate the scope of the relevant coverage[.]" *USA Gymnastics,* 27 F.4th at 533. The dissenting opinion also referred to the policyholder and the insurer as "sophisticated parties." 27 F.4th at 537.

Ignoring that the insurer never raised the "sophistication" argument and the lack of evidence concerning the parties' sophistication or their negotiation of any actual words), the Seventh Circuit still should have never pinned this dicta on policyholder sophistication. *Lilly* makes clear such references are legally irrelevant and improper under Indiana law. *USA Gymnastics* makes no reference to this binding case.

USA Gymnastics was not the Seventh Circuit's only improper reference to policyholder sophistication under Indiana law. In *Emmis Communications Corp. v. Illinois National Ins. Co,* the Seventh Circuit adopted the district court's rational and attached its opinion to Seventh Circuit's decision. *Emmis,* 937 F.3d at 836 ("The judgment of the district court is AFFIRMED for the reasons stated in the district court's opinion of March 21, 2018, which is attached.") The Seventh Circuit's adopted opinion

addressed the insurer's sophisticated-policyholder argument. 937 F.3d at 853–54 ("INIC argues that [*contra proferentem*] should not apply in this case because 'Emmis is a sophisticated corporate insured who was assisted by a broker in negotiating the terms of the manuscript EVENT(S) Exclusion,' and 'the equal bargaining power between Emmis and INIC, as evidenced by Emmis' direct input into the language of the EVENT(S) Exclusion with Illinois National's underwriter supports application of the EVENT(S) Exclusion that Emmis specifically agreed to include.'") While the court rejected the insurer's argument, the opinion is flawed for multiple reasons on this issue.

First, this decision makes no reference to the binding *Lilly* decision, rejecting the sophisticated-policyholder-exception argument as a matter of law. *Eli Lilly*, 482 N.E.2d 470. There was no need for the court to evaluate the evidence the insurer submitted.

Second, the opinion improperly relied on *Phillips v. Lincoln Nat. Life Ins. Co.*, 978 F.2d 302, 313–14 (7th Cir. 1992). *Phillips* was based on Illinois law—not Indiana law. Indiana law is clear on this point and inconsistent with *Phillips*.

Conclusion

Given the clear statement of Indiana law in *Lilly*, the Seventh Circuit's dicta concerning the policyholder's "sophistication" in *USA Gymnastics* and *Emmis* should neither be relied upon, nor considered controlling or persuasive authorities under Indiana law.

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