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# Judicial Interpretations of Insurance Contract Disputes: Toward a Realistic Middle Ground Approach,

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# Judicial Interpretations of Insurance Contract Disputes: Toward a Realistic Middle Ground Approach

PETER NASH SWISHER\*

Welcome to the world of insurance coverage litigation where nothing is certain, but if plaintiffs are in the right state, they may be covered for everything from dog bites to herpes, child molestation or even intentional shootings.

Or they may not be.

The uniformity some might expect from standardized insurance language . . . has instead provided lawyers with a wonderland of surprises. . . . The problem, in part, stems from the fact that even though most policies are standardized, each state's courts supply their own interpretations.<sup>1</sup>

This court has not explicitly adopted the doctrine of "reasonable expectations," at least by name, in any of its forms. Neither has this court explicitly rejected it . . . . At some point, this court will have to address the series of conflicting precedents in our cases which today's majority opinion simply ignores.<sup>2</sup>

Probably the most interesting litigation currently under way in the United States involves insurance coverage disputes. The novelty of the legal issues, the enormous amount of money involved, and the caliber of counsel all combine to produce extremely difficult disputes.<sup>3</sup>

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<sup>1</sup> Milt Policzer, *Same Words, Different Meanings: Lawyers Struggle to Make Sense of Insurance Coverage Language*, NAT'L L.J., Nov. 25, 1991, at 1.

<sup>2</sup> *Collins v. Farmers Ins. Co.*, 822 P.2d 1146, 1162 (Or. 1991) (Unis, J., dissenting).

<sup>3</sup> Francis E. McGovern, *Mass Tort Litigation and Insurance Coverage Cases: Five Models for Judicial Case Management*, THE BRIEF, Winter 1993, at 25, 54.

## I. INTRODUCTION

In a previous law review article,<sup>4</sup> this author analyzed the seemingly arbitrary and contradictory decisional patterns in American insurance law cases. The article concluded that these contradictory judicial patterns could be understood and appreciated if one recognized the fundamental impact—and clash—of two competing theories of American jurisprudence: Legal Formalism and Legal Functionalism in an insurance law context.

Broadly speaking, Legal Formalism is based upon the traditional view that correct legal decisions are determined by pre-existing legal rules, and that the courts must reach their decisions in a logical, socially neutral manner. Formalist judges therefore apply the philosophy of judicial restraint in favor of established legislative and administrative authority.<sup>5</sup> In an insurance law context, Legal Formalism is exemplified by the writings of Professor Samuel Williston and others who believe that insurance contracts ought to be judicially interpreted under the same legal principles as contracts in general, with the exception of various insurance forms, laws, and procedures that are regulated by statute.<sup>6</sup>

Legal Functionalism, on the other hand, is based upon the view that the paramount concern of the courts should not be logical consistency, as the Formalists believe, but socially desirable consequences. Functionalist judges therefore apply the philosophy of judicial activism, co-equal to legislative and administrative authority.<sup>7</sup> In an insurance law context, Legal Functionalism is exemplified by the writings of Professor Robert Keeton and others who believe that the reasonable expectations of the insured ought to be honored, even though a careful examination of the insurance policy contractually would have negated those expectations.<sup>8</sup>

The article concluded that although Legal Functionalism is widely recognized as the dominant theory of legal jurisprudence in many other areas of American law today, Legal Formalism nevertheless has maintained continuing theoretical credibility with many courts in the field of insurance law, while Legal Functionalism—as exemplified by the Keeton insurance law doctrine of reasonable expectations—has experienced a more limited judicial application than various commentators initially had predicted.<sup>9</sup>

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<sup>4</sup> Peter N. Swisher, *Judicial Rationales in Insurance Law: Dusting Off the Formal for the Function*, 52 OHIO ST. L.J. 1037 (1991).

<sup>5</sup> *Id.* at 1039–47, 1073.

<sup>6</sup> *Id.* at 1047–73.

<sup>7</sup> *Id.* at 1039–47, 1073.

<sup>8</sup> *Id.* at 1047–74.

<sup>9</sup> *Id.* at 1074 (“It is not enough, therefore, to understand insurance law ‘in the books’ and

The reaction to this article from a number of academic colleagues, practitioners, and judges has been supportive and encouraging. Indeed, I was asked if I might expand upon my original article and answer two additional questions:

(1) Why do many courts, which seemingly apply a more Functionalist judicial approach to other areas of the law, still retain a more Formalistic judicial approach in cases involving insurance contract disputes?

(2) Is there any viable way to reconcile these two competing doctrines of Legal Formalism and Legal Functionalism in an insurance law context?

The answer to the first question necessarily leads to some speculation and alternative possibilities. However, law professors are seldom shy about rushing in where others fear to tread,<sup>10</sup> so I shall offer a number of possible answers to this first question.

In answering the second—and the most important—question, I will argue that the best elements of Legal Formalist and Legal Functionalist judicial interpretations of insurance coverage disputes may indeed be reconciled and incorporated into a viable, contractually based, and eminently realistic judicial approach to insurance contract interpretation that a number of courts are already applying on an informal basis. It is a common sense “middle ground” judicial approach to the interpretation of insurance contract disputes that is both

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insurance law ‘in action.’ One must also know the judge—and understand the jurisprudential philosophy of each particular court.”).

This Formalist-Functionalist analysis in an insurance law context has been questioned by at least one commentator, James M. Fischer, *Why Are Insurance Contracts Subject to Special Rules of Interpretation?: Text Versus Context*, 24 ARIZ. ST. L.J. 995 (1992). Initially Fischer observes that “Professor Swisher’s description of the insurance law landscape is accurate.” *Id.* at 998 n.11. Fischer later states, “I believe Swisher overstates the importance of the formalistic [contractual] approach as a jurisprudential model. I tend to see it as more of a default approach, which courts use when the functional approach is not needed or is inappropriate.” *Id.* at 1001–02 n.19. Professor Fischer’s “default approach,” however, puts the cart before the horse, and is at odds with the great weight of historical and contemporary insurance contract analysis. *See infra* notes 13, 15–20, 27–28, 33–34, 41–56, 61–71, 76–77, 148, 161–65, 190–96, and accompanying text; *see also infra* notes 197–315 and accompanying text.

<sup>10</sup> *See, e.g.*, Richard A. Posner, *The Decline of Law As an Autonomous Discipline: 1962–1987*, 100 HARV. L. REV. 761, 777 (1987) (“I daresay that many legal scholars who today are breathing the heady fumes of deconstruction, structuralism, moral philosophy, and the theory of second best would be better employed . . . synthesizing the law of insurance.”).

legally sound and socially expedient. Accordingly, I call this synthesis of judicial Formalism and judicial Functionalism in an insurance law context the realistic middle ground approach to insurance contract interpretation.

## II. LEGAL FORMALISM AND LEGAL FUNCTIONALISM IN AN INSURANCE LAW CONTEXT

As discussed in greater depth in a previous article,<sup>11</sup> there are presently two<sup>12</sup> conflicting judicial philosophies coexisting within the field of American insurance law today: Legal Formalism<sup>13</sup> and Legal Functionalism.<sup>14</sup>

In an insurance law context, Legal Formalism is best exemplified by the seminal writings and the major influence of Professor Samuel Williston relating to American contract law in general, and American insurance law in particular.<sup>15</sup> The bedrock principle underlying Williston's Formalistic view of

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<sup>11</sup> See Swisher, *supra* note 4, at 1047–73.

<sup>12</sup> A third newly emerging school of American legal theory, the Critical Legal Studies Movement, which calls for the dismantling of existing political and legal institutions in favor of newly empowered forms of social democracy, has not yet made any measurable impact on the field of American insurance law. See generally MARK KELMAN, A GUIDE TO CRITICAL LEGAL STUDIES (1987); ROBERTO M. UNGER, THE CRITICAL LEGAL STUDIES MOVEMENT (1986); William Ewald, *Unger's Philosophy: A Critical Legal Study*, 97 YALE L.J. 665 (1988); Mark V. Tushnet, *Critical Legal Studies: A Political History*, 100 YALE L.J. 1515 (1991).

<sup>13</sup> Legal Formalism, also known as Legal Positivism, is the traditional view that correct legal decisions are determined by pre-existing judicial and legislative precedent, and the law is viewed as a complete and autonomous system of logical, socially neutral principles and rules. Judging under this Formalistic theory is thus a matter of logical necessity rather than a matter of choice. See, e.g., MARIO JORI, LEGAL POSITIVISM (1992); Frederick Schauer, *Formalism*, 97 YALE L.J. 509 (1988) (discussing how Legal Formalism still serves to limit judicial discretion or judicial activism); Ernest J. Weinrib, *Legal Formalism: On the Imminent Rationality of Law*, 97 YALE L.J. 949 (1988) (questioning whether law is essentially rational as the Formalists believe, or whether law is essentially political as the Functionalists believe); see also Swisher, *supra* note 4, at 1039–47.

<sup>14</sup> Legal Functionalism, also known as Legal Realism or Legal Pragmatism, is based on the belief that the Formalistic theory of a logical and socially neutral legal "certainty" is rarely attainable and may be undesirable in a changing society, and the paramount concern of the law should not be logical consistency, but socially desirable consequences. Thus, where Legal Formalism is more logically based and precedent oriented, Legal Functionalism is more sociologically based and result oriented. See, e.g., ROSCOE POUND, JURISPRUDENCE (1959); WILFRED RUMBLE, AMERICAN LEGAL REALISM (1968); ROBERT SUMMERS, PRAGMATIC INSTRUMENTALISM AND AMERICAN LEGAL THEORY (1982); see also Swisher, *supra* note 4, at 1039–47.

<sup>15</sup> See, e.g., SAMUEL WILLISTON, THE LAW OF CONTRACTS (1921); SAMUEL WILLISTON, LIFE AND LAW; SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS (W. Jaeger 3d ed.

insurance contract interpretation is that an insurance policy must be construed and enforced according to general principles of contract law,<sup>16</sup> and the courts therefore are not at liberty to reinterpret or modify the terms of a clearly written and unambiguous insurance policy.<sup>17</sup> A number of courts continue to

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1957–1978 & Supp. 1995). The latter treatise currently comprises 18 substantive volumes and three volumes of forms. Professor Williston also was the reporter for the *Restatement of the Law of Contracts* (1928).

<sup>16</sup> See 7 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 900, at 28 (W. Jaeger 3d ed. 1963 & Supp. 1995) (“Unless contrary to statute or public policy, a contract of insurance will be enforced according to its terms.”).

<sup>17</sup> See, 4 WILLISTON, *supra* note 16, § 610, at 513 (footnote omitted).

Under the guise of interpretation, courts are repeatedly importuned to give a meaning to the writing under consideration, which is not to be found in the instrument itself, but which is based entirely on direct evidence of intention. And just as steadfastly, the courts reiterate the well-established principle that it is not the function of the judiciary to change the obligations of a contract which the parties have seen fit to make.

*Id.*

See also BARRY R. OSTRAGER & THOMAS R. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES 3–5 (7th ed. 1994).

As a general rule, the language of an insurance policy will be given its plain meaning and there will be no resort to rules of construction unless an ambiguity exists. . . . Whenever there is any question of interpretation of a written contract, the court will seek to determine the intention of the parties as derived from the language employed . . . . In short, any clause which has been inserted in an insurance policy with the insured’s consent is valid as long as it is clear, unambiguous, and not in contravention of public policy.

*Id.* One commentator asserts that this strong contractual foundation for interpreting insurance policy disputes is from a “now bygone era.” Fischer, *supra* note 9, at 1001. However, a substantial number of courts and commentators disagree with his assessment. See *infra* notes 18–20, 30, 33–34, 47–50, 61–70, 75–76, 81–82, 96; Swisher, *supra* note 4, at 1047–74. One commentator has stated:

The plain meaning [contractual] approach [in interpreting insurance coverage disputes] is, however, far from extinct . . . . The potential implications of a large-scale refusal to enforce boilerplate insurance policy clauses are apparently too daunting for the judiciary. Instead, judges intervene on an ad hoc basis through other doctrines—for example, waiver, estoppel, contra proferentem, and reasonable expectations—to police insurance policies when perceived as necessary to avoid unfairness.

Jeffrey W. Stempel, *Reassessing the “Sophisticated” Policyholder Defense in Insurance*

follow Professor Williston's often-cited legal axiom regarding this contractual interpretation of insurance contracts,<sup>18</sup> and this Formalistic legal principle of insurance contract interpretation is also recognized in influential insurance law treatises, such as Appleman's *Insurance Law and Practice*,<sup>19</sup> and Couch's *Cyclopedia of Insurance Law*.<sup>20</sup>

Although a strict Formalistic contractual approach in the judicial

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*Coverage Litigation*, 42 DRAKE L. REV. 807, 810-11 (1993) (footnote omitted).

<sup>18</sup> See, e.g., *Schultz v. Hartford Fire Ins. Co.*, 569 A.2d 1131, 1134 (Conn. 1990) ("an insurance policy is to be interpreted by the same general rules that govern the construction of any written contract and enforced in accordance with the real intent of the parties as expressed in the language employed in the policy"); *Showers v. Allstate Ins. Co.*, 222 S.E.2d 198, 199 (Ga. Ct. App. 1975) (an insurance policy, which by clear and unambiguous terms is limited in its coverage, cannot be so construed as to expand coverage beyond its stated terms); *Insurance Co. of N. America v. Adkisson*, 459 N.E.2d 310, 313-14 (Ill. Ct. App. 1984); *Eli Lilly & Co. v. Home Ins. Co.*, 482 N.E.2d 467, 470 (Ind. 1985), *cert. denied*, 479 U.S. 1060 (1987); *American Family Mut. Ins. Co. v. National Ins. Ass'n*, 577 N.E.2d 969, 971 (Ind. Ct. App. 1991) ("[W]hen interpreting an insurance [contract, the court must] ascertain and enforce the parties' intent as manifested in the insurance contract. [A court] cannot extend coverage beyond that provided in the contract and [it] may not rewrite plain and unambiguous language in the contract."); *Duke v. Mutual Life Ins. Co.*, 210 S.E.2d 187, 247 (N.C. 1974) (if "the language of an insurance policy is plain, unambiguous, and susceptible [to only one] reasonable construction, the courts [must] enforce the contract according to its terms") (quotation omitted); *Hybud Equip. Corp. v. Sphere Drake Ins. Co.*, 597 N.E.2d 1096, 1102 (Ohio 1992), *cert. denied*, 507 U.S. 987 (1993); *Standard Venetian Blind Co. v. American Empire Ins. Co.*, 469 A.2d 563, 566 (Pa. 1983); *Transit Casualty Co. v. Hartman's, Inc.*, 239 S.E.2d 894 (Va. 1978) ("A contract of insurance, as any other contract, must be construed to give effect to the intention of the parties, if that intention can be determined from the instrument when read as a whole."); *Sears, Roebuck & Co. v. Hartford Accident & Indem. Co.*, 313 P.2d 347, 350 (Wash. 1957) ("Since an insurance policy is a written contract between an insurer and the insured, courts cannot rule out of the contract any language which the parties thereto have put into it; cannot revise the contract under the theory of construing it; and neither abstract justice nor any rule of construction can create a contract for the parties which they did not make for themselves.").

<sup>19</sup> 1 JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 1, at 3-4 (rev. ed. 1981 & Supp. 1995) ("There are certain principles applying to the law [of] . . . insurance which pertain to all contracts . . . except for special forms regulated by statute."); 13 JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* §§ 7386, 7402 (rev. ed. 1976 & Supp. 1995) (an insurance contract will be enforced according to its terms, unless ambiguous); 6B JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 4254 (rev. ed. 1979 & Supp. 1995). See generally *infra* notes 47-49 and accompanying text.

<sup>20</sup> 1-2 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* §§ 1:4, 2:1, 2:12-13, 15:1-97 (Mark S. Rhodes, rev. 2d ed. 1984 & Supp. 1995); see also OSTRAGER & NEWMAN, *supra* note 17, at 3-5; JEFFREY W. STEMPEL, *INTERPRETATION OF INSURANCE CONTRACTS: LAW AND STRATEGY FOR INSURERS AND POLICYHOLDERS* § 2.1, at 33-40 (1994); 1 ALLAN D. WINDT, *INSURANCE CLAIMS & DISPUTES* 352-58 (3d ed. 1995); *infra* notes 47-49.

interpretation of insurance policies arguably brings a great deal of uniformity and predictability to insurance contract disputes, a serious problem with a strict Formalistic interpretive approach is that insurance policies very often are *not* ordinary contracts negotiated by parties with roughly equal bargaining power. Rather, insurance policies are perceived to be adhesion contracts, where the insurance company has a superior bargaining position and the insured often has to accept the policy on a “take it or leave it” basis if the insured desires any kind of insurance coverage.<sup>21</sup> Moreover, in the real world, few insureds take

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<sup>21</sup> See, e.g., *Healy Tibbitts Const. Co. v. Employers' Surplus Lines Ins. Co.*, 140 Cal. Rptr. 375, 379 (Cal. Ct. App. 1977) (“insurance contracts are regarded as contracts of adhesion expressing the superior bargaining power of the insurer”); *Stewart v. Preferred Fire Ins. Co.*, 477 P.2d 966 (Kan. 1970); *Powers v. Detroit Auto. Inter-Ins. Exch.*, 398 N.W.2d 411, 413 (Mich. 1986) (an insurance contract is “not a hard-bargained contract drafted [by] two negotiators with equal skills and resources[; it] is a contract of adhesion, a take-it-or-leave-it insurance policy not drafted by the buyer or even by the seller of the policy, but by insurance and legal experts of a state, national, or international organization, hundreds and maybe thousands of miles away”); *Prudential Ins. Co. v. Lamme*, 425 P.2d 346, 347 (Nev. 1967) (“insurance contracts are contracts of adhesion, complex instruments unilaterally prepared by the insurer and seldom understood by the insured”); *Meier v. New Jersey Life Ins. Co.*, 503 A.2d 862 (N.J. 1986); *Bunn v. Monarch Life Ins. Co.*, 478 P.2d 363 (Or. 1970); see also WINDT, *supra* note 20, § 6.03, at 375–76.

The underlying premise of the [Functionalist] rule [of the insured’s reasonable expectations] is that insurance policies are adhesion contracts. Their terms are not the result of formal assent, but are imposed; insurance policies are, for the most part, form contracts. The existence of a negotiated consent, therefore, on which the law of contracts is based, is a fiction in the case of most policies.

*Id.* Edwin W. Patterson, *The Interpretation and Construction of Contracts*, 64 COLUM. L. REV. 833, 856 (1964) (describing the concept of a “contract of adhesion” as a rule of construction where the court favors the weaker party whenever “it appears that the drafting party was in the stronger bargaining position”). See generally Albert A. Ehrenzweig, *Adhesion Contracts in the Conflict of Laws*, 53 COLUM. L. REV. 1072 (1953); Fredrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943); Todd Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173 (1983); W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529 (1971). But see Fischer, *supra* note 9, at 1014–15.

Even if insurance contracts involve standardized agreements provided in the proverbial “take it or leave it” fashion, the pro-insured bias may amount to excessive correction if courts fail to accurately and precisely identify the danger that standardized agreements present. Use of the term “adhesion contracts” invites courts to employ a pro-insured bias without first determining whether the contract terms, in fact, reflect an anti-insured or pro-insurer bias.



the time or effort to read their insurance policies, although under a strict Formalistic interpretative approach they are generally bound by the terms of their insurance contracts.<sup>22</sup>

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*Id.*

Another response to this adhesion contract argument is that standardized insurance contracts are indispensable instruments in conducting the insurance business in a mass society. *See, e.g.,* STEMPEL, *supra* note 20, at 101.

Standardized adhesion contracts are not necessarily bad, although lawyers for policyholders often talk that way. The standardized contract exists for a reason: It is efficient. Instead of spending valuable employee time (especially expensive, but not always valuable, attorney time), the commercial actor can avoid all these individualized costs by investing in one tightly drafted contract and using it repeatedly. In effect, the contract becomes part of a mass-produced product with an economy of scale all its own. In insurance, the contract is itself the product.

*Id.* *See also infra* notes 82–83 and accompanying text.

<sup>22</sup> *See, e.g.,* Powers v. Detroit Auto. Inter-Ins. Exch., 398 N.W.2d 411, 413 (Mich. 1986) (“The common wisdom is that very few insurance policy purchasers read all or even substantially all of the purchased contract, and it is not guaranteeable that they would understand it if they did.”); State Sec. Life Ins. Co. v. Kinter, 185 N.E.2d 527, 531 (Ind. 1962). In *Kinter*, Chief Justice Arterburn stated:

Coupled with this situation [that an insurance policy is a contract of adhesion] is the recognized fact that rarely, if ever, does an insured read his insurance contract, although the law has said, with reference to contracts generally, that a party is bound by what the instrument says, though ignorant of its terms. In fact, realistically, even if the insured had the inclination to attempt to read the policy, I doubt that he would gain much more knowledge than he previously had because of the technical language he would encounter. I doubt that most lawyers or even judges (who say one is presumed to have read his insurance policy) have ever read them.

*Id.* (Arterburn, C.J., concurring).

Chief Justice Arterburn was referring to another underlying principle of Formalistic insurance contract interpretation, that the insured is bound by the terms of the insurance contract, whether the insured has read the policy or not. *See, e.g.,* Vasquez v. Bankers Ins. Co., 502 So. 2d 894 (Fla. 1987); Western Casualty & Sur. Co. v. Sliter, 555 F. Supp. 369 (E.D. Mich. 1983); *see also* 16A JOHN A. APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE § 8843, at 231 (rev. ed. 1981) (stating that most insureds never read their policies, and 90% of those who do read their insurance policies would not understand them).

This conventional wisdom that insureds seldom read their insurance policies has been challenged by at least one recent survey conducted by the Independent Insurance Agents of America finding that 48% of insurance consumers “always” read and re-read their policies and 29% “sometimes” read and re-read their policies. USA TODAY, Oct. 23, 1995, at 1A. Perhaps

In reaction to this strict Formalistic contractual interpretation of insurance policies, a number of courts and commentators, beginning in the early 1970s and largely influenced by the writings of Professor (now Judge) Robert Keeton<sup>23</sup> and others,<sup>24</sup> utilized a more result-oriented Functionalist approach in interpreting insurance contract disputes in order to protect the reasonable expectations” of the insured policyholder from possible forfeiture of coverage that might occur under a more traditional Formalistic<sup>25</sup> insurance contract analysis. As propounded by Professor Keeton, this Functionalist “doctrine of reasonable expectations” is based upon a two-prong rationale: (1) an insurer should be denied any unconscionable advantage in an insurance contract; and (2) the reasonable expectations of the insurance applicants and intended beneficiaries regarding the terms of insurance contracts should be honored even though a painstaking study of the policy provisions contractually would have negated those expectations.<sup>26</sup>

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insurance consumers are now more sophisticated than they were 10 or 20 years ago. On the other hand, reading an insurance policy is not always synonymous with understanding all of its terms.

Professor Karl Llewellyn argues that a “blanket assent” is presumed in standardized contracts as long as the contractual provisions are fair and not absurd. Thus, if the terms of an insurance policy are plain, unambiguous, and explicit to the “reasonable layman” or the “common person in the marketplace,” then the insurer in the vast majority of American jurisdictions has no affirmative duty to orally explain any policy exclusions or limitations to the insured. See KARL LLEWELLYN, *THE COMMON LAW TRADITION—DECIDING APPEALS* 370–71 (1960); see, e.g., *Mutual of Omaha Ins. Co. v. Russell*, 402 F.2d 339 (10th Cir. 1968), cert. denied, 394 U.S. 973 (1969); *supra* notes 15–19 and accompanying text; see also *infra* notes 77, 167 and accompanying text.

<sup>23</sup> Robert Keeton, *Insurance Law Rights at Variance With Policy Provisions*, 83 HARV. L. REV. 961 (1970); Robert Keeton, *Insurance Law Rights at Variance With Policy Provisions: Part Two*, 83 HARV. L. REV. 1281 (1970); see also ROBERT KEETON & ALAN WIDISS, *INSURANCE LAW: A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES, AND COMMERCIAL PRACTICES* §§ 6.1–.10 (1988).

<sup>24</sup> See, e.g., Kenneth Abraham, *Judge-Made Law and Judge-Made Insurance: Honoring the Reasonable Expectations of the Insured*, 67 VA. L. REV. 1151 (1981); Roger Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L.J. 823, 823 (1990); see also Fischer, *supra* note 9, at 998, 1064–65. Fischer argues that a Functionalist approach to insurance contract interpretation (context) is preferable to a Formalist approach (text). *Id.* He concludes that a number of “pro-insured bias rules” are appropriate whenever an insurer fails to disclose information concerning underwriting risks in a way that would allow both the insurer and the insured to select efficient levels of coverage, and such pro-insured bias rules would therefore “reconstruct the contract to create the contract that full disclosure would have achieved.” *Id.*

<sup>25</sup> See *supra* notes 13, 15–20 and accompanying text.

<sup>26</sup> Keeton, *supra* note 23, at 963–64; see also KEETON & WIDISS, *supra* note 23, § 6.3, at

The major problem with this Functionalist approach regarding the interpretation of insurance contract disputes, however, is that under the Keeton reasonable expectations formula, the insurance policy need *not* be interpreted according to its clear and unambiguous contractual language—which is anathema to a Formalistic theory of insurance contract interpretation:

The Keeton formula suggests that an insured can have reasonable expectations of coverage that arise from some source *other* than the policy language itself, and that such an extrinsic expectation can be powerful enough to override any policy provisions no matter how clear. So interpreted, the Keeton formula pushes insurance law in a dramatic new direction, one that discards the traditional [Formalist] contract premise that a written agreement is the controlling code for determining the parties' rights and duties.<sup>27</sup>

Moreover, those courts purportedly applying the Keeton reasonable expectation doctrine in interpreting insurance contracts have been unable to agree on what specific factors actually constitute such a reasonable expectation of coverage and what factors do not.<sup>28</sup>

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633. "In general, courts will protect the reasonable expectations of applicants, insureds, and intended beneficiaries regarding the coverage afforded by insurance contracts even though a careful examination of the policy provisions indicates that such expectations are contrary to the expressed intention of the insurer." *Id.* (emphasis omitted).

<sup>27</sup> Mark Rahdert, *Reasonable Expectations Reconsidered*, 18 CONN. L. REV. 323, 335 (1986); see also WINDT, *supra* note 20, § 6.03, at 376.

The reasonable expectations rule, therefore, abandons the general contract principle that the insured's legitimate expectations are necessarily governed and limited by the terms of the policy. That principle will, instead, be applied only when it is fair to do so. As a result, in a proper case, an insured may be held to be entitled to coverage despite unambiguous language in the policy to the contrary.

*Id.* (citation omitted). See also *Stordahl v. Government Employees Ins. Co.*, 564 P.2d 63 (Alaska 1977); *Stewart v. Bohnert's Estate*, 162 Cal. Rptr. 126 (Cal. Ct. App. 1980); *Collister v. Nationwide Life Ins. Co.*, 388 A.2d 1346 (Pa. 1978), *cert. denied*, 439 U.S. 1089 (1979). But see *Gene & Harvey Builders, Inc. v. Pennsylvania Mfrs. Ass'n Ins. Co.*, 517 A.2d 910 (Pa. 1986) (apparently limiting the Keeton reasonable expectation approach as enunciated by the Pennsylvania Supreme Court in the *Collister* case).

<sup>28</sup> See Rahdert, *supra* note 27, at 335.

[T]he Keeton [reasonable expectations] formula gives no hint at what factors other than the policy provisions courts might use to define the "terms" of the insurance arrangement, or how the courts are to measure the force of these external factors against the force of restrictive policy provisions to determine which should prevail in any given

Accordingly, the interpretive battle lines have been drawn between the Functionalist supporters<sup>29</sup> and the Formalist critics<sup>30</sup> of Professor Keeton's insurance law doctrine of reasonable expectations.<sup>31</sup> Likewise, a number of state courts have either expressly adopted<sup>32</sup> or expressly rejected<sup>33</sup> Professor

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instance.

*Id.* See also Abraham, *supra* note 24, at 1153.

The courts [purportedly following the Keeton doctrine] have employed the [reasonable] expectations principle in cases where the insured's expectation of coverage was probably real and reasonable. They have also employed it where an expectation of coverage was less probable, but the policy's denial of coverage seemed unfair. Finally, they have relied on the principle even where an expectation of coverage was improbable and the denial of coverage would not appear unfair. In short, the [Keeton Functionalist] judicial concept of an "expectation" of coverage is not a monolithic one.

*Id.* (footnote omitted); WINDT, *supra* note 20, at 376 ("Unfortunately, however, the courts have had little success in formulating a test for determining when equity necessitates that the [Keeton] reasonable expectations rule be applied."); Henderson, *supra* note 24, at 837-38.

[E]ven after two decades, there still seems to exist a great deal of uncertainty as to the doctrinal content and when the [reasonable expectations] principle may be invoked, including most of the jurisdictions that have professed to have adopted it. In short, questions remain as to whether the principle has developed into a full-fledged doctrine which can be applied in a predictable and evenhanded manner by the courts.

*Id.*

<sup>29</sup> See, e.g., Abraham, *supra* note 24; Fischer, *supra* note 9; Henderson, *supra* note 24; Keeton, *supra* note 23; Keeton, *Reasonable Expectations in the Second Decade*, 12 FORUM 275 (1976).

<sup>30</sup> See, e.g., Frank E. Gardner, *Reasonable Expectations: Evolution Completed or Revolution Begun?* 669 INS. L.J. 573 (1978); Rakoff, *supra* note 21, at 1268-69 (attacking the reasonable expectations doctrine as a fiction the courts have created to avoid addressing the concept of contracts of adhesion); Conrad L. Squires, *A Skeptical Look at the Doctrine of Reasonable Expectations*, 6 FORUM 252 (1971); Edward Collins, Comment, *Insurance Law—Insurance Contract Interpretation: The Doctrine of Reasonable Expectations Has No Place in Illinois*, 1985 S. ILL. U. L.J. 687 (1985); William M. Lashner, Note, *A Common Law Alternative to the Doctrine of Reasonable Expectations in the Construction of Insurance Contracts*, 57 N.Y.U. L. REV. 1175 (1982); Stephen J. Ware, Comment, *A Critique of the Reasonable Expectations Doctrine*, 56 U. CHI. L. REV. 1461, 1487-93 (1989) (criticizing the reasonable expectations doctrine for limiting the parties' freedom to contract and unreasonably interfering with the market control of insurance companies); see also *supra* note 21.

<sup>31</sup> See generally Radhert, *supra* note 27; Swisher, *supra* note 4, at 1051-58.

<sup>32</sup> See, e.g., *Lambert v. Liberty Mut. Ins. Co.*, 331 So. 2d 260 (Ala. 1976); *Puritan Life*

Keeton's reasonable expectations doctrine as applied to the judicial interpretation of insurance contracts. Many other courts, however, have not yet expressly adopted nor expressly rejected the Keeton doctrine of reasonable expectations.<sup>34</sup>

*So Query:* Does this mean that an irreconcilable conflict now exists—and must continue to exist—between judicial Formalists and judicial Functionalists involving the interpretation of insurance contract coverage disputes? Not necessarily, since these two interpretive theories arguably may be reconciled

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Ins. Co. v. Guess, 598 P.2d 900 (Alaska 1979); Zuckerman v. Transamerica Ins. Co., 650 P.2d 441 (Ariz. 1982); C & J Fertilizer, Inc. v. Allied Mut. Ins. Co., 227 N.W.2d 169 (Iowa 1975); Brown v. Blue Cross & Blue Shield, 427 So. 2d 139 (Miss. 1983); Transamerica Ins. Co. v. Royle, 656 P.2d 820 (Mont. 1983).

According to Professor Henderson, the following states have adopted the Keeton reasonable expectations doctrine: Alabama, Alaska, Arizona, California, Iowa, Montana, Nebraska, Nevada, New Hampshire, and New Jersey. Henderson, *supra* note 24, at 827–28. Another six states may—or may not—have adopted the reasonable expectations doctrine, but the case decisions and judicial rationales in these states are not entirely clear and require further analysis: Colorado, Delaware, Hawaii, North Carolina, Pennsylvania, and Rhode Island. *Id.* at 829–34.

<sup>33</sup> See, e.g., Meekert v. Transamerica Ins. Co., 701 P.2d 217 (Idaho 1985); Menke v. Country Mut. Ins. Co., 401 N.E.2d 539 (Ill. 1980); Bond Bros. v. Robinson, 471 N.E.2d 1332 (Mass. 1984); Robbins Auto Parts Inc. v. Granite State Ins. Co., 435 A.2d 507 (N.H. 1981); Sterling Merchandise Co. v. Hartford Ins. Co., 506 N.E.2d 1192 (Ohio Ct. App. 1986); Ryan v. Harrison, 699 P.2d 230 (Wash. Ct. App. 1985); St. Paul Fire & Marine Ins. Co. v. Albany County Sch. Dist., 763 P.2d 1255 (Wyo. 1988).

According to Professor Henderson, nine state courts have declared that the Keeton reasonable expectations doctrine has not been adopted: Idaho, Illinois, Massachusetts, North Dakota, Ohio, Oklahoma, South Carolina, Washington, and Wyoming. Henderson, *supra* note 24, at 834 n.68.

<sup>34</sup> A majority of state courts to date apparently have neither expressly adopted—nor expressly rejected—the Keeton doctrine of reasonable expectations. See, e.g., Collins v. Farmers Ins. Co., 822 P.2d 1146, 1162 (Unis. J., dissenting) (“This court has not explicitly adopted the [Keeton] doctrine of ‘reasonable expectations,’ at least by name, in any of its forms. Neither has this court explicitly rejected it. . . . At some point, this court will have to address the series of conflicting precedents in our cases which today’s majority opinion simply ignores.”); see also Henderson, *supra* note 24, at 829–38 (“In short, questions remain as to whether the principle has developed into a full-fledged doctrine which can be applied in a predictable and evenhanded manner by the courts.”); Radhert, *supra* note 27, at 367 (arguing that various states apply strong and weak versions of the reasonable expectation doctrine just as they apply strong and weak versions of the doctrine of ambiguities); Stempel, *supra* note 17 (arguing that characterizing the states’ use of the reasonable expectations doctrine is to a great extent an exercise in futility). See *infra* notes 52–56 and accompanying text. See generally Swisher, *supra* note 4, at 1053–57.

and synthesized into a viable and realistic middle ground judicial approach to insurance contract interpretation, as will be discussed and demonstrated below.<sup>35</sup>

### III. WHY DO MANY COURTS STILL APPLY A FORMALISTIC JUDICIAL APPROACH TO INSURANCE CONTRACT DISPUTES?

Why do many courts, which seemingly apply a Functionalistic judicial approach to other areas of the law, still apply a more Formalistic judicial approach in cases involving insurance contract disputes? The reasons for this apparent dichotomy are historical, complex, and interrelated. First, trial and appellate court judges must, out of necessity, become knowledgeable in an incredibly large number of legal areas during the course of their judicial careers.<sup>36</sup> Practicing attorneys, on the other hand, normally specialize in a much more limited area of the law,<sup>37</sup> as do academic lawyers.<sup>38</sup> A judge, therefore, realistically may not be as well-versed in the field of insurance law as he or she might wish to be.<sup>39</sup> Moreover, where the vast majority of judges

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<sup>35</sup> See *infra* part IV.

<sup>36</sup> For example, areas of the law in which trial court judges and appellate court judges are asked to decide legal disputes include, but are not limited to: contract law, tort law, property law, criminal law, criminal procedure, state and federal civil procedure, administrative law, admiralty law, agency and partnership law, antitrust law, bankruptcy law, commercial law, conflict of laws, constitutional law, construction law, consumer protection law, corporate law, creditor's rights law, disability law, education law, elder law, employment law, energy law, environmental law, equity law, estate planning law, evidence, family law, federal tax law, health care law, immigration law, insurance law, intellectual property law, international business transactions, international law, juvenile law, labor law, land use planning, law and medicine, legislation, local government law, military law, mortgages and suretyship, probate law, products liability law, real estate development law, remedies, sales and secured transactions, securities regulation law, social security law, sports law, state and local tax law, Uniform Commercial Code law, workers compensation law, and wills and trusts law.

<sup>37</sup> See, e.g., MARTINDALE-HUBBELL LAW DIRECTORY (1995) (listing the rather limited areas of legal specialties that most American lawyers and law firms practice).

<sup>38</sup> As a law professor, my own principal areas of concentration are insurance law, products liability law, and family law. If I find it difficult to stay current in these three limited fields of the law, a judge's necessary familiarity with over 60 legal fields and hundreds of legal specialties boggles the mind and numbs the soul. See *supra* note 36.

<sup>39</sup> Realistically, how many trial court or appellate judges actually have the opportunity or the time to read at least some of the insurance law articles cited in *supra* notes 23-34—or this law review article? How many attorneys have read at least some of these insurance law articles? How many law professors? See *infra* notes 44, 58 and accompanying text. *Query*: Is anyone out there?

almost certainly were introduced to a basic first-year course in contract law while in law school,<sup>40</sup> it is doubtful that a majority of these same judges took any introductory insurance law course while in law school.<sup>41</sup> Judges and their legal staffs, therefore, out of necessity must rely on often unquestioned, and often unexplained, insurance law precedent within their particular jurisdictions.<sup>42</sup> And frequently these judges and their law clerks also must rely on various insurance law treatises<sup>43</sup> in order to understand and apply the law of insurance within the limited context of a particular insurance law coverage dispute.<sup>44</sup>

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<sup>40</sup> The vast majority of American law schools continue to offer introductory contracts courses in the first year, although not necessarily in the format of Professor Kingsfield of *Paper Chase* fame, or Scott Turow's *IL*. Currently there are approximately 640 law professors teaching contracts courses in 177 accredited American law schools. ASSOCIATION OF AM. L. SCH., AALS DIRECTORY OF LAW TEACHERS 1034-42 (1994-95).

<sup>41</sup> According to the 1994-95 *AALS Directory of Law Teachers* there are only 105 law professors currently teaching insurance law courses in American law schools today and not all law schools offer a course in insurance law. Of this number, only 41 professors currently teaching insurance law have taught insurance law for 10 years or more. *Id.* at 1102-03.

<sup>42</sup> See *infra* notes 45-46 and accompanying text.

<sup>43</sup> See, e.g., JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* (rev. ed. 1981) (approximately 59 volumes, with cumulative annual supplements and forms); GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* (Mark S. Rhodes, rev. 2d ed. 1984) (approximately 30 volumes, with cumulative annual supplements); see also SAMUEL WILLISTON, *THE LAW OF CONTRACTS* (W. Jaeger 3d ed. 1963) (approximately 21 volumes, with cumulative annual supplements).

One-volume general insurance law treatises also include: WILLIAM VANCE, *HANDBOOK ON THE LAW OF INSURANCE* (3d Anderson ed. 1951); ROBERT H. JERRY II, *UNDERSTANDING INSURANCE LAW* (1987); KEETON & WIDISS, *supra* note 23 (a successor work to ROBERT KEETON, *BASIC TEXT ON INSURANCE LAW* (1971)); OSTRAGER & NEWMAN, *supra* note 17; EDWIN PATTERSON, *ESSENTIALS OF INSURANCE LAW* (2d ed. 1957); STEMPER, *supra* note 20; WINDT, *supra* note 20.

Older influential insurance law treatises include: ROGER W. COOLEY, *BRIEFS ON THE LAW OF INSURANCE* (2d ed. 1927); CHARLES B. ELLIOT, *THE LAW OF INSURANCE* (rev. impression ed. 1907); and ROWLAND H. LONG, *RICHARDS ON THE LAW OF INSURANCE* (4th ed. 1932) (Professor Richards published his previous editions in 1892 and 1909.).

<sup>44</sup> The interpretation of insurance contract disputes has normally been the function of the judge, rather than the jury. See, e.g., *Parsons v. Bristol Dev. Co.*, 402 P.2d 839, 842 (Cal. 1965) (according to Justice Traynor, insurance contract interpretation is "solely a judicial function" unless the insurance contract interpretation "turns upon the credibility of extrinsic evidence"). See generally 2 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 15:3 (Mark S. Rhodes, rev. 2d ed. 1984) ("As a general rule, the construction and effect of a written contract of insurance is to be determined by the court and not by the jury.") (citations omitted).

Although most judges must rely on insurance law precedent within their own jurisdictions,

The precedential value of many insurance law cases, however, is hampered by a large number of insurance law decisions that are “less than ordinarily enlightening” regarding their underlying rationales and bases for decision,<sup>45</sup> and over the years this has resulted in “a mass of litigation and confused precedent” in the field of American insurance law, “the like of which cannot be found in any other field of our law.”<sup>46</sup> On the other hand, various insurance law treatises continue to utilize a number of judicial cases as doctrinal examples for the interpretation of insurance coverage disputes that often predate<sup>47</sup> or

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and although they may occasionally rely on various insurance law treatises as secondary authority, it is axiomatic that law review articles written by academic lawyers and legal scholars in the field of insurance law generally are not heavily utilized by a majority of American judges. See, e.g., Edward L. Rubin, *The Practice and Discourse of Legal Scholarship*, 86 MICH. L. REV. 1835, 1889 (1988). “Do judges really need to be told [by legal scholars] how to interpret prior cases, or how to construct a legal argument? That is the very essence of their job, after all, and most people tend to believe that they can do their job reasonably well on their own.” *Id.* See also *infra* notes 57–58 and accompanying text.

<sup>45</sup> See, e.g., ROBERT E. KEETON, *BASIC TEXT ON INSURANCE LAW* 341 (1971); KEETON & WIDISS, *supra* note 23; see also JERRY, *supra* note 43, §§ 25A–25B.

<sup>46</sup> See, e.g., William R. Vance, *The History of the Development of the Warranty in Insurance Law*, 20 YALE L.J. 523, 534 (1911); see also KEETON & WIDISS, *supra* note 23, at 615 (“[J]udicial opinions resolving such [insurance contract] disputes were often less than ordinarily enlightening about the principles or doctrines upon which the decisions were being made. To some observers, the judicial decisions in these cases often appeared to be arbitrary and unpredictable.”).

This interpretive problem of insurance coverage disputes by state court judges continues today. See, e.g., Milt Policzer, *Same Words, Different Meanings: Lawyers Struggle to Make Sense of Insurance Coverage Language*, NAT’L L.J., Nov. 25, 1991, at 1.

Welcome to the world of insurance coverage litigation where nothing is certain, but if plaintiffs are in the right state, they may be covered for everything from dog bites to herpes, child molestation or even intentional shootings. Or they may not be. The uniformity some might expect from standardized insurance language—particularly in homeowners and auto liability policies—has instead provided lawyers a wonderland of surprises. It’s all because some courts—but definitely not others—have found the incidents to be “accidental,” “unintentional,” or “arising out of the use of a vehicle.” The problem, in part, stems from the fact that even though most policies are standardized, each state’s courts supply their own interpretations.

*Id.* at 1.

<sup>47</sup> See *supra* notes 23–26 and accompanying text. Earlier influential insurance law treatises also predate the Keeton Functionalist doctrine of reasonable expectations. See, e.g., PATTERSON, *supra* note 43; VANCE, *supra* note 43. Even the newer editions of John Appleman’s *Insurance Law and Practice* (rev. ed. 1981), and George J. Couch’s *Cyclopedia of Insurance Law* (2d ed. 1984) continue to include many illustrative judicial cases predating the



basically ignore<sup>48</sup> the Keeton Functionalist reasonable expectations doctrine. These influential insurance law treatises therefore continue to maintain, justify, and reinforce a more traditional Formalistic approach to insurance contract interpretation by basically ignoring the Keeton Functionalist reasonable expectation doctrine.<sup>49</sup>

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1970s and 1980s. See also SAMUEL WILLISTON, *THE LAW OF CONTRACTS* (W. Jaeger 3d ed. 1963).

<sup>48</sup> For example, John Appleman, in his extensive Introduction and Preface to the 1981 revised edition of *Insurance Law and Practice*, makes no mention whatever to Professor Keeton's doctrine of reasonable expectations, and the Applemans basically ignore the Keeton Functionalist reasonable expectations doctrine of insurance contract interpretation in their 1981 "massive rewrite." 1 JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE XI-LI* (rev. ed. 1981).

It may be significant that Mr. Appleman was the former head of the Legal Department of the State Farm Insurance Companies in the 1930s when he found "much of the insurance field in chaotic condition," and this may have influenced his treatise's general philosophy of emphasizing the more predictable and more uniform Formalistic contractual approach to the interpretation of insurance policies. *Id.* at V, XI. As a former insurance defense attorney while writing his impressive insurance law treatise from 1939-47, Mr. Appleman arguably may not have been a strong advocate of Legal Functionalism in the academic or legal community. Furthermore, his law school training may, or may not, have predated the rise of Legal Realism as a jurisprudential model in American law school classrooms of the 1930s.

Likewise, Couch's *Cyclopedia of Insurance Law*, in its discussion of the interpretation of insurance contracts, has no mention whatever of the Keeton Functionalist doctrine of reasonable expectations, other than a tangential discussion dealing with ambiguous contract provisions. See, e.g., 1-2 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* §§ 1:4, 15:16 (Mark S. Rhodes, rev. 2d ed. 1984).

Little is known of George J. Couch except that he was born in 1881, that he was a member of the New York Bar, and that he wrote his insurance law treatise from 1929-31, a time which predated the Keeton Functionalist reasonable expectations approach, and which arguably predated the predominant view of Legal Realism in American law schools. Subsequent authors and revisers to the Couch treatise include Ronald A. Anderson, a member of the Pennsylvania Bar, and Mark S. Rhodes, a member of the Illinois Bar. Both revising authors have paid little, if any, attention to the Keeton Functionalist reasonable expectations doctrine in the *Cyclopedia of Insurance Law*, 2d edition.

<sup>49</sup> See, e.g., 1 JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 1 (rev. ed. 1981). "There are certain principles applying to the laws of personal insurance which pertain to all contracts alike, except for special forms regulated by statute."

There are only two indexed references to the doctrine of reasonable expectations in the Appleman insurance law treatise. The first is in 6B JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 4254 (rev. ed. 1981).

The obligation of a liability insurer has been held to be contractual and is determined by the terms of the policy. . . .

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Insurance policies, like other forms of contracts, are interpreted as a reasonable man would understand them. The terms of policies are construed in their plain, ordinary, and popular sense. This policy has been referred to as the "principle of reasonable expectations" . . . .

While insurance policy provisions must be construed liberally in favor of the insured, that maxim neither mandates nor even permits rewriting of provisions to give a strained construction. Nor is there a basis for such construction if the provisions are not ambiguous.

*Id.* (citations omitted).

The second indexed reference to the doctrine of reasonable expectations in the Appleman treatise appears in 13 JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 7386 (rev. ed. 1976).

The construction of an insurance policy should be a natural and reasonable one, fairly construed, to effectuate its purpose . . . . Furthermore, the contract should be read to accord with the reasonable expectations of the purchaser so far as its language will permit . . . .

Of course, such construction must be reasonable and not such as to deprive the insurer of the benefit of an unambiguous provision placed in the contract for its protection . . . . Insurance is matter of contract, not sympathy . . . .

Where the policy language is clear and simple, nothing ought to be imported into it by construction . . . .

*Id.* (citations omitted).

Clearly, this is *not* the Functionalist noncontractual insurance law doctrine of reasonable expectations, see *supra* note 26 and accompanying text, but another more limited reasonable expectations of coverage model based upon an insurance contract interpretation as it would be understood by a reasonable insured or common man or woman in the marketplace. Accordingly, the Appleman insurance law treatise basically ignores the Keeton Functionalistic noncontractual doctrine of reasonable expectations in favor of the more traditional Formalistic interpretation of insurance contract disputes.

See also 1 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 1:4 (Mark S. Rhodes, rev. 2d ed. 1984) ("Insurance is a matter of contract . . . . The parties to the insurance contract are bound by the terms thereof, the same as parties to other contracts."); 2 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 15:10 (Mark S. Rhodes, rev. 2d ed. 1984).

The relation of the parties to a contract of insurance are contractual and must be determined by its terms, as in the case of any other contract . . . . The court is not permitted, under the guise of interpretation, to write a new contract for the parties, or to do violence to the plain meaning of the language used. If the language used by the parties in writing the contract is plain and susceptible to but one meaning, and the transaction is free from fraud or mistake, that language will control . . . .

A number of more recent insurance law treatises also have emphasized the traditional contractual framework underlying insurance coverage disputes. Professor Jeffrey Stempel, for example, states that:

Although insurance contract law is often reputed to bear little relation to basic contract law, this aphorism is inaccurate. For the most part, insurance contract law is “real” or “regular” contract law applied to situations involving insurance. These situations may to a greater degree than usual involve: standard form contracting, unequal bargaining power, non-negotiated terms, ambiguity, and recurring equitable considerations that tend to bring results less doctrinaire and consistent than those perhaps found in other areas of the law.

Courts and legislatures have frequently attempted to organize or explain these results by enunciating contract axioms that purport to be peculiar to insurance disputes, but these pronouncements and case outcomes are not so different from what one would expect from “ordinary” contract litigation.<sup>50</sup>

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*Id.* (citations omitted).

According to the Couch treatise, the doctrine of reasonable expectations applies when ambiguities appear within the policy. 2 GEORGE J. COUCH, CYCLOPEDIA OF INSURANCE LAW § 15:16 (Mark S. Rhodes, rev. 2d ed. 1984).

If the terms of a policy are clear, consistent, and unambiguous, no forced or strained construction can be indulged, even to give effect to the policy, for a contract of insurance cannot be given an interpretation at variance with the clear sense and meaning of the language in which it is expressed.

*Id.*

Again, it is clear that the Couch analysis of an insured’s reasonable expectations, like the Appleman analysis, is *not* the same as the Keeton noncontractual reasonable expectations doctrine. Thus, the Couch insurance law treatise, like the Appleman insurance law treatise, basically ignores the Keeton noncontractual reasonable expectations doctrine of insurance policy interpretation.

<sup>50</sup> STEMPEL, *supra* note 20, § 2.1; *see also* Stempel, *supra* note 17, at 809–10.

Although insurance contract cases often differ from sale-of-goods or other typical contract cases, the conventional view categorizes insurance policy interpretation as an occasionally erratic subset of contract law. Regardless of practical differences between insurance disputes and commercial contract cases, courts continue to use the contract law model, contract jargon, and basic contract interpretation methods in deciding insurance disputes. Cases routinely hold insurance policies are to be construed in the same manner as any other contract. Basic contract law forms the framework for addressing policy coverage disputes, but the discussion frequently focuses on issues peculiar to insurance law.

Author Allan D. Windt likewise criticizes the noncontractual reasonable expectations doctrine,<sup>51</sup> and although authors Barry Ostrager and Thomas Newman assert that courts “in thirty-two jurisdictions have recognized some variations of the reasonable expectation doctrine,”<sup>52</sup> a number of these judicial decisions cited by Ostrager and Newman actually deal with ambiguous insurance policies and other contractually based interpretive rules.<sup>53</sup> Thus, most American courts have not adopted the Keeton reasonable expectation doctrine *in toto*,<sup>54</sup> and since a majority of state courts have neither expressly adopted nor expressly rejected the Keeton reasonable expectation doctrine,<sup>55</sup> these courts still continue to employ a more traditional contractual analysis in

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*Id.*

Indeed, it appears that only one state actually has applied Functionalistic § 211 of the *Restatement (Second) of Contracts* (1981) to an insurance policy dispute, and thus a plain meaning contractual approach to insurance coverage disputes is “far from extinct.” *Id.* at 810. See also *supra* notes 16–20 and accompanying text.

<sup>51</sup> WINDT, *supra* note 20, at 376, 383 (“In short, if a policy is not a contract of adhesion or if the policy provisions are not inequitable, either in substance or in form, the policy should be enforced as written, regardless of what the insured’s expectations might have been.”).

<sup>52</sup> OSTRAGER & NEWMAN, *supra* note 17, at 20–24.

<sup>53</sup> *Id.* at 18–24. Indeed, many courts that currently recognize an insured’s reasonable expectation to coverage may in fact be utilizing a contractually based reasonable expectations doctrine, rather than expressly adopting Professor Keeton’s Functionalistic reasonable expectation doctrine that is at variance with the clear and unambiguous terms in an insurance policy. See *supra* note 49; *infra* notes 99–102; see also STEMPPEL, *supra* note 20, at 354.

Characterizing the states’ use of reasonable expectations under [any] classification scheme . . . is to a large extent an exercise in futility . . . [since] intra-state variance in the cases or among the panels, courts, and shifting appellate court majorities is often at least as great as the differences between states. However, like most situations involving mild chaos, it offers great opportunity for counsel to present the client’s case as falling within a currently reigning precedent or distinguishable from adverse rulings. This is especially true since so many of [these] inconsistent decisions . . . did not involve formal overruling or resulted from plurality disposition.

*Id.*

<sup>54</sup> For example, Ostrager and Newman state that only Illinois, Ohio, and Idaho “have rejected all formulations of the reasonable expectations doctrine which conflict with the traditional principle that unambiguous policy language must be given effect.” OSTRAGER & NEWMAN, *supra* note 17, at 24–25. But see *supra* note 33 and accompanying text (stating that courts in states such as Massachusetts, New Hampshire, North Dakota, Washington, and Wyoming also have expressly rejected a noncontractual reasonable expectations doctrine); *supra* note 34; *infra* note 56.

<sup>55</sup> See *supra* note 34 and accompanying text.

the interpretation of insurance contract disputes.<sup>56</sup>

Another reason why the Keeton Functionalist reasonable expectations doctrine has not been enthusiastically embraced by a majority of judges may be that it might not be perceived to be “practical” legal scholarship.<sup>57</sup>

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<sup>56</sup> See *supra* notes 15–20, 50–51 and accompanying text; Stempel, *supra* note 17, at 827–28.

Approximately fifteen states have adopted a strong or broad version of the reasonable expectations concept and have invoked the doctrine to find in favor of policyholders, despite clear policy language, when the language is insufficiently apparent and not drawn to the policyholder’s attention. Some reasonable expectations states appear to have moved from the Keeton-stated formula to a more narrow view in which the degree of the policyholder’s reasonableness, reliance, and damage is weighed against the clarity of the policy, insurer conduct, and disclosure in light of the overall equities of the situation. A similarly sized group of states has rejected the reasonable expectations doctrine in more or less explicit terms.

Another third of the states appear receptive to the underlying notions of vindicating the reasonable expectations of the policyholder but stop short of treating the notion as a distinct doctrine or principle for decision.

*Id.* (citations omitted).

<sup>57</sup> See, e.g., Judge Harry T. Edwards, *The Growing Disjunction Between Legal Education and the Legal Profession*, 91 MICH. L. REV. 34, 42–43, 50 (1992).

The growing disjunction between legal education and legal practice is most salient with respect to scholarship. There has been a clear decline in the volume of “practical” scholarship published by law professors. “Practical” legal scholarship, in the broadest sense, has several defining features. It is *prescriptive*: it analyzes the law and the legal system with an aim to instruct attorneys in their consideration of legal problems; to guide judges and other decisionmakers in their resolution of legal disputes; and to advise legislators and other policymakers on law reform. It is also *doctrinal*: it attends to the various sources of law (precedents, statutes, constitutions) that constrain or otherwise guide the practitioner, decisionmaker, and policymaker. . . .

There are too few books, treatises, and law review articles now that usefully “chart the line of development and progress” for judges and other governmental decisionmakers. . . .

[L]aw schools must hire more “practical” scholars. . . .

Judge Edwards has particular criticism for critical legal studies and law-and-economics theoretical approaches as “impractical” legal scholarship. *Id.* at 47–48. *But see* Learned Hand, *Have the Bench and Bar Anything to Contribute to the Teaching of Law?*, 24 MICH. L. REV. 466 (1926) (arguing that judges are a proper audience for academic scholars); George L. Priest, *Social Science Theory and Legal Education: The Law School As University*, 33 J. LEGAL EDUC. 437 (1983) (arguing in favor of a “graduate school” model for legal education and legal

Additionally, in the real world, law review articles are not often read by the judiciary, nor are law review articles often cited in appellate decisions.<sup>58</sup>

Moreover, a continuing Formalistic doctrinal approach to the interpretation of insurance contracts may also be explained by a rather surprising resurgence of Legal Formalism as a viable theory of contemporary American jurisprudence<sup>59</sup> and as a framework for judicial decisionmaking in the field of insurance law.<sup>60</sup> Indeed, a number of state courts have either rejected, retracted, or limited their earlier Functionalist approaches to the interpretation of insurance contracts, and have instead recognized a more Formalistic

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scholarship). For a persuasive reply to Judge Edwards' criticism, see Barbara Bennett Woodhouse, *Mad Midwifery: Bringing Theory, Doctrine, and Practice to Life*, 91 MICH. L. REV. 1977, 1997 (1993) ("[T]he disease of disjunction between legal education and the profession is not caused by too much theory or too little doctrine and practice, but by too little attention to their essential interplay in a complex and interconnected world. The cure I prescribe is not further polarization but a more thoughtful integration not only of theory, doctrine, and practice in the classroom, but of the complementary roles of scholar, teacher, and lawyer in ourselves and in our understanding of each other.").

It is also interesting to note in an insurance law context that Professor Keeton himself later served as a federal district court judge and subsequently wrote a treatise on judging. See ROBERT E. KEETON, *JUDGING* (1990). Nevertheless, his insurance law doctrine of reasonable expectations was expressly rejected by the supreme court in his own home state of Massachusetts. See, e.g., *Bond Bros. v. Robinson*, 471 N.E.2d 1332, 1334-36 (Mass. 1984).

<sup>58</sup> See, e.g., Louis J. Sirico Jr. & Beth A. Drew, *The Citing of Law Reviews by the United States Courts of Appeals: An Empirical Analysis*, 45 U. MIAMI L. REV. 1051, 1052 (1991). Arguably, however, a number of state court appellate judges are familiar with Professor Keeton's reasonable expectation insurance law doctrine by expressly adopting, or expressly rejecting, his theory. See *supra* notes 32-33 and accompanying text. A majority of state courts, however, apparently continue to ignore it. See *supra* note 34 and accompanying text.

<sup>59</sup> See *supra* notes 13-20 and accompanying text; Swisher, *supra* note 4, at 1037-47; see also JOHN AGRESTO, *THE SUPREME COURT AND CONSTITUTIONAL DEMOCRACY* (1984); GARY JAN ACHELE, *LEGAL REALISM AND TWENTIETH-CENTURY AMERICAN JURISPRUDENCE X* (1990) ("Impossible only a decade ago, 'mechanical jurisprudence' has made a remarkable comeback, and a new Legal Formalism may yet triumph as the principal mode of [judicial] interpretation."); ROBERT BORK, *THE TEMPTING OF AMERICA: THE POLITICAL SEDUCTION OF THE LAW* (1990); MARIO JORI, *LEGAL POSITIVISM* (1992).

It will be interesting and informative to see how judicial appointments made under the Clinton administration will affect the federal judiciary after 12 years of Republican administrations. As governor of Arkansas, Clinton was an active participant in the moderate Democratic Leadership Conference. So whether his judicial appointments will be "moderate" or "liberal" jurists remains to be seen. Likewise, the underlying political philosophy of a new Republican majority in Congress after nearly half a century cannot be ignored.

<sup>60</sup> See generally Swisher, *supra* note 4, at 1047-73.

doctrinal analysis of insurance contracts.<sup>61</sup>

Finally—as will be discussed below—a contractually based middle ground analysis of insurance coverage issues, with supplemental interpretive rules to protect the reasonable expectations of the insured to coverage, may still constitute the better-reasoned judicial approach in the interpretation of insurance contract disputes.

All these interrelated factors help explain why many American courts today still continue to apply a more Formalistic and contractually based judicial

<sup>61</sup> See, e.g., *Hallowell v. State Farm Mut. Ins. Co.*, 443 A.2d 925 (Del. 1982); *Casey v. Highlands Ins. Co.*, 600 P.2d 1387 (Idaho 1979); *Gene & Harvey Builders, Inc. v. Pennsylvania Mfrs. Ass'n Ins. Co.*, 517 A.2d 910 (Pa. 1986) (all retracting or limiting an earlier Functionalist approach to the interpretation of insurance contracts); see also *Menke v. Country Mut. Ins. Co.*, 401 N.E.2d 539 (Ill. 1980); *Bond Bros. v. Robinson*, 471 N.E.2d 1332 (Mass. 1984); *Robbins Auto Parts v. Granite State Ins. Co.*, 435 A.2d 507 (N.H. 1981); *Sterling Merchandise Co. v. Hartford Ins. Co.*, 506 N.E.2d 1192 (Ohio Ct. App. 1986); *Ryan v. Harrison*, 699 P.2d 230 (Wash. Ct. App. 1985); *St. Paul Fire & Marine Ins. Co. v. Albany County Sch. Dist.*, 763 P.2d 1255 (Wyo. 1988) (all expressly rejecting the Keeton Functionalist doctrine of reasonable expectations).

[The California Supreme Court under Chief Justice Lucas] also has expressed a preference for deferring policy judgments affecting important social issues and commercial relationships to legislative decision making. Some court watchers see this as a healthy return to the proper role of the court as an interpreter, rather than a maker, of law.

Others . . . think the court is too deferential . . .

In the area of the common law . . . [the Lucas court's] conservatism is reflected in the notion that it is unwise to expand liability, that liability on the whole should be contracted, that contract principles should be applied strictly and without regard, or with very little regard, for differences in bargaining power between the parties, and in a tendency toward the insistence upon clear, bright lines and rules.

Blum, *The California Supreme Court: Toward a Radical Middle*, 77 A.B.A. J. 48, 50 (1991); see also Claire Cooper, *California Courts*, CAL. LAW., Apr. 1993, at 27 ("In the past six years . . . the Malcolm Lucas Court's conservative majority usually has seemed more comfortable following the conservative U.S. Supreme Court [and] [t]earing up state rules laid down by its more liberal predecessors. . .").

Although Chief Justice Lucas has announced that he will retire on May 1, 1996, "it seems unlikely that [the California Supreme Court's] philosophical orientation will change," and California legal scholar Bernard F. Witkin was quoted as saying that Lucas's administration of the court "marks the most significant effort to improve the administration of justice in the history of California." Nancy McCarthy, *Supreme Court Faces Major Change*, CAL. ST. B.J., Dec. 1995, at 12.

See generally Swisher, *supra* note 4, at 1045-47, 1056-57.

approach to the interpretation of insurance contracts, rather than embracing a noncontractual Functionalist doctrine of reasonable expectations which may be at variance with the clear and unambiguous language found in the insurance policy itself.

#### IV. RECONCILING THE FORMALIST AND FUNCTIONALIST INTERPRETATIONS OF INSURANCE CONTRACT DISPUTES: A REALISTIC MIDDLE GROUND APPROACH

Is there a viable and realistic way to reconcile these two competing doctrines of Legal Formalism and Legal Functionalism in the judicial interpretation of insurance contracts? I believe there is—and I will demonstrate below how the best elements of the Formalist and Functionalist judicial approaches to insurance contract interpretation may be reconciled and incorporated into a realistic, contractually based judicial approach that a number of courts already are applying on an informal basis. It is a middle ground interpretive approach that is supplemental to—rather than at variance with—traditional contract-based interpretations of insurance coverage disputes.<sup>62</sup>

For example, the Wisconsin Supreme Court in the 1973 case of *Brown v. Equitable Life Insurance Co.*<sup>63</sup> interpreted insurance policies under a Formalistic theory of strict contractual construction:

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<sup>62</sup> See, e.g., Stempel, *supra* note 17, at 828.

[A] third of the states appear receptive to the underlying notion of vindicating the reasonable expectations of the policyholder but stop short of treating the notion as a distinct doctrine or principle for decision. Instead, these courts introduce reasonable expectations thinking into their opinions, often combining it with the ambiguity doctrine and relatively broad notions of promissory and equitable estoppel, waiver, unconscionability, and public policy review, but stop short of using the policyholders' expectations, however reasonable, to override policy language viewed as clear.

*Id.*

Although some recent commentators criticize contractually based interpretations of insurance contracts, see, e.g., Fischer, *supra* note 9, the underlying rationale and justification for a contractually based middle ground approach to insurance coverage disputes remains doctrinally and jurisprudentially sound. Moreover, it is a realistic and pragmatic approach to insurance contract interpretation, since a majority of American courts today still apply some form of a contractually based analysis in the interpretation of insurance coverage disputes. See *also infra* notes 197–315 and accompanying text. See *generally supra* notes 16–20, 33–34, 49–50, 61; *infra* notes 76–77 and accompanying text.

<sup>63</sup> 211 N.W.2d 431 (Wis. 1973).



We think the theory of strict contractual construction of insurance contracts followed by a majority of jurisdictions is consistent with the philosophy of this court. . . . “Contracts of insurance rest upon and are controlled by the same principles of law that are applicable to other contracts, and parties to an insurance contract may provide such provisions as they deem proper as long as the contract does not contravene law or public policy.”<sup>64</sup>

However, sixteen years later, in the case of *Wood v. American Family Mutual Insurance Co.*,<sup>65</sup> the Wisconsin Supreme Court arguably had adopted a more realistic middle ground approach to insurance contract interpretation—rejecting a strict Formalistic contractual interpretation on one hand, but refusing to recognize a noncontractual Functionalistic reasonable expectations approach on the other hand:

Insurance contracts are controlled by the same rules of construction as are applied to other contracts [citing as authority *Vidmar v. American Family Mut. Ins. Co.*, 312 N.W.2d 129, 131 (Wis. 1981) and other cases]. The goal of construction is to ascertain the true intentions of the parties to an insurance contract [citing again to the *Vidmar* case, 312 N.W.2d at 131]. In the case of an insurance contract, the words are to be construed in accordance with the principle that the test is not what the insurer intended the words to mean but what a reasonable person in the position of an insured would have understood the words to mean [citing *Vidmar*, 312 N.W.2d at 131 and one other case]. Ambiguities in coverage are to be construed in favor of coverage, while exclusions are narrowly construed against the insurer [citing again to the *Vidmar* case, 312 N.W.2d at 131 and other authority].<sup>66</sup>

One commentator believes that the Wisconsin Supreme Court in *Wood* therefore had “combined” various Formalistic and Functionalistic interpretative standards in the same opinion.<sup>67</sup> However, a careful reading of the *Wood* decision suggests otherwise. First, the *Wood* court expressly reaffirmed its contractual commitment to the interpretation of insurance policies.<sup>68</sup> Second,

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<sup>64</sup> *Brown*, 211 N.W.2d at 435 (quoting *McPhee v. American Motorists Ins. Co.*, 205 N.W.2d 152, 152 (Wis. 1973)).

<sup>65</sup> 436 N.W.2d 594 (Wis. 1989).

<sup>66</sup> *Wood*, 436 N.W.2d at 599.

<sup>67</sup> See Fischer, *supra* note 9, at 1001–02 n.19. “Wisconsin courts, like most jurisdictions, frequently combine formalistic and functional standards in the same opinion.” *Id.* See, e.g., *Wood v. American Family Mut. Ins. Co.*, 436 N.W.2d 594, 599 (Wis. 1989) (“[i]nsurance contracts are controlled by the same rules as are applied to other contracts” but reasonable expectations of the insured control, and “exclusions are construed narrowly against the insurer”).

<sup>68</sup> *Wood*, 436 N.W.2d at 599.

the court never stated in its opinion that the “reasonable expectations of the insured control.” The test of a “reasonable insured” as cited in *Wood* was derived instead from a more traditional contractually based insurance law concept of the reasonable insured in the marketplace,<sup>69</sup> and thus it falls far short of embracing a noncontractual Functionalist reasonable expectation test.<sup>70</sup> Third, in the absence of ambiguity, the reasonable expectations of the insured may *not* always control, since the Wisconsin Supreme Court also has held that “when the terms of an insurance policy are plain on their face, the policy should not be rewritten by construction to cover matters not contemplated by the insurer nor paid for by the insured.”<sup>71</sup> Thus, a realistic middle ground approach to insurance contract interpretation, as illustrated in the *Wood* case, expands a number of contractually based interpretive safeguards favoring the insured, but still falls far short of embracing a noncontractual Functionalist reasonable expectations analysis.

This contractually based synthesis of judicial Formalism and judicial Functionalism in an insurance law context therefore constitutes a realistic middle ground approach to insurance contract interpretation and this middle ground judicial approach to the interpretation of insurance contract disputes may be summarized as follows:

A. In general, insurance contracts will be construed according to general principles of contract law, unless modified or regulated by state statute, or unless contrary to state public policy.

B. However, since insurance contracts are not ordinary contracts and are often perceived to be contracts of adhesion, and since the reasonable expectations of the insured should be honored when appropriate, insurance contracts are subject to the following additional interpretive rules:

1. Insurance contracts will be construed and interpreted in their ordinary sense, rather than in a purely technical or legal sense, from the viewpoint of the untrained mind or the “common man or woman in the marketplace.”

2. If the insurance contract is susceptible to two or more reasonable interpretations, then it generally will be construed liberally in favor of the nondrafting party, the insured, and it will be strictly construed against the drafting party, the insurer. This rule, however, is subject to extrinsic evidence to determine the parties’ intent, and subject to the “sophisticated policyholder” defense.

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<sup>69</sup> See *supra* note 49 and accompanying text; *infra* notes 99–103 and accompanying text.

<sup>70</sup> See *supra* note 26 and accompanying text.

<sup>71</sup> *Vidmar v. American Family Mut. Ins. Co.*, 312 N.W.2d 129, 131 (Wis. 1981).

3. Based upon the acts and representations made by the insurer and its agents, the legal doctrines of waiver, estoppel, election, and reformation of contract are available to the insured and should be liberally construed to validate the insured's reasonable expectation to coverage.

4. In order to further validate the reasonable expectations of the insured to coverage, any exclusion, exception, or limitation to coverage must be clearly, expressly, and unambiguously stated in the insurance contract.

At this initial stage, a number of readers might observe that this middle ground approach to insurance contract disputes incorporates a number of insurance contract interpretive rules that are already well recognized in a number of jurisdictions today. These readers therefore might conclude that there is nothing strikingly new about this middle ground interpretive approach. Yet a realistic synthesis and application of these analytical rules establishes the strength, rationale, and underlying justification for a middle ground reconciliation of judicial Formalism and judicial Functionalism in insurance contract disputes. It also brings greater uniformity, predictability, and precedential credibility to the confusing field of American insurance law as it presently exists today. Moreover there are a number of subtle—but very important—distinctions in the underlying theory and application of this middle ground interpretive approach that differ from both a strict Formalistic approach and a more modern Functionalistic approach to insurance contract interpretation, and thus require further elaboration, as discussed in more detail below.<sup>72</sup>

*A. In General, Insurance Contracts Will Be Construed According to General Principles of Contract Law, Unless Modified or Regulated by State Statute, or Unless Contrary to State Public Policy.*

Since the Keeton Functionalist doctrine of reasonable expectations<sup>73</sup> has been criticized for its lack of uniformity and predictability,<sup>74</sup> and since a serious lack of uniformity and predictability continues to exist, even among those courts that purportedly apply the Keeton Functionalist reasonable expectations doctrine,<sup>75</sup> a middle ground approach to insurance contract

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<sup>72</sup> For example, parts (A) and (B)(1)–(4) all involve important interpretive distinctions that go beyond a traditional Formalist insurance contract analysis, but stop well short of the Keeton Functionalist doctrine of reasonable expectations.

<sup>73</sup> See *supra* notes 23–26 and accompanying text.

<sup>74</sup> See *supra* notes 27–28 and accompanying text.

<sup>75</sup> See *supra* note 32 and accompanying text.

interpretation would continue to recognize the well settled doctrinal rule that insurance contracts should be construed according to general principles of contract law, unless modified or regulated by state statute, or unless contrary to state public policy.<sup>76</sup> However, this middle ground approach to insurance

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<sup>76</sup> See 1 JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 1 (rev. ed. 1981) ("There are certain principles applying to the laws of personal insurance which pertain to all contracts alike, except for special forms regulated by statute."); 2 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 15:15 (Mark S. Rhodes, rev. 2d ed. 1984) ("In the absence of a statute to the contrary, an insurance policy, being a contract, is construed as an ordinary contract") (citing many supporting cases).

See, e.g., *Industrial Indem. Co. v. Aetna Casualty & Sur. Co.*, 465 F.2d 934 (9th Cir. 1972) (applying Hawaii law); *Schultz v. Hartford Fire Ins. Co.*, 569 A.2d 1131, 1134-35 (Conn. 1990) ("An insurance policy is to be interpreted by the same general rules that govern the construction of any written contract and enforced in accordance with the real intent of the parties as expressed in the language employed in the policy."); *Kane v. Royal Ins. Co. of Am.*, 768 P.2d 678, 680 (Colo. 1989) ("unambiguous insurance contracts . . . should be enforced according to their terms"); *Cantrell v. Home Sec. Life Ins. Co.*, 302 S.E.2d 415 (Ga. Ct. App. 1983); *Seeburg Corp. v. United Founders Life Ins. Co.*, 403 N.E.2d 503 (Ill. App. Ct. 1980); *Aetna Life & Casualty Ins. Co. v. Stapleton*, 556 F. Supp. 228 (S.D. Ind. 1982); *Cody v. Conn. General Life Ins. Co.*, 439 N.E.2d 234 (Mass. 1982); *Moore v. Prudential Life Ins. Co.*, 491 P.2d 227 (Utah 1971); *Western Casualty & Sur. Co. v. Budrus*, 332 N.W.2d 837 (Wis. Ct. App. 1983); see also *Casey v. Highlands Ins. Co.*, 600 P.2d 1387, 1391 (Idaho 1979).

[We reject] an adoption of the [Keeton] doctrine of reasonable expectations and [rely] upon the traditional basic principles involved in construing contracts. Intent is to be determined from the language of the contract itself and "in the absence of ambiguity, contracts for insurance must be construed as any other and understood in their plain, ordinary and proper sense, according to the meaning derived from the plain wording of the contract."

Reliance on this traditional approach avoids the danger that the court might create liability by [a Keeton Functionalist] construction of the contract terms or creation of a new contract for the parties. In the event that there is an ambiguity in the terms of the policy, special rules of construction apply to insurance contracts to protect the insured.

Since these rules protect the insured under a more traditional approach, it becomes unnecessary to adopt a new theory of recovery where, conceivably, the periphery of what losses would be covered could be extended by an insured's affidavit of what he "reasonably expected" to be covered.

*Id.*; see *supra* notes 15-20, 49-50 and accompanying text.

Even Professor James Fischer, a proponent of functionalist "pro-insured bias rules," admits that at a minimum, "the insurance contract is subject to the same rules as apply to contracts in general." Fischer, *supra* note 9, at 1001. Fischer recommends as an alternative to his pro-insured bias rules the creation of "neutral rules that would give greater effect to the literal terms of the contract." *Id.* at 1065.

contract interpretation would further moderate the strict contractual Formalist rule by providing that a literal contractual interpretation would be avoided if such an interpretation would lead to an unreasonable or absurd result.<sup>77</sup>

There are a number of compelling reasons for applying this middle ground contractual approach to the interpretation of insurance policies. First, the application of the Keeton Functionalist doctrine of reasonable expectations has

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State legislative and administrative regulation of the insurance industry, including the form and content of insurance policies, is well established in all fifty states. *See, e.g.*, Spencer L. Kimball & Werner Pfennigstorf, *Legislative and Judicial Control of the Terms of Insurance Contracts: A Comparative Study of American and European Practice*, 39 IND. L.J. 675 (1964); Spencer L. Kimball & Werner Pfennigstorf, *Administrative Control of the Terms of Insurance Contracts: A Comparative Study*, 40 IND. L.J. 143 (1965). The jurisdictions are split, however, on whether the state insurance commissioner or the courts should decide whether or not the terms of an insurance contract violate a state's strong public policy. *Compare* Burne v. Franklin Life Ins. Co., 301 A.2d 799 (Pa. 1973) (the court may determine state public policy in interpreting an insurance policy) *with* Kirk v. Financial Sec. Life Ins. Co., 389 N.E.2d 144 (Ill. 1978) (state public policy is best left to the state legislature and the insurance commissioner). *See generally* Swisher, *supra* note 4, at 1062-66.

<sup>77</sup> *See, e.g.*, Seeburg Corp. v. United Founders Life Ins. Co., 403 N.E.2d 503, 506 (Ill. App. Ct. 1980) (the court should give effect to the plain and obvious import of the policy language without considering extrinsic evidence unless the construction would lead to unreasonable and absurd consequences); Frank Lucas Ins. Agency, Inc. v. Fireman's Fund Am. Ins., 425 A.2d 1378, 1381 (Md. Ct. Spec. App. 1981) (an interpretation that is fair and reasonable is preferred to one which leads to an unreasonable result); Dixon v. Gunter, 636 S.W.2d 437, 441 (Tenn. Ct. App. 1982) (an insurance contract should not be given a forced, unnatural, or unreasonable construction which would extend or restrict the policy beyond what is fairly within its terms, or which would lead to an absurd conclusion or render the policy nonsensical or ineffective).

This approach is consistent with Professor Karl Llewellyn's observation that in a standardized contract, such as a standard form insurance contract, both the consumers and the insurers are aware that the consumer has not read the insurance contract in its entirety. This knowledge by both the consumers and the insurers therefore creates an additional element to any traditional "bargained for" or "dickered" contractual assent regarding insurance policy provisions that the consumer is aware of. This additional element "is a blanket assent (not a specific assent) to any not unreasonable or indecent terms the seller may have on its form, which do not alter or eviscerate the reasonable meaning of the dickered terms." Thus, according to Professor Llewellyn, supplementary standardized or "boiler plate" terms in an insurance contract should be honored to the extent that: (1) they do not undercut the meaning of the bargained-for terms; and (2) they are not manifestly unfair. LLEWELLYN, *supra* note 22, at 370-71 (1960).

This middle ground contractual approach thus allows enforcement of unread supplementary boiler plate terms and provisions in a standard form insurance contract, as long as such terms are reasonable and not manifestly unfair. *See also* Lashner, *supra* note 30, at 1196-97.

been criticized for its lack of uniformity and predictability.<sup>78</sup> Although uniformity and predictability in the law should not be bought at too high a price,<sup>79</sup> courts still must legitimately focus upon—and must legally justify—their judicial interpretive approach to insurance contract disputes based upon a fundamental, well settled, and realistically applied doctrine of insurance contract interpretation rather than based upon an amorphous Functionalistic pro-insured or pro-insurer subjective judicial “bias.”<sup>80</sup> However, in

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<sup>78</sup> See *supra* notes 27–28, 30, 33–34 and accompanying text.

<sup>79</sup> See, e.g., BENJAMIN CARDOZO, *THE NATURE OF THE JUDICIAL PROCESS* 112–13 (1949).

One of the most fundamental social interests is that the law shall be uniform and impartial. There must be nothing in its action that savors of prejudice or favor or even arbitrary whim or fitness. Therefore, in the main there shall be adherence to precedent... But symmetrical development may be bought at too high a price. Uniformity ceases to be good when it becomes uniformity of oppression. The social interest served by symmetry... must then be balanced against the social interest served by equity and fairness or other elements of social welfare.

*Id.*

<sup>80</sup> See *supra* notes 16–20, 50, 66, 68–71 and accompanying text; see also Lashner, *supra* note 30, at 1195 (“The piecemeal creation of [judicial] standards would cause uncertainty lasting as long as new [policy] provisions continued to be created. The disparity in [judicial] standards among different jurisdictions would make risk distribution over more than a single jurisdiction difficult, if not impossible.”) (footnote omitted); *supra* notes 45–46 and accompanying text.

Professor Jeffrey Stempel suggests, however, that:

the criticism that [the Keeton] reasonable expectations analysis makes insurance case result too unpredictable and undermines the actuarial precision sought by insurers seems overdone. Courts are probably no more likely to adopt “wild” arguments regarding expectations than they are to embrace equally wild arguments about the meaning of [insurance contract] language.

STEMPEL, *supra* note 20, at 356. I respectfully disagree with Professor Stempel. Trial court judges, although possessing a great deal of judicial discretion in deciding insurance contract disputes, still require at least some definitive parameters in order to reach a reasoned decision with some degree of predictability and uniformity, rather than relying on an amorphous judicial bias in the absence of such interpretive rules. Courts that make a judicial practice of finding “constructive” ambiguities in insurance policies are just one example of such “wild” judicial arguments. See, e.g., *Smith v. Westland Life Ins. Co.*, 450 P.2d 271 (Cal. 1975); *Ransom v. Pennsylvania Mut. Life Ins. Co.*, 274 P.2d 633 (Cal. 1954); *Prudential Ins. Co. v. Lamme*, 539 P.2d 433 (Nev. 1967). Even Professor Keeton has criticized this unwarranted judicial role. See Robert E. Keeton, *Insurance Law Rights at Variance With Policy Provisions*, 83 HARV. L. REV. 961, 972 (1970) (“To extend the principle of resolving ambiguities against the draftsman

recognizing the crucial importance of governmental regulation over the insurance industry in general, and governmental regulation of insurance policies in particular,<sup>81</sup> such a middle ground interpretive approach likewise must reject a strict contractual Formalist interpretation of insurance policies in favor of a middle ground regulatory/contractual hybrid approach.

For example, it is generally acknowledged today that standardized insurance contracts are indispensable instruments in conducting an insurance business in a mass society,<sup>82</sup> and that insurance companies must be legally and contractually protected in their legitimate assumption and limitation of insurable risks.<sup>83</sup> These contractual rights of the insurer, however, are not absolute,

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in this fictional way not only causes confusion and uncertainty about the effective scope of judicial regulation of [insurance] contract terms but also creates an impression of unprincipled judicial prejudice against insurers.”).

<sup>81</sup> See Kimball & Pfennigstorf, *supra* note 76.

<sup>82</sup> Professor Slawson estimates that over 99% of all contracts are standard form contracts. See W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 529 (1971). According to Professor Friedrich Kessler, the benefits of standard form contracts are five-fold: (1) saving contract formation costs; (2) reducing an agent's authority to modify the terms of the contract; (3) allowing collection of necessary underwriting data; (4) reducing performance costs; (5) allowing an insured to purchase packages of coverage that meet the insured's basic needs, even when an insured is unable to identify all of his or her basic insurance coverage needs. Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 631–32 (1943).

See also KEETON & WIDISS, *supra* note 23, at 119.

One of the major benefits of standardization for the consumer is lower costs: in insurance, as in other areas, customization invariably costs more than standardization. By using standard policy forms, insurers are able to avoid incurring many expenses that would inevitably result from individualizing millions of transactions.

Standardization of insurance coverages is also important to insurers because it is a very significant factor in the basic process of transferring risks from an insured to an insurer. In fact, risk distribution on the scale that exists in a complex commercial society may only be feasible if insurance transactions employ standardized insurance policy terms.

*Id.*

<sup>83</sup> See, e.g., *Gowing v. Great Plains Mut. Ins. Co.*, 483 P.2d 1072, 1075 (Kan. 1971); *Estin Constr. Co. v. Aetna Casualty & Sur. Co.*, 612 S.W.2d 413, 418 (Mo. Ct. App. 1981); see also Birnbaum, Stahl & West, *Standardized Agreements and the Parol Evidence Rule: Defining and Applying the Expectations Principle*, 26 ARIZ. L. REV. 793 (1984); Lashner, *supra* note 30; Slawson, *supra* note 82; Conrad L. Squires, *A Skeptical Look at the Doctrine of Reasonable Expectations*, 6 FORUM 252 (1971).

because it is universally recognized in all American jurisdictions that state legislatures and insurance commissioners have the power and the right to regulate the insurance industry<sup>84</sup> through legislative statutes<sup>85</sup> and administrative regulations.<sup>86</sup> Accordingly, insurance contracts are heavily regulated by appropriate legislative and administrative agencies representing the public welfare of the citizens of each state, in addition to being subjected to judicial scrutiny.<sup>87</sup>

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<sup>84</sup> Insurance is affected with a strong public interest, and thus any insurer's alleged constitutional right to contract free of state regulation will be rejected by the courts unless the objectives of such state statutes and administrative regulations go well beyond the reasonable and legitimate interest of the state. *See, e.g., California State Auto. Ass'n Inter-Ins. Bureau v. Maloney*, 341 U.S. 105 (1951); *Kenton & Campbell Benevolent Burial Ass'n v. Goodpaster*, 200 S.W.2d 120 (Ky. 1946); *see also* Spencer Kimball, *The Purpose of Insurance Regulation*, 45 MINN. L. REV. 471, 490-91 (1961) ("Insurance law is . . . a hybrid mixture of private contractual law and state statutes which seek to control the substantive terms of the insurance policy so that the insured may enter into a fair and equitable contract.").

<sup>85</sup> *See, e.g., Spencer Kimball & Werner Pfennigstorf, Legislative and Judicial Control of the Terms of Insurance Contracts*, 39 IND. L.J. 675 (1964).

<sup>86</sup> *See, e.g., Spencer Kimball & Werner Pfennigstorf, Administrative Control of the Terms of Insurance Contracts*, 40 IND. L.J. 143 (1965).

<sup>87</sup> *See, e.g., Kirk v. Financial Sec. Life Ins. Co.*, 389 N.E.2d 144, 147-48 (Ill. 1978).

Furthermore, public policy of a State or the nation is found imbedded in its constitution and its statutes, and, when these are silent on a subject, in the decisions of the courts. . . . The legislature has not been silent on the matter of public policy as it relates to the contents of insurance policies. The Director of the Department of Insurance is required by statute to review the policies of insurance in certain categories and approve or disapprove them, based on criteria including the established public policy of this State. . . .

The approval of . . . limitation periods in policies of insurance by the Department, although not conclusive on the courts, is, however, entitled to great weight against the contention that such a provision is against public policy.

*Id.* (citations omitted).

A court, therefore, is not the sole interpreter, regulator, or enforcer of insurance contracts. Other state agencies also play a legitimate and important role in this interrelated process. *See also* Fischer, *supra* note 9, at 1065 ("Likewise, the legislature could provide its own rules of coverage or insurance commissioners could exercise greater scrutiny with respect to the content of insurance contracts.").

This state legislative and administrative function in regulating the insurance industry, however, needs more attention. *See, e.g., Jane B. Quinn, The Regulator's Boogie: Insurance Commissioners Can't Break Free of the Industry They Oversee*, NEWSWEEK, Oct. 3, 1994, at 54, 54-55:



Yet even though some forms of insurance—such as automobile no-fault insurance, uninsured motorist statutes, and motor vehicle financial responsibility acts—statutorily mandate compulsory insurance coverages, under a better reasoned middle ground approach to insurance contract interpretation, such compulsory insurance programs would not completely abolish an insurer's underlying fundamental right to contract with the insured. For example, in the case of *Ferrell v. Columbia Mutual Casualty Insurance Co.*,<sup>88</sup> the insurer sought to rescind an automobile insurance policy based upon fraudulent and material misrepresentations made by the insured in an application for automobile insurance. The insured contended, however, that the insurer no longer possessed any contractual right of rescission since the automobile policy was protected under compulsory state insurance statutes.

The *Ferrell* court correctly observed that although, under the common law, an insurance company could retroactively and contractually rescind insurance coverage based on an insured's fraud or material misrepresentation, many courts today have interpreted no-fault automobile insurance legislation and compulsory state motor vehicle acts as expressing a strong public policy that one who suffers loss as a result of an automobile accident shall have a legal source and means of recovery. As a result, many courts now hold that when an innocent third party suffers damages as a result of the insured's negligent operation of an insured vehicle, there is no contractual right to a retroactive rescission of the policy by the insurer. These courts therefore have held that an insurance company's contractual right to a retroactive policy rescission for fraud or misrepresentation has been abrogated by state statute, and the only remedy for an insurance company is for prospective cancellation of the policy in accordance with the terms and parameters of state statute.<sup>89</sup> Thus, most

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Long term, however, the regulatory structure tips too far toward [the insurance] industry. On deceptive sales, consumers aren't being heard at all. [National Association of Insurance Commissioners President David] Walsh says that improving the marketplace will be the NAIC's next job, but he won't get the industry backing that he did when he tackled solvency rules. An alternative approach would be federal standards for price disclosure and policy access, with the NAIC hashing out the rules and enforcement handed to the states. Either way, alas, it may take a crisis of loss and fraud before [the insurance] industry accepts reform.

*Id.*

<sup>88</sup> 816 S.W.2d 593 (Ark. 1991).

<sup>89</sup> *Id.* at 595 (quoting with approval *Teeter v. Allstate Ins. Co.*, 192 N.Y.S.2d 610 (A.D. 1959), *aff'd*, 212 N.Y.S.2d 71 (N.Y. 1961)). One reason for this statutory rule is that if an insurer could unilaterally rescind coverage, unscrupulous automobile insurers might hold the

courts that have considered the question as it applies to an innocent third-party claimant have held that an insurer cannot, on the contractual ground of fraud and misrepresentation, retroactively avoid coverage under a compulsory insurance or financial responsibility law.<sup>90</sup>

Nevertheless, the *Ferrell* court also recognized that there is no compulsory automobile insurance statute which requires one to insure oneself against personal property loss. When a case involves the insured and the insurer and lacks a third-party claimant, and the loss involves the insured's property, then there is no public policy reason to hold that the insurance company's common law contractual right to rescission has been completely abrogated. To hold otherwise would permit an insured to benefit from his or her fraudulent misrepresentations and leave the insurer without a remedy.<sup>91</sup> The *Ferrell* court therefore protected the insurer's underlying contractual right to rescind its policy under a middle ground contractual interpretation by holding that compulsory state insurance statutes did not totally abrogate the insurer's contractual rights of rescission when the insurer and insured were involved in a dispute concerning noncompulsory provisions within the insurance policy itself.

Other courts have adopted this middle ground interpretive approach by continuing to recognize the contractual rights and obligations of the parties, even as these contractual rights coexist within an acknowledged legislative and administrative right to regulate the insurance industry in general, and to regulate insurance policies in particular. For example, the Eleventh Circuit Court of Appeals in the case of *King v. Allstate Insurance Co.*<sup>92</sup> recognized the legal right of the parties to "contract out of" or "contract around" state and federal law within a particular insurance contract, so long as there was nothing in the contract in violation of state or federal statutory law or against public policy.<sup>93</sup> A number of other courts also have allowed the parties to contract out of or contract around state insurance law within their particular insurance contracts, as long as there was no violation of state statutory law or state public

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threat of insurance contract rescission over the head of third-party claimants in an attempt to bargain down claims. *Id.* at 595-96. *See also* Metropolitan Property & Liab. Ins. Co. v. Insurance Comm'r, 535 A.2d 588 (Pa. 1987).

<sup>90</sup> 816 S.W.2d at 596. *See* Dunn v. Safeco Insurance Co., 798 P.2d 955 (Kan. 1990), for a listing of these cases.

<sup>91</sup> 816 S.W.2d at 596; *see also* Dunn v. Safeco Ins. Co., 798 P.2d 955 (Kan. 1990); United Sec. Ins. Co. v. Commissioner of Ins., 348 N.W.2d 34 (Mich. Ct. App. 1984). *But see* Metropolitan Property & Liab. Ins. Co. v. Insurance Comm'r, 535 A.2d 588 (Pa. 1987).

<sup>92</sup> 906 F.2d 1537 (11th Cir. 1990) (holding that state insurance law would apply to a marine insurance contract, rather than federal admiralty law, based upon the contractual language in the particular marine insurance policy).

<sup>93</sup> *Id.* at 1540.

policy.<sup>94</sup>

A final legal safeguard in favor of the insured under this middle ground interpretive approach is that even though an insurance contract is clearly and expressly written, and even though its policy language is unambiguous according to traditional rules of contract interpretation, it may still be declared to be null and void if it is contrary to state public policy.<sup>95</sup> State public policy normally is expressed through the state legislature and through the legislature's duly authorized administrative agency, the state insurance commission, because a state possesses a valid legal right to regulate and control the business of insurance for the public good.<sup>96</sup> Various courts, however, also have held that an insurance policy may be void not only because it violates a state's statutorily declared public policy, but also because it violates a public policy that the courts would enforce in the absence of any statutory authority.<sup>97</sup>

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<sup>94</sup> See, e.g., *Scarborough v. Travelers Ins. Co.*, 718 F.2d 702, 709 (5th Cir. 1983) (holding that an insurance policy is the "law between the parties" and must be enforced as written, unless its provisions are contrary to public policy or statutory law); *Compagnie Des Bauxites de Guinee v. Insurance Co. of N. Am.*, 551 F. Supp. 1239, 1242 (W.D. Pa. 1982) (noting that insurance is a matter of contract, and parties are free to agree to any reasonable conditions not contrary to public policy); *Zurich Ins. Co. v. Boulter*, 198 So. 2d 129, 131 (La. Ct. App. 1967) (recognizing the "settled principle" that a contract of insurance is a voluntary agreement between the parties, who may incorporate into the contract any provisions and conditions that they see fit as long they are not contrary to statutory law or public policy).

<sup>95</sup> See, e.g., *Concord Gen. Mut. Ins. Co. v. McLain*, 270 A.2d 362 (Maine 1970). See generally 12 JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 7027 (rev. ed. 1981); 9 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 39:14 (Mark S. Rhodes, rev. 2d ed. 1985).

The test of whether or not an insurance contract is void as against public policy is whether it is injurious to the public or contravenes some important established societal interest, or when its purpose is to promote, effect, or encourage a violation of the law. See *L'Orange v. Medical Protective Co.*, 394 F.2d 57 (6th Cir. 1968) (applying Ohio law).

<sup>96</sup> See, e.g., *Swanco Ins. Co. v. Hager*, 879 F.2d 353 (8th Cir. 1989), *cert. denied*, 493 U.S. 1057 (1990); *California State Auto. Ass'n Inter-Ins. Bureau v. Maloney*, 341 U.S. 105 (1951); *Mutual Life Ins. Co. v. Daddy\$ Money, Inc.*, 646 S.W.2d 255 (Tex. Ct. App. 1982).

<sup>97</sup> For example, some Functionalist courts have liberally utilized state public policy grounds to override nonambiguous, explicit terms in an insurance contract whenever the contract terms would arguably operate to defeat the reasonable expectations of the insured. See, e.g., *Sands v. Granite Mut. Ins. Co.*, 331 A.2d 711 (Pa. 1974). Formalist courts, however, would reiterate the traditional rule that any seemingly harsh contractual result against an insured should not justify public policy "meddling" by the courts in the absence of clearly stated legislative or administrative guidelines. See, e.g., *Putnam v. New Amsterdam Casualty Co.*, 269 N.E.2d 97 (Ill. 1970). See generally Swisher, *supra* note 4, at 1062-66.

A middle ground interpretive approach to these public policy arguments would be to follow the traditional Formalist rule of giving judicial deference to clearly stated legislative or

Thus, a middle ground interpretive approach to insurance contracts rejects the noncontractual Functionalistic reasonable expectations doctrine based upon its lack of uniformity and predictability of application. Likewise, the middle ground interpretive approach rejects the strict Formalistic contractual approach to insurance policies in favor of a more realistic regulatory/contractual hybrid approach. This middle ground regulatory/contractual approach recognizes the right of the state to properly regulate the insurance industry, but it also recognizes the contractual rights of the parties to contract out of or around noncompulsory state insurance law as long as the contract is not in violation of state statutory law or state public policy.

However, since insurance contracts are not ordinary contracts, and are often perceived to be contracts of adhesion,<sup>98</sup> insurance contracts under a middle ground interpretive approach are subject to additional interpretive rules, as discussed below.

*B. Because Insurance Contracts Are Not Ordinary Contracts and Are Often Perceived to Be Contracts of Adhesion, and Because the Reasonable Expectations of the Insured Should Be Honored When Appropriate, Insurance Contracts Are Subject to the Following Additional Interpretive Rules.*

Before discussing these additional rules of insurance contract interpretation under a realistic middle ground contractual approach, it is important to understand that although the reasonable expectations of the insured should be honored when appropriate, this middle ground interpretive approach does *not* implicitly adopt the noncontractual Keeton reasonable expectations doctrine at variance with the insurance policy provisions.<sup>99</sup> Rather, the middle ground interpretive approach subsumes and expands upon a more traditional reasonable expectations test as propounded in Appelman's *Insurance Law and Practice* and Couch's *Cyclopedia of Insurance Law*<sup>100</sup> which recognizes a contractually based reasonable expectations interpretation when there is an ambiguity in the insurance contract,<sup>101</sup> or when the policy is to be interpreted by the untrained

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administrative public policy guidelines, unless a literal contractual interpretation would lead to unreasonable or absurd results. *See supra* note 77 and accompanying text.

<sup>98</sup> *See supra* notes 21–22 and accompanying text. *But see supra* notes 82–83 and accompanying text.

<sup>99</sup> *See supra* notes 23–26 and accompanying text.

<sup>100</sup> *See supra* note 49 and accompanying text.

<sup>101</sup> *See, e.g.*, *Progressive Casualty Ins. Co. v. Marnel*, 587 F. Supp. 622, 624 (D.C. Conn. 1983); *Menke v. Country Mut. Ins. Co.*, 401 N.E.2d 539, 541 (Ill. 1980); *Bond Bros. v. Robinson*, 471 N.E.2d 1332, 1334–36 (Mass. 1984); *see infra* notes 127–43 and

mind or the common man or woman in the marketplace.<sup>102</sup> This middle ground reasonable expectations approach thus differs significantly from the Keeton Functionalist reasonable expectations doctrine which does not necessarily depend on contractual ambiguity or contractual terms of coverage in its analysis of insurance law disputes.<sup>103</sup> Likewise, this middle ground judicial approach to insurance contract interpretation does *not* adopt a rigid and inflexible traditional rule of insurance contract interpretation,<sup>104</sup> and thus it rejects a strict Formalistic contractual insurance law doctrine as propounded by Professor Williston and others.<sup>105</sup>

The “appropriateness” of the insured’s reasonable expectations under a middle ground contractual analysis also differs from the Keeton Functionalist reasonable expectations doctrine in one other important respect. Under this middle ground analysis, the reasonable expectations of the insured cannot deprive the insurer of any clear and unambiguous policy provisions placed in the insurance contract for its protection.<sup>106</sup> Stated another way, an insurance

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accompanying text; *see also* St. Paul Fire & Marine Ins. Co. v. Albany County Sch. Dist., 763 P.2d 1255, 1263 (Wyo. 1988) (“A rule of construction that considers the reasonable expectations of the parties is of no assistance where the policy terms are clear and unambiguous.”)

<sup>102</sup> *See infra* notes 109–19 and accompanying text. This interpretive approach in favor of the unsophisticated insured or the common man or woman in the marketplace also has important implications on the supplemental interpretive doctrines of waiver and estoppel, as well as the interpretive doctrine relating to exclusions or limitations of coverage in insurance contracts. *See infra* notes 170–89.

<sup>103</sup> *See, e.g.,* Stordahl v. Government Employees Ins. Co., 564 P.2d 63 (Alaska 1977); Gordinier v. Aetna Casualty & Sur. Co., 742 P.2d 277 (Ariz. 1987); Corgatelli v. Globe Life & Accident Ins. Co., 533 P.2d 737 (Idaho 1975); *see supra* note 26; *infra* note 164 and accompanying text.

<sup>104</sup> *See supra* note 75 and accompanying text.

<sup>105</sup> *See supra* notes 15–16 and accompanying text; *see also* Swisher, *supra* note 4, at 1039–49.

<sup>106</sup> *See, e.g.,* Rivers v. Richard Schwartz/Neil Weber Inc., 459 N.W.2d 166, 172 (Minn. Ct. App. 1990) (holding that the doctrine of reasonable expectations would not apply to provide coverage to the insured when there was an express exclusion in the policy, and when there were no ambiguities within the policy); *see also* State Farm Mut. Ins. Co. v. Thomas, 549 S.W.2d 616 (Mo. Ct. App. 1977); Devanzo v. Newark Ins. Co., 374 N.Y.S.2d 619 (N.Y. 1974) (both holding that a court cannot rewrite a clear and unambiguous insurance contract in order to avoid harsh results to the insured).

This assumes, of course, that the clear and unambiguous policy language is not in contravention of state statutes or state public policy. *See, e.g.,* Calvert v. Farmers Ins. Co., 697 P.2d 684, 690 (Ariz. 1985); Cardin v. Royal Ins. Co., 476 N.E.2d 200, 204 (Mass. 1985) (both holding that clear and unambiguous exclusionary language in an automobile insurance policy was a nullity since it contravened state uninsured motorist statutes); Mutual Life Ins. Co. v.

contract under this middle ground reasonable expectation analysis cannot be given a judicial interpretation at variance with the clear and unambiguous language appearing within the insurance contract itself.<sup>107</sup> However, a Formalistic literal interpretation of an insurance contract would also be avoided under a middle ground contractual analysis whenever such an interpretation would lead to an unreasonable or absurd result.<sup>108</sup>

Whether or not the language in an insurance contract is clearly understandable by the insured, and whether that language is ambiguous or unambiguous, however, are two additional issues of paramount importance under the middle ground interpretive approach, as will be addressed in greater depth below.

*1. Insurance Contracts Will Be Construed and Interpreted in Their Ordinary Sense, Rather Than in a Purely Technical or Legal Sense, from the Viewpoint of the Untrained Mind or the Common Man or Woman in the Marketplace.*

Since insurance contracts are not ordinary contracts, and are often perceived to be contracts of adhesion,<sup>109</sup> the middle ground interpretive approach to insurance contracts is that insurance contracts will be construed and interpreted in their ordinary sense, rather than in a purely technical or legal sense, from the viewpoint of the untrained mind or the common man or woman in the marketplace.<sup>110</sup>

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Daddy\$ Money, Inc., 646 S.W.2d 255 (Tex. Ct. App. 1982) (a life insurance endorsement was a nullity since it was not approved by the State Insurance Board as required by the Texas Insurance Code).

<sup>107</sup> In this important respect, the middle ground interpretive approach of the insured's reasonable expectations and the noncontractual Functionalist reasonable expectations approach doctrinally cannot be reconciled. *See supra* notes 23–34 and accompanying text; *see also infra* note 165 and accompanying text.

<sup>108</sup> *See supra* note 77 and accompanying text.

<sup>109</sup> *See supra* note 21 and accompanying text. *But see supra* notes 82–83 and accompanying text.

<sup>110</sup> *See, e.g.,* United States Fire Ins. Co. v. Colver, 600 P.2d 1, 3 (Alaska 1979) (an insurance policy will be construed “to provide that coverage which a layperson would have reasonably expected from a lay interpretation of the policy terms”); *see also* Pacific Indem. Co. v. Interstate Fire & Casualty Co., 488 A.2d 486, 488 (Md. 1985); Greer v. Zurich Ins. Co., 441 S.W.2d 15, 27 (Mo. 1969); Guardian Life Ins. Co. v. Scott, 405 S.W.2d 64, 65 (Tex. 1966). *See generally* 6B JOHN A. APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE § 4254 (rev. ed. 1981) (“Insurance policies, like other forms of contracts, are interpreted as a reasonable man would understand them. The terms of policies are construed in their plain, ordinary, and popular sense. This policy has been referred to as the “principle of reasonable expectations.”).

For example, in the case of *Dixon v. Gunter*,<sup>111</sup> the Tennessee appellate court embraced this middle ground approach by stating that:

A contract of insurance should be given a fair and reasonable construction; and likewise should be given a sensible construction, consonant with the apparent object and plain intention of the parties; a construction such as would be given the contract by an ordinary intelligent business man; and a practical and reasonable rather than a literal interpretation.<sup>112</sup>

Similarly, in the case of *Barber v. Old Republic Life Insurance Co.*<sup>113</sup> the Arizona appellate court agreed that “[i]n ascertaining the meaning of an insurance policy, the language must be viewed from the standpoint of the average layman who is untrained in either law or insurance . . . . That is to say, simply, that a universal standard of plain English prevails, and an insurer who chooses esoteric language does so at its risk.”<sup>114</sup> Accordingly, a middle ground approach to insurance contract interpretation would reject any confusing legal or technical language in insurance policies in favor of a “plain English” or “ordinary” interpretation made by the untrained layman or the common man or woman in the marketplace.<sup>115</sup>

In life and accident insurance policies, for example, a confusing and highly technical insurance law doctrine that purportedly distinguishes between “accidental means”—which is interpreted as synonymous with “cause”—and “accidental results” is still recognized in a number of jurisdictions.<sup>116</sup> However, a realistic middle ground interpretation of insurance contracts would reject this highly confusing, technical, and legalistic distinction between accidental means and accidental results as creating an unwarranted “Serbian

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<sup>111</sup> 636 S.W.2d 437 (Tenn. Ct. App. 1982).

<sup>112</sup> 636 S.W.2d at 441 (Tenn. Ct. App. 1982).

<sup>113</sup> 647 P.2d 1200 (Ariz. Ct. App. 1982).

<sup>114</sup> 647 P.2d at 1202 (Ariz. Ct. App. 1982). *See generally* WINDT, *supra* note 20, at 353–75.

<sup>115</sup> *See, e.g., Queen City Farms Inc. v. Central Nat'l Ins. Co.*, 827 P.2d 1024, 1032 (Wash. Ct. App. 1992) (undefined terms in an insurance contract must be given their plain, ordinary and popular meaning, and the courts can look to standard dictionaries to determine such meaning). Nevertheless, under this middle ground approach an insurer may still contractually define the policy terms in a way that differs from the ordinary understanding of those terms. *Filip v. North River Ins. Co.*, 559 N.E.2d 17, 18 (Ill. Ct. App. 1990).

<sup>116</sup> *See, e.g., Linder v. Prudential Ins. Co.*, 250 S.E.2d 662, 665 (N.C. Ct. App. 1979); *see also* Rothman, *The Meaning of the “Accidental Means” Clause in Accident Insurance Policies*, 48 INS. COUNSEL J. 231 (1981). *See generally* O.C. Sattinger, Annotation, *Insurance: “Accidental Means” as Distinguishable from “Accident,” “Accidental Result,” “Accidental Death,” “Accidental Injury,” Etc.*, 166 A.L.R. 469–79 (1947).

Bog” for the unwary and unsophisticated insured.<sup>117</sup>

Another example of interpreting the “plain meaning” of an insurance policy with highly technical coverage language is found in the case of *Allen v. Manhattan Fire & Marine Insurance Co.*<sup>118</sup> In *Allen*, the insured sued his insurance carrier on the ground that the destruction of his tanker truck was caused by an explosion within the terms and coverage of his insurance policy. For some unknown reason, however, the insured and his attorney voluntarily stipulated with the insurer that the actual cause of the loss was by an “implosion,” defined as an internal collapse followed immediately by a rush of air. The insured then argued that such implosion should come under the coverage of an explosion, defined as a sudden breaking forth of a confined substance as a result of an internal force, rather than as a result of an internal collapse. This unwise stipulation by the insured and his attorney regarding the technical definition of an implosion ultimately sealed his fate and the court held that the insurer was not liable for loss under the policy. Arguably, had there been no prior implosion stipulation, the destruction of the tanker truck probably would have been covered under a nontechnical lay definition of an explosion from the understanding of the untrained mind or the common man or woman in the marketplace.<sup>119</sup>

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<sup>117</sup> See, e.g., *Landress v. Phoenix Mut. Life Ins. Co.*, 291 U.S. 491 (1934) (dissenting opinion by Justice Cardozo, stating that attempting to distinguish accidental means and accidental results would plunge the courts into a “Serbonian Bog”); *Equitable Life Assurance Soc’y of the United States v. Hemenover*, 67 P.2d 80, 81 (Colo. 1937) (“Whatever kind of a bog that is, we concur.”); see also *Burr v. Commercial Travelers Mut. Accident Ass’n*, 67 N.E.2d 248, 251–52 (N.Y. 1946) (“Legal scholars have spent much effort in attempts to evolve a sound theory of causation and to explain the nature of an ‘accident’ . . . . Our guide must be the reasonable expectation and purpose of the ordinary business man when making an insurance contract such as we have here. . . . In this State there is no longer any distinction made between accidental death and death by accidental means, nor between accidental means and accidental results.”).

Many courts since the *Burr* decision have adopted this realistic middle ground approach. See, e.g., *Allstate Ins. Co. v. Sparks*, 493 A.2d 1110, 1112 (Md. Ct. App. 1985). See generally 43 AM. JUR. 2D *Insurance* § 561 (1982); KEETON & WIDISS, *supra* note 23, § 5.4[b][3].

<sup>118</sup> 519 S.W.2d 706 (Tex. Ct. App. 1975).

<sup>119</sup> *Id.*; see *Rohlfing v. State Farm Fire & Casualty Co.*, 349 S.W.2d 472, 482 (Mo. Ct. App. 1961) (holding that a jury could find that loss of a furnace was caused by an explosion where witnesses heard a loud “boom” and found the furnace blown open); *Ormsby v. Travelers Indem. Co.*, 573 S.W.2d 281, 284 (Tex. Ct. App. 1978) (holding that an “explosion” is to be construed in its popular sense, rather than in a highly technical or legal sense); *Graham v. Public Employees Mut. Ins. Co.*, 656 P.2d 1077 (Wash. 1983) (characterizing the Mount St. Helens volcanic eruption as an explosion within the coverage of a homeowners insurance policy); see also *infra* notes 282–83 and accompanying text.



Thus, although a number of courts will allow expert testimony and extrinsic evidence to be admitted in court if the insurance policy language has a peculiar or unusual meaning in a particular trade, business, profession, or commercial usage,<sup>120</sup> expert testimony as to the meaning of nontechnical words or phrases would *not* be a proper subject for expert testimony. For example, in the case of *Truck Insurance Exchange v. Marks Rentals, Inc.*,<sup>121</sup> the Maryland Supreme Court correctly defined the parameters for allowing expert testimony in interpreting insurance policy language within a middle ground insurance contract context:

Expert testimony will not be admitted to prove to a court or jury the proper or legal construction of any instrument in writing. Where parol or extrinsic evidence is otherwise admissible, however, in construing a contract, expert testimony is admissible to aid the fact finder in interpreting words or phrases in the instrument which have a peculiar meaning in a trade, business, or profession . . . .<sup>122</sup>

The principles admitting opinion evidence do not permit a party to a contract to testify as to the effect of the language of the contract as he or she understood it; nor do they permit any other witness to testify as to what is meant by statements in a document prepared by another, unless the words, phrases, or statements used have some unusual or technical meaning peculiar to a certain trade, business, or profession. Thus, expert testimony cannot be received to prove to the court or jury what the proper or legal construction of any instrument of writing is. If, however, words have an unusual meaning or application in a peculiar trade, persons familiar with such trade may testify to such meaning and thereby assist the jury or court in interpreting the written or

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<sup>120</sup> See, e.g., *Savoy Medical Supply Co. v. F & H Mfg Corp.*, 776 F. Supp. 703, 710 n.2 (E.D.N.Y. 1991) (language in a business policy must be given the meaning that an ordinary businessman in the insured's line of business would give the language); *Frank Lucas Ins. Agency v. Fireman's Fund Am. Ins.*, 425 A.2d 1378, 1381-82 (Md. Ct. App. 1981) (while one of the primary rules of insurance contract interpretation is that the common or normal meaning will be given to the words in which it is expressed, nevertheless if those words have a meaning different from the meaning commonly or generally given to them which is peculiar to a locality, a trade, a profession, or the like, then evidence of such a particular or peculiar meaning may be submitted to the court); *Purdy v. Tennessee Farmers Mut. Ins. Co.*, 586 S.W.2d 128, 130 (Tenn. Ct. App. 1979) (the terms of an insurance contract are to be construed according to their plain, ordinary, and popular sense unless the words have acquired a technical sense by commercial usage).

<sup>121</sup> 418 A.2d 1187 (Md. 1980).

<sup>122</sup> *Id.* at 1190 (quoting *Della Ratta, Inc. v. American Better Community Developers, Inc.*, 380 A.2d 627, 635 (Md. 1977)).

verbal passage in which the words occur.<sup>123</sup>

In this particular case, neither alleged expert witness testified that the insurance policy language in question had any peculiar or particular trade usage. Each expert merely stated that he believed the language meant one thing or the other. Consequently, there were no disputed issues of fact presented through this extrinsic evidence.<sup>124</sup>

*2. If the Insurance Contract Is Susceptible to Two or More Reasonable Interpretations, Then It Will Be Construed Liberally in Favor of the Nondrafting Party, the Insured; and It Will Be Strictly Construed Against the Drafting Party, the Insurer. This Rule Is Subject, However, to Extrinsic Evidence to Determine the Parties' Intent, and Subject to the Sophisticated Policyholder Defense.*

Under both a Formalistic approach<sup>125</sup> and a Functionalistic approach<sup>126</sup> to the interpretation of insurance contracts, a general rule has evolved that whenever an insurance policy is susceptible to two or more reasonable<sup>127</sup> interpretations so that an ambiguity exists, under the doctrine of *contra proferentem*, any ambiguous insurance policy language should be strictly construed against the insurer who drafted the contract, and the policy should be liberally construed in favor of the insured who was the nondrafting party.<sup>128</sup>

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<sup>123</sup> *Id.* (quoting 31 AM. JUR. 2D *Expert and Opinion Evidence* § 171).

<sup>124</sup> *Id.*

<sup>125</sup> See *supra* notes 13, 15–20 and accompanying text.

<sup>126</sup> See *supra* notes 14, 23–26 and accompanying text.

<sup>127</sup> See, e.g., *New Castle County v. Hartford Accident & Indem. Co.*, 933 F.2d 1162, 1182 (3d Cir. 1991) (applying Delaware law) (“Policy language is considered ambiguous only if it ‘permits of two or more *reasonable* interpretations.’” To establish an ambiguity, “the insured must do more than proffer a competing ‘*possible* construction of the policy.’”), *cert. denied*, 507 U.S. 1030 (1993); *Norfolk & Western Ry. Co. v. Accident & Casualty Ins. Co.*, 796 F. Supp. 929, 936 (W.D. Va. 1992) (*Norfolk* held that even when the insured is able to proffer two meanings for the policy language, that does not necessarily make the policy language ambiguous. “Competent legal counsel can always make a colorable argument that language is ambiguous by proffering two meanings. Ultimately, the court must examine both proffered meanings and decide if each is plausible.”), *aff’d in part*, 41 F.3d 928 (4th Cir. 1994).

<sup>128</sup> See 13 JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 7401 (rev. ed. 1981); 2 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 15:74 (Mark S. Rhodes, rev. 2d ed. 1984); KEETON & WIDISS, *supra* note 23, at 628–30; RESTATEMENT OF CONTRACTS § 236(d) (1932); RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981); JERRY, *supra* note 43, at 94–98; OSTRAGER & NEWMAN, *supra* note 17; WINDT, *supra* note 20, at 361–75. This is a widely recognized rule of contract interpretation in general, and insurance contract

On this general rule of insurance contract interpretation many Formalist and Functionalist courts apparently agree.<sup>129</sup> However, a closer analysis of the doctrine of ambiguities in an insurance law context demonstrates that a wide interpretive disparity still exists in how the courts actually apply the doctrine of ambiguities to insurance coverage disputes.

On one hand, some courts have applied the doctrine of ambiguities strictly against the insurer, irrespective of whether or not the insured was a sophisticated policyholder,<sup>130</sup> and without utilizing any extrinsic evidence<sup>131</sup>

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law in particular, although there has been recent criticism of this rule. *See, e.g.*, OSTRAGER & NEWMAN, *supra* note 17; Rahdert, *supra* note 27, at 330, 369–70. *But see* Stempel, *supra* note 17, at 826.

Contra proferentem continues to have force when applied to many coverage questions because most policyholders are nondrafters who have nothing to say about the language of the contract. Consequently, if someone has to lose a contract dispute, one can make a good case it should not be the nondrafting policyholder.

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If anything, drafters of standardized contracts have more time, resources, and experts to devote to contract drafting than their customized contract predecessors. . . . The complex nature of insurance, the information disparity between insurer and policyholder, the virtual necessity for insurance, and the industry's ability to collaborate on contract terms without legal liability (because of the McCarran-Ferguson Act's antitrust exception for insurers) all make modern consumer insurance a stronger case for calling close questions in favor of the nondrafter than were presented in the customized land lease, sale of goods, and shipping contracts from which the ambiguity doctrine sprang. Thus, the implicit rationale of contra proferentem continues with some vigor.

*Id.*

<sup>129</sup> *See, e.g.*, Hartnett v. Southern Ins. Co., 181 So. 2d 524, 528 (Fla. 1965) (“so long as [insurance] contracts are drawn in such a manner that it requires the proverbial Philadelphia lawyer to comprehend the terms embodied in it, the courts should and will construe them liberally in favor of the insured and strictly against the insurer to protect the buying public who rely upon [insurers] and agencies in such transactions”); *see also* Swisher, *supra* note 4, at 1058–62. However, a “strong” application of the Functionalist doctrine of reasonable expectations could still find coverage “even though the insurer’s [policy] form is very explicit and unambiguous.” *See infra* note 164 and accompanying text.

<sup>130</sup> The term “sophisticated policyholder” refers to policyholders who have substantial economic strength, desirability as customers, understanding of insurance, or readily available assistance in understanding and procuring insurance. For the most part, sophisticated policyholders are relatively large commercial enterprises. *See* Stempel, *supra* note 17, at 808 n.1. Sophisticated policyholders would also include insurance companies in reinsurance or excess insurance contract disputes. *See, e.g.*, Keystone Ins. Co. v. Allstate Ins. Co., 633 F. Supp. 1358, 1360 (W.D. Pa. 1986); Auto-Owners Ins. Co. v. Blue Cross & Blue Shield, 349 N.W.2d 238, 246 (Mich. Ct. App. 1984).

not found in the insurance policy itself that might resolve the uncertainty. For example, in the case of *Adrian Associates, General Contractors v. National Surety Co.*,<sup>132</sup> a Texas appellate court held that under the insurance law doctrine of ambiguities, the language construction urged by the insured “must be adopted as long as the construction itself is not unreasonable, and even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the intent of the parties.”<sup>133</sup> Other courts also have held that under a strict application of the doctrine of ambiguities extrinsic evidence cannot be used to interpret ambiguous policy provisions, and such ambiguous provisions must be interpreted against the insurer.<sup>134</sup> This rather severe contractual application of the doctrine of ambiguities in an insurance law context has been criticized by a number of recent commentators.<sup>135</sup>

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<sup>131</sup> Under a traditional contractually based parol evidence rule, the terms of an insurance contract may not be contradicted—or supplemented—by evidence of any prior agreement or negotiations of the parties that are not found in the contract itself, unless the terms of that contract are ambiguous. *See, e.g., JERRY, supra* note 43, at 274.

Considerable controversy exists over the circumstances under which parol evidence should be admitted to supplement a writing. Under the strict view, if the contract is clear on its face, as indicated by evaluation of the “four corners” of the document, parol evidence is inadmissible to contradict the writing. This approach has been applied to assertedly “unambiguous” insurance policies; parole testimony seeking to alter the coverage terms has been held inadmissible. Under the broader, more modern view, evidence concerning the circumstances surrounding the contract’s formation, including negotiation and prior dealings and conduct, are all admissible to determine whether the contract is “integrated”, a finding preliminary to applying the parol evidence rule.

*Id.*

<sup>132</sup> 638 S.W.2d 138 (Tex. Ct. App. 1982).

<sup>133</sup> *Id.* at 140; *see also* *Chen v. Metropolitan Ins. & Annuity Co.*, 907 F.2d 566, 569 (5th Cir. 1990) (applying Texas law); *Niagara County v. Utica Mut. Ins. Co.*, 427 N.Y.S.2d 171, 176 (Sup. Ct. 1980), *aff’d*, 439 N.Y.S.2d 538 (App. Div. 1981); *Gunn v. Aetna Life & Casualty Co.*, 629 S.W.2d 59, 60 (Tex. Ct. App. 1981).

<sup>134</sup> *See, e.g., Eli Lilly & Co. v. Home Ins. Co.*, 794 F.2d 710, 714–16 (D.C. Cir. 1986) (applying Indiana law), *cert. denied*, 479 U.S. 1060 (1987); *ACANDS, Inc. v. Aetna Casualty & Sur. Co.*, 764 F.2d 968, 973 (3d Cir. 1985) (applying Pennsylvania law); *Eli Lilly & Co. v. Home Ins. Co.*, 482 N.E.2d 467, 470 (Ind. 1985), *cert. denied*, 479 U.S. 1060 (1987).

<sup>135</sup> *See, e.g., WINDT, supra* note 20, at 368–69.

[Under this strict rule], once an ambiguity is discovered, courts may not look first to extrinsic evidence in order to eliminate the ambiguity; they may, instead, automatically resolve the ambiguity against the insurer. This can, of course, result in the creation of policy coverage when neither party intended or expected such coverage. This should not,

On the other hand, a larger and growing number of courts have held that if insurance policy terms are ambiguous, then extrinsic evidence should be permitted to ascertain the parties' true intent, and the *contra proferentem* rule interpreting ambiguous policy language in favor of the insured should be relied upon only as a last resort or an interpretive tie-breaker.<sup>136</sup> This middle ground contractual analysis appears to be the better-reasoned interpretive approach to ascertain the parties' intent, rather than relying solely upon a strict and inflexible "four corners of the contract" traditional approach.<sup>137</sup>

A final important element of the *contra proferentem* doctrine of ambiguities involves the sophisticated policyholder.<sup>138</sup> Normally, the terms of an insurance contract will be construed and interpreted in their ordinary sense, rather than in

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therefore, be the law.

The rule interpreting ambiguous policy language in favor of the insured should be relied on only as a last resort. It should not be permitted to frustrate the intention of the parties, if that intent can somehow be ascertained. As a result, courts should resort to the rule only if an evaluation of the pertinent extrinsic evidence does not indicate the parties' true intent.

*Id.*

See also OSTRAGER & NEWMAN, *supra* note 17, at 5-7.

The parol evidence rule general precludes consideration of extrinsic evidence of the meaning of an insurance contract unless the policy language is ambiguous. . . . If there appears to be an ambiguity in the policy, a court must consider extrinsic evidence submitted by the parties to assist in determining the actual intent of the parties. . . .

If the intent of the contracting parties cannot be ascertained after the trier of fact considers extrinsic evidence about the meaning of an ambiguous policy term, other rules of construction may then be applied *only* as a last resort. . . . Thus, the issue of whether an insured is entitled to contra-insurer rules of construction does not arise unless it is first demonstrated that: (a) the policy is ambiguous; and (b) the ambiguity may not be resolved by resort to extrinsic evidence of intent.

*Id.*

<sup>136</sup> See, e.g., *Kenevan v. Empire Blue Cross & Blue Shield*, 791 F. Supp. 75, 79 (S.D.N.Y. 1992); *Wolf Bros. Oil Co. v. International Surplus Lines Ins. Co.*, 718 F. Supp. 839, 843 (W.D. Wash. 1989); *Rainer Credit Co. v. Western Alliance Corp.*, 217 Cal. Rptr. 291, 295 (Cal. Ct. App. 1985); *Inland Constr. Co. v. Home Indem. Co.*, 447 N.E.2d 1023, 1024 (Ill. Ct. App. 1983); *Walle Mut. Ins. Co. v. Sweeney*, 419 N.W.2d 176, 180 (N.D. 1980); *General Am. Life Ins. Co. v. Barrett*, 847 S.W.2d 125, 132 (Mo. Ct. App. 1993).

<sup>137</sup> See, e.g., *Stempel*, *supra* note 17, at 821. "This notion of invoking the contra-proferentem principle as a tie breaker only after consideration of extrinsic evidence specific to the case is the better reasoned modern view of contract law." *Id.*

<sup>138</sup> See *supra* note 130.

a purely technical or legal sense, from the viewpoint of the untrained mind or the common man or woman in the marketplace.<sup>139</sup> However, should a sophisticated policyholder such as an insurance company in a reinsurance or excess insurance contract, or a large commercial policyholder with ready access to available legal and technical assistance in procuring and understanding insurance coverage, be entitled to this same interpretive rule as the untrained policyholder or the common man or woman in the marketplace? Again, the courts have split on this important issue.

Some courts have applied a strict contractual interpretation to every policyholder under the *contra proferentem* doctrine of ambiguities, irrespective of whether or not the policyholder was “sophisticated” or “unsophisticated” in procuring insurance coverage or in understanding the technical language within the insurance policy.<sup>140</sup> Other courts, however, have recognized that in the real world insurance companies and other large commercial corporations often are sophisticated policyholders, and therefore they should *not* be entitled to the doctrine of ambiguities interpretive rule under a sophisticated policyholder defense, and the *contra proferentem* doctrine should only be applied to the unsophisticated policyholder or the common man or woman in the marketplace.<sup>141</sup> Again, this latter approach appears to be the better-reasoned

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<sup>139</sup> See *supra* notes 109–24 and accompanying text.

<sup>140</sup> See, e.g., *St. Paul Mercury Ins. Co. v. Grand Chapter of Phi Sigma Kappa*, 651 F. Supp. 1042 (E.D. Pa. 1987) (holding that the doctrine of ambiguities applies to commercial policyholders as well as ordinary consumers unless the parties possessed equal bargaining power); *Minier v. Traveler Indem. Co.*, 159 F. Supp. 230 (N.D. Ill. 1958) (holding that the doctrine of ambiguities is based, not upon the sophistication or bargaining power of the policyholder, but on the concept that the insurer drafted the policy); *Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 607 N.E.2d 1204 (Ill. 1992) (holding that the sophistication of the insured is irrelevant); see also *Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 15 Cal. Rptr. 815 (Cal. Ct. App. 1993); *Boeing Co. v. Aetna Casualty & Sur. Co.*, 784 P.2d 507 (Wash. 1990); *D’Annunzio v. Security Conn. Life Ins. Co.*, 410 S.E.2d 275 (W.Va. 1991).

<sup>141</sup> See, e.g., *Eastern Associated Coal Corp. v. Aetna Casualty & Sur. Co.*, 632 F.2d 1068, 1080 (3d Cir. 1980) (applying Pennsylvania law) (“If an ambiguity does exist and if the insurer wrote the policy or is in a stronger bargaining position than the insured, the ambiguity is generally resolved in favor of the insured and against the insurer. However, the principle that ambiguities in policies should be strictly construed against the insurer does not control the situation where large corporations, advised by counsel and having equal bargaining power, are the parties to a negotiated policy.”), *cert. denied*, 451 U.S. 986 (1981); *Eagle Leasing Corp. v. Hartford Fire Ins. Co.*, 540 F.2d 1257, 1261 (5th Cir. 1976) (applying Missouri law) (“We do not feel compelled to apply, or indeed, justified in applying the general rule that an insurance policy is construed against the insurer in the commercial insurance field when the insured is not an innocent but a corporation of immense size, carrying insurance with annual premiums of six figures, managed by sophisticated business men, and represented by counsel on the same

middle ground contractual view for ascertaining the parties' intent, especially in a business insurance context.<sup>142</sup> However, not all commercial policyholders necessarily will be sophisticated policyholders, and two commentators suggest similar checklists for determining whether or not a commercial policyholder would constitute a sophisticated policyholder.<sup>143</sup>

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professional level as the counsel for the insurers.”), *cert. denied*, 431 U.S. 967 (1977); *see also* Halpern v. Lexington Ins. Co., 715 F.2d 191 (5th Cir. 1983); Fireman's Fund Ins. Co. v. Fibreboard Corp., 227 Cal. Rptr. 203 (Cal. Ct. App. 1986).

<sup>142</sup> *See generally* Barry Ostrager & David Ichel, *Should the Business Insurance Policy Be Construed Against the Insurer? Another Look at the Reasonable Expectations Doctrine*, 33 FED. INS. & CORP. COUNSEL Q. 273 (1983); Stempel, *supra* note 17. Although Ostrager and Ichel characterize the sophisticated policyholder defense in more functionalistic terms, Professor Stempel's characterization of the sophisticated policyholder defense in contractual terms is apt and, in this author's view, more appropriate. *See, e.g.*, Stempel, *supra* note 17, at 855-57:

The sophistication of the policyholder is, however, a valid consideration in applying a number of contract principles. For example, a policyholder's expertise and historical experience create specialized understanding of the meaning of policy language, making it less likely that a court will find the language ambiguous. Also, the policyholder's sophistication may foreclose as unreasonable certain policy interpretations that would be reasonable to the average layperson. The policyholder's discussion and rejection or acceptance of certain policy options also creates context and extrinsic evidence courts may employ in deciding cases, thereby making ambiguity less frequent as a tie breaker. . . .

. . . .  
Treating Fortune 500 companies like impoverished and credulous individuals makes no sense. A blanket or reflexive rejection of the time-honored ambiguity approach for commercial policyholders, however, makes even less sense.

*Id.*

<sup>143</sup> *See generally* OSTRAGER & NEWMAN, *supra* note 17, at 26-36.

The courts that have declined to apply the contra-insurer rule [to business insurance coverage disputes] have relied on evidence establishing the equivalence of bargaining power between the insurer and the insured, including: (1) the large size of the business insured; (2) the involvement of counsel on behalf of the insured in the negotiation of the policy; (3) the representation of the insured by an independent [insurance] broker in the negotiation of the policy; (4) the use of a "manuscript" policy [an individually negotiated and drafted policy rather than a "standard form" policy]; (5) the "insurance" sophistication of the insured; (6) whether the dispute is between two insurance companies; and (7) whether the parties possess equal bargaining power.

*Id.*

*See also* STEMPEL, *supra* note 20, at 849-57.

Thus, under a middle ground interpretive view, the contractually based *contra proferentem* doctrine of ambiguities would be retained in favor of an unsophisticated policyholder's reasonable expectation of coverage, but subject to extrinsic evidence to help clarify any such ambiguity, and subject also to a sophisticated policyholder defense.

***3. Based upon the Acts and Representations Made by the Insurer and Its Agents, the Legal Doctrines of Waiver, Estoppel, Election, and Reformation of Contract Are Available to the Insured and Should Be Liberally Construed to Validate the Reasonable Expectation of the Insured to Coverage.***

Insurance coverage today is sold by a multitude of insurance agents who often emphasize the insured's "peace of mind" and reasonable expectation to

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Several issues are worth considering.

First, courts should consider the actual identity of the drafter. At the outset, commentators and courts should distinguish more carefully between situations in which the policyholder is merely a sophisticated party adhering to a standardized contract of adhesion, and those cases in which the policyholder is more than the consumer of a prefabricated insurance product. . . . Second, courts should consider broker presence and activity. . . . Third, courts must consider attorney presence and activity. . . . Fourth, courts should consider the degree of negotiation surrounding the policy and whether it is fairly characterized as "customized" rather than standardized. . . . Fifth, courts must consider whether, regardless of the drafter's identity, the term in dispute is really ambiguous if examined in light of the parties and the facts. . . . Sixth, courts should consider the understanding conveyed by the oral and written conduct of the parties surrounding the negotiation, finalization, and implementation of the policy. . . . Seventh, courts should consider the presence of an objectively reasonable expectation of or reasonable reliance upon coverage due to no fault of the policyholder. . . . Eighth, courts should consider the presence of a genuine contractual relationship between the disputants. . . . Ninth, courts must consider the presence of extrinsic evidence. . . . Tenth, courts should consider whether, in the absence of more probative evidence of contract meaning, it is fundamentally fair to invoke *contra proferentem* against the insurer. . . . Finally, courts must consider impact of policyholder sophistication on contract doctrines other than ambiguity. . . .

Assessing future coverage questions involving sophisticated policyholders by reference to this Article's list of considerations can form an initial basis for a sounder insurance coverage doctrine.

*Id.*



coverage,<sup>144</sup> even though the insured seldom reads his or her policy,<sup>145</sup> and even though there may be a number of contractual conditions, limitations, or exclusions within the insurance policy that the insurer subsequently may cite in order to defeat the insured's reasonable expectation to coverage.<sup>146</sup> Although some commentators have characterized these insurance sales/coverage disputes in terms of a more Functionalistic analysis,<sup>147</sup> judicial interpretations of sales/coverage disputes are more persuasive utilizing an insurance-as-contract analysis.<sup>148</sup> Accordingly, under a contractually based middle ground interpretive view of insurance coverage disputes, and based upon the acts and representations made to the insured by the insurer and its agents, the legal doctrines of waiver, estoppel, election, and reformation of contract also are available to the insured and should be liberally construed to validate the

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<sup>144</sup> See, e.g., Robert H. Jerry, II, *Remedying Insurer's Bad Faith Contract Performance: A Reassessment*, 18 CONN. L. REV. 271, 298-99 (1986) (stating that insurers and their agents often emphasize the catastrophic effects of loss, and the "peace of mind" that insurance provides when attempting to convince a prospective insured to purchase insurance coverage).

<sup>145</sup> See *supra* note 22 and accompanying text.

<sup>146</sup> See, e.g., *D'Ambrosio v. Penn. Nat'l Mut. Ins. Co.*, 396 A.2d 780, 786 (Pa. Super. 1978) ("The insurer's promise to the insured to 'simplify his life,' to put him in 'good hands,' to back him with 'a piece of the rock' or to be 'on his side' hardly suggests that the insurer will abandon the insured in his time of need."), *aff'd*, 431 A.2d 966 (Pa. 1981). But see *Rodio v. Smith*, 587 A.2d 621, 624 (N.J. 1991) ("However persuasive, 'You're in good hands with Allstate' is nothing more than puffery."). For an excellent discussion of the duality between insurers' sales inducements to the insured on the one hand, and insurers' contractual claims defenses on the other hand, see Tom Baker, *Constructing the Insurance Relationship: Sales Stories, Claims Stories, and Insurance Contract Damages*, 72 TEX. L. REV. 1395 (1994).

<sup>147</sup> See Baker, *supra* note 146, at 1417 n.77, citing as some examples: SPENCER L. KIMBALL, *CASES AND MATERIALS ON INSURANCE LAW* 8-31 (1992); KENNETH S. ABRAHAM, *INSURANCE LAW AND REGULATION: CASES AND MATERIALS* 33-52 (1990); and ALAN I. WIDISS, *INSURANCE MATERIALS ON FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES, AND REGULATORY ACTS* 599-654 (1989). But see Spencer Kimball, *Distributing Risk: Insurance, Legal Theory, and Public Policy*, 19 CONN. L. REV. 311 (book review) (expressing criticism of the Functionalist reasonable expectations doctrine).

<sup>148</sup> See, e.g., Baker, *supra* note 146, at 1417 ("The 'insurance-as-contract' story is typically the baseline [for judging the insurance relationship]. Many, if not most, courts—whether deciding in favor of insurance companies or insureds—rely heavily on a straightforward interpretation of the insurance company's printed form."); STEMPER, *supra* note 20, at 298 ("Although insurance marketing involves sales force solicitation, mass advertising, and efforts to build a secure, positive image rather than to promote a given coverage scheme or contract language, the insurance policy still figures prominently in the manner in which insurance is usually sold.") (footnote omitted); see also EMERIC FISCHER & PETER N. SWISHER, *PRINCIPLES OF INSURANCE LAW* 1-12, 20-40 (2d ed. 1994); *supra* notes 15-20, 33-34, 41-56, 61-71 and accompanying text.

reasonable expectation of the insured to coverage.

A waiver is the voluntary and intentional relinquishment of a known right which may result from either the affirmative acts of the insurer or its authorized agents, or from the insurer's inaction, with knowledge of the applicable facts.<sup>149</sup> Because there must be a clear, requisite intent to establish such a waiver, it generally cannot be found in negligence or mistake.<sup>150</sup> Common examples of waiver on the insurer's part in sales/coverage disputes include: (1) the insurer waiving or accepting overdue premium payments;<sup>151</sup> and (2) the insurer waiving certain misrepresentations in the insurance application, or waiving conditions or warranties found in the insurance policy.<sup>152</sup> Estoppel, on the other hand, does not require any actual surrender of a known right. Rather, the doctrine of estoppel implies some misleading act, conduct, or inaction on the part of the insurer or its agent, upon which the insured detrimentally relies.<sup>153</sup> Estoppel has been utilized by the insured in insurance sales/coverage

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<sup>149</sup> 16B JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* §§ 9081-9090 (rev. ed. 1981); 7 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* §§ 35:248-:275 (Mark S. Rhodes, rev. 2d ed. 1985); WINDT, *supra* note 20, at 468-73. Waiver principles are well recognized and well established supplemental rules of American contract law. *See, e.g.*, 2 E. ALLAN FARNSWORTH, *FARNSWORTH ON CONTRACTS* §§ 8.5, 8.19 (1990); ARTHUR L. CORBIN, *CORBIN ON CONTRACTS*, §§ 752-766 (1 vol. ed. 1952).

<sup>150</sup> *See, e.g.*, *Reserve Life Ins. Co. v. Howell*, 357 P.2d 400 (Or. 1960).

<sup>151</sup> *See, e.g.*, *Kramer v. Metropolitan Life Ins. Co.*, 494 F. Supp. 1026 (D. N.J. 1980); *Northeast Ins. Co. v. Concord Gen. Mut. Ins. Co.*, 461 A.2d 1056 (Me. 1983); *Lawrimore v. American Health & Life Ins. Co.*, 276 S.E.2d 296 (S.C. 1981).

<sup>152</sup> *See* 16B JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 9082 (rev. ed. 1981) (stating that the doctrine of waiver evolved in insurance law to prevent forfeitures of the insured's coverage that would otherwise result when an insured breaches a policy condition); *see also* W.C. Crais, III, Annotation, *Doctrine of Estoppel or Waiver As Available to Bring Within Coverage of Insurance Policy Risks Not Covered by Its Terms or Expressly Excluded Therefrom*, 1 A.L.R.3d 1139-83 (1965).

<sup>153</sup> *See, e.g.*, *Loyola Univ. v. Humana Ins. Co.*, 996 F.2d 895, 902 (7th Cir. 1993) (applying Illinois law) ("[E]stoppel occurs when one party knowingly misrepresents or conceals a material fact and the other party, not knowing the truth, reasonably relies on that misrepresentation or concealment to his detriment."). However, in the absence of a reasonable belief of coverage or detriment reliance on the part of the insured, estoppel will not be available. *See Transamerica Ins. Group v. Turner Constr. Co.*, 601 N.E.2d 473, 477 (Mass. Ct. App. 1992); *see also* 7 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* §§ 35:250-:275; (Mark S. Rhodes, rev. 2d ed. 1985); Crais, *supra* note 152; WINDT, *supra* note 20, at 460-67.

Increasingly, the courts are viewing estoppel in terms of the standards set forth in the *Restatement (Second) of Contracts* § 90 (1981):

- (1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such

disputes when an insurance agent misrepresents that the insured has more coverage than is found in the policy itself.<sup>154</sup>

Although the doctrines of waiver and estoppel “have been used to deprive insurers of defenses in virtually every context in which the insurer might deny liability,”<sup>155</sup> and although waiver and estoppel often are utilized as doctrines of judicial discretion<sup>156</sup> by Formalist and Functionalist judges alike<sup>157</sup> in order to validate the insured’s reasonable expectation of coverage, one commentator opines that “it is somewhat surprising that courts in most jurisdictions hold that the doctrines [of waiver and estoppel] are not available to broaden coverage.”<sup>158</sup> Nevertheless, a majority of jurisdictions have held that the doctrines of waiver and estoppel cannot be used to extend the coverage of an insurance policy, nor to create any new liability, but may only affect those contractual rights that are already reserved in the policy. Thus, while a forfeiture of benefits already contracted for in an insurance policy may be waived, or an insurer may be estopped to deny them, the doctrines of waiver or estoppel cannot create liability on the insurer for any new coverage benefits that were not already contracted for in the first place.<sup>159</sup> In other words, a number

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action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981). Estoppel principles are well recognized and well established supplemental rules of American contract law. *See* FARNSWORTH, *supra* note 149, §§ 2.19, 6.12; CORBIN, *supra* note 149, §§ 93–209; *see also* STEMPER, *supra* note 20, at 222–29.

<sup>154</sup> *See, e.g., Weaver v. Metropolitan Life Ins. Co.*, 545 F. Supp. 74 (E.D. Mo. 1982) (holding that an agent’s misrepresentation of coverage in a disability insurance policy, plus the company’s “sales aids” promising coverage, and the acceptance of the insured’s premiums, constituted actual or apparent authority of the agent to act on behalf of his principal, and waiver and estoppel principles applied against the insurer, providing coverage to the insured); *Jones v. United Ins. Co. of Am.*, 338 S.E.2d 532 (Ga. Ct. App. 1985) (holding that an agent’s knowledge of the insured’s health and drinking habits were imputed to the company, even though material misrepresentations had been made in the insurance application, and the company therefore waived and was estopped to deny any defense to coverage); *Durham v. Cox*, 310 S.E.2d 371 (N.C. Ct. App. 1984) (holding that an agent’s knowledge of the insured’s upholstery business in his garage, and acceptance of enhanced premiums, constituted waiver and estoppel barring the insurer to deny coverage).

<sup>155</sup> JERRY, *supra* note 43, at 269–73.

<sup>156</sup> *See* STEMPER, *supra* note 20, at 222–25.

<sup>157</sup> *See, e.g., Crais, supra* note 152 and cases cited therein; *see also* KEETON & WIDISS, *supra* note 23.

<sup>158</sup> *See, e.g., McGee v. Guardian Life Ins. Co.*, 472 So. 2d 993 (Ala. 1985); *Ricci v. New Hampshire Ins. Co.*, 721 P.2d 1081 (Wyo. 1986); *see* JERRY, *supra* note 43, at 269.

<sup>159</sup> *See, e.g., Topeka Tent & Awning Co. v. Glen Falls Ins. Co.*, 774 P.2d 984 (Kan. Ct.

of courts utilizing a middle ground interpretive approach, hold that waiver and estoppel defenses would apply to representations, warranties, and conditions in the insurance contract, but waiver and estoppel would not apply to exclusions or limitations to coverage.<sup>160</sup> Other middle ground courts have applied waiver and estoppel principles more broadly, and have liberally construed their application to provide coverage that, in certain circumstances, may be excluded in the policy.<sup>161</sup> Under this middle ground interpretive view, judicial discretion in the utilization of waiver and estoppel principles, although expanded from a traditional contractual analysis and liberally construed,<sup>162</sup> is not limitless, and although the doctrines of waiver and estoppel have been used to protect the reasonable expectations of the consuming public to coverage, for the most part the courts have acted with reasonable restraint.<sup>163</sup> Adopting a more

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App. 1989); *Daca, Inc. v. Commonwealth Land Title Ins. Co.*, 822 S.W.2d 360 (Tex. Ct. App. 1992); *Shannon v. Shannon*, 442 N.W.2d 25 (Wis. 1989); *see also* 16B JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* (rev. ed. 1981); 7 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* (Mark S. Rhodes, rev. 2d ed. 1985); Crais, *supra* note 152.

<sup>160</sup> *See, e.g.*, *Fishel v. American Sec. Life Ins. Co.*, 835 F.2d 613, 615–16 (5th Cir. 1988) (applying Mississippi law) (allowing estoppel to prevent forfeiture of coverage, but not as a basis for the nonexistence of coverage in the first place); *Gordon v. Liberty Mut. Ins. Co.*, 675 F. Supp. 321, 323 (E.D. Va. 1987); *Vision Inc. v. Fireman's Fund Ins. Co.*, 744 P.2d 998, 1001 (Or. 1987) (estoppel may be invoked with regard to conditions of forfeiture, but it cannot be invoked to expand the scope of insurance coverage).

Accordingly, it is very important to determine how these particular middle ground courts will characterize an insurance policy provision: (1) as a condition to coverage; or (2) as an exclusion from coverage. *See, e.g.*, *Durham v. Cox*, 310 S.E.2d 371 (N.C. Ct. App. 1984) (characterizing a fire loss of a garage used for commercial purposes in a homeowners insurance policy as a mode of use warranty or “accepted risk” rather than as a business exclusion provision or “excepted risk,” thus allowing waiver and estoppel defenses to apply in favor of the insured). *But see* *Badger Mut. Ins. Co. v. Hancock*, 157 S.E.2d 58 (Ga. Ct. App. 1967) (characterizing a fire loss of a garage used for commercial purposes as a business exclusion “excepted risk,” and thus denying any waiver or estoppel defenses in favor of the insured).

<sup>161</sup> *See, e.g.*, *Loyola Univ. v. Humana Ins. Co.*, 996 F.2d 895 (7th Cir. 1993) (applying Illinois law); *Alan Corp. v. International Surplus Lines Ins. Co.*, 823 F. Supp. 33 (D. Mass. 1993), *aff'd*, 22 F.3d 339 (1st Cir. 1994); *Childress v. Foremost Ins. Co.*, 411 So. 2d 124 (Ala. 1982). For example, such exceptional circumstances have included when the insurer's agent materially misrepresents the extent of policy coverage to the insured, and when the insurer fails to transmit a proper reservation of rights notice while defending the insured. *See infra* notes 241–49 and accompanying text.

<sup>162</sup> *See supra* notes 160–61 and accompanying text; *see also* WINDT, *supra* note 20, at 460 (“Numerous courts have summarily stated that the doctrine of estoppel cannot be used to provide coverage that is excluded by the policy. That proposition, however, read literally is far too broad.”); *infra* notes 241–55 and accompanying text.

<sup>163</sup> *See* JERRY, *supra* note 43, at 272; *see also* STEMPEL, *supra* note 20, at 223–24.

Functionalistic view of “broadening” coverage without relying on waiver or estoppel principles<sup>164</sup> would, in effect, eviscerate these important parameters of judicial restraint, uniformity of decision, predictability of result, and a more balanced interpretive approach affecting both the insured and the insurer.<sup>165</sup>

Additionally, the insured also may utilize the doctrine of election in order to validate the insured’s reasonable expectation of coverage. The doctrine of

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Judicial discretion over waiver and estoppel doctrines is not limitless. . . .

Despite limits on [these] doctrines and a general sense that courts have not “gone overboard” to assist policyholders, insurers can improve the odds by acting quickly in the event of a claim to analyze the loss in terms of applicable policy exclusions. If a potential defense exists, insurers should raise it with the policyholder as soon as possible and emphasize its impact on coverage.

*Id.*

<sup>164</sup> See JERRY, *supra* note 43, at 273.

The reasonable expectations doctrine . . . in its strong form has the potential to create coverage where none would otherwise exist. Professor (now Judge) Keeton, who was instrumental in the early growth of the doctrine, wrote that insurers should not be able to limit coverage inconsistently with the insured’s reasonable expectations “even though the insurer’s form is very explicit and unambiguous. . . . [N]ot only should a policyholder’s reasonable expectations be honored in the face of difficult and technical language, but those expectations should prevail as well when the language of an unusual provision is clearly understandable,” unless the insurer shows that the insured acted unreasonably in not reading the policy.

. . . This doctrine has more far-reaching implications for coverage than estoppel because the reasonable expectations doctrine does not require the insured to show reliance, which is an element of both equitable and promissory estoppel.

*Id.* (ellipsis in original) (quoting ROBERT KEETON, *INSURANCE LAW* 351–52 (1971)).

<sup>165</sup> See WINDT, *supra* note 20, at 465 (stating that some courts “have been all too willing to find an estoppel, even in the absence of prejudice to and justifiable reliance by the insured”); see also Clarence Morris, *Waiver and Estoppel in Insurance Policy Litigation*, 105 U. PA. L. REV. 925, 926 (1957).

[T]his process of favoring [insurance] consumers can be carried too far. Insurance companies need and are entitled to reasonable limits on their responsibilities; the public is prejudiced when company liabilities are by generous caprice stretched over risks that cannot be profitably underwritten at a just premium. By and large, however, the courts have not been overgenerous to the public. Judges have limited their use of the doctrines of waiver and estoppel because of their awareness of important underwriting realities.

*Id.*

election is a hybrid legal remedy between waiver and estoppel. It contemplates a rule of law that restricts the actor—normally the insurer—to a choice from among a limited number of legal options. It is similar to estoppel because it is an imposed rule of law, and it is similar to waiver because a choice must still be made by the actor. Election is most commonly found in insurance law when the insurer has the option to repair or rebuild insured property or pay a monetary claim.<sup>166</sup> According to Professors Keeton and Widiss, although the concept of election is “more troublesome” for the courts to employ than either waiver or estoppel, it is often more useful for the insured to utilize the doctrine of election since it does not require the voluntary relinquishment element for waiver, nor the detrimental reliance factor for estoppel.<sup>167</sup>

The insured has a final contractual remedy to safeguard his or her reasonable expectation to coverage in the form of contract reformation. If an insurance agent makes an innocent or fraudulent representation to the insured regarding policy coverage, the insured may bring an action for a reformation of the insurance contract based upon a mutual mistake of the parties, or based upon mistaken or fraudulent representations or conduct of the insurer or its agent who issues the policy.<sup>168</sup> Under traditional contract law principles,

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<sup>166</sup> When the insurer elects to repair or rebuild, the former contract of insurance is transformed into a construction contract, and the insured no longer has an action on the policy to recover any monetary indemnity. Likewise, the insurer cannot later claim a breach of any condition in the insurance policy that would lead to a forfeiture. *Walker v. Republic Underwriters Ins. Co.*, 574 F. Supp. 686 (D. Minn. 1983); *Home Indem. Co. v. Bush*, 513 P.2d 145 (Ariz. Ct. App. 1973). If the insurer elects to repair a damaged vehicle or rebuild a damaged building, the insurer is bound by its election—even though the cost of this undertaking may be more or less than the original amount of the insurance coverage under the policy. *Venable v. Import Volkswagen Inc.*, 519 P.2d 667 (Kan. 1974); *Walker*, 574 F. Supp. at 688; *see also* *Howard v. Reserve Ins. Co.*, 254 N.E.2d 631 (Ill. App. Ct. 1969).

The doctrine of election likewise may be applied against the insured. *See, e.g.*, *Dunn v. Way*, 786 P.2d 649 (Mont. 1990) (holding that the insureds' failure to elect as to whether they wished to replace destroyed items or seek reimbursement from the insurer on the basis of depreciated costs, as required in their homeowners' insurance policy, precluded a suit against their insurer). *See also* FARNSWORTH, *supra* note 149, § 8.19; 15 GEORGE J. COUCH, CYCLOPEDIA OF INSURANCE LAW §§ 54:17–18, :20–26 (Mark S. Rhodes, rev. 2d ed. 1983).

<sup>167</sup> *See generally* KEETON & WIDISS, *supra* note 23, at 618–20.

<sup>168</sup> *See, e.g.*, *Continental Casualty Co. v. Didier*, 783 S.W.2d 29 (Ark. 1990) (holding that a written instrument may be reformed if there has been a mistake of one party accompanied by fraud or other inequitable conduct of the other party); *Magnus v. Barrett*, 557 N.E.2d 252 (Ill. App. Ct. 1990) (holding that reformation of contract should be allowed only when clear and convincing evidence compels the conclusion that the contractual instrument as it stands does not properly reflect the intention of the parties, and that there has been either a mutual mistake of the parties or mistake by one party and fraud by the other); *see also* *Board of Trustees v. Insurance Corp.*, 969 F.2d 329 (7th Cir. 1992) (applying Illinois law); *Raymond v. Zeringue*,

contract reformation must be proved by clear and convincing evidence, although some recent insurance cases have required less proof. The insured also may show by parol evidence that the parties' intent was different from the terms of the insurance contract and may, in some jurisdictions, also present evidence that the insured had not read the policy to support the insured's allegations that he or she had a mistaken understanding of its terms.<sup>169</sup>

The legal doctrines of waiver, estoppel, election, and reformation of contract, as utilized in a realistic middle ground interpretive approach to insurance coverage disputes, therefore provide additional parameters for judicial discretion in recognizing and honoring the insured's reasonable expectation of coverage that are supplemental to—rather than at variance with—the terms of the parties' insurance contract.

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422 So. 2d 534 (La. Ct. App. 1982); *Wood Goods Galore, Inc. v. Reinsurance Ass'n*, 478 N.W.2d 205 (Minn. Ct. App. 1991). Indeed, it has been held that the insured and the insurer can legally reform an insurance contract subsequent to the insured loss, even to the detriment of an excess insurer. *See, e.g., Great Atlantic Ins. Co. v. Liberty Mut. Ins. Co.*, 773 F.2d 976 (8th Cir. 1985) (applying Missouri law).

<sup>169</sup> *See, e.g., National Ben Franklin Ins. Co. v. Davidovitch*, 462 N.E. 2d 696 (Ill. App. Ct. 1984) (holding that for reformation to be ordered, evidence of mutual mistake must be clearly and convincingly proven); *see also* FARNSWORTH, *supra* note 149, § 7.5. *See generally* 17 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* §§ 66:1–164 (Mark S. Rhodes, rev. 2d ed. 1983); Irwin J. Schiffres, Annotation, *Reformation of Insurance Policy to Correctly Identify Risks and Causes of Loss*, 32 A.L.R.3d 661–735 (1970); 43 AM. JUR. 2D *Insurance* §§ 357–359 (1982).

Some courts have held that under traditional principles of insurance contract law, the insured is held to the duty of reading his or her insurance policy, and failure to read the policy would bar the insured from having the policy reformed. *See, e.g., Equitable Life Assurance Soc'y v. Aaron*, 108 F.2d 777 (6th Cir. 1940). Other courts, however, have applied a better-reasoned middle ground interpretive approach, holding that the failure of the insured to read his or her policy will not per se constitute negligence or laches to deprive the insured of the remedy of contract reformation. Instead, the courts have interpreted the insurance policy as a reasonable person would. *See, e.g., Schafer v. Maryland Casualty Co.*, 123 F. Supp. 873 (D.S.C. 1954); *Mogil v. Maryland Casualty Co.*, 26 N.W.2d 126 (Neb. 1947); *Portella v. Sonnenberg*, 181 A.2d 385 (N.J. Super. 1962). This latter approach realistically recognizes that few insureds do in fact read or fully understand their insurance policies. *See supra* notes 22, 77 and accompanying text.

4. *In Order to Further Validate the Reasonable Expectations of the Insured to Coverage, Any Exclusion, Exception, or Limitation to Coverage Must Be Clearly, Expressly, and Unambiguously Stated in the Insurance Contract.*

Since insurance policies are often perceived to be contracts of adhesion where the insurance company often has a superior bargaining position, and the insured often must accept the policy on a take it or leave it basis;<sup>170</sup> since insurers and their agents often promise the insured peace of mind coverage protection without fully explaining the contractual conditions, limitations, or exclusions in the policy;<sup>171</sup> and, since insurers normally possess a superior information position to the insureds,<sup>172</sup> the middle ground interpretive

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<sup>170</sup> See *supra* notes 21 and 109 and accompanying text.

<sup>171</sup> See *supra* notes 144–46 and accompanying text.

<sup>172</sup> See Fischer, *supra* note 9, at 1047–48.

It is a point of general understanding that the average insurer is much more sophisticated and knowledgeable than the average insured. . . .

The insurer's superior position is the result of several factors. First, the insurer is a repeat player in the business of insurance whereas the insured is an occasional player. The average insured probably looks at her insurance contract twice: once, cursorily, when the contract is formed and again, with much greater care, when a loss or claim arises which the insured hopes is covered by the policy. The specialized assistance that insurance brokers and risk managers provide is not generally available to the average insured at the time of insurance contract formation. Insurers, on the other hand, constantly review and revise their contracts as they (or the ISO) receive data that reflects on loss experience, judicial decisions, sales experience, etc. The insurer has the added benefit of experts in both law and risk management to provide advice concerning whether its contract language adequately will address the "risk" the insurer is willing to accept. Finally, the insurer has in its employ, or at its call, actuaries and underwriters who can evaluate the data and price the risk. These assets simply are not available to the average insured.

*Id.*

See also STEMPER, *supra* note 20, at 300.

The overall structure of insurance policy marketing thus tends to advantage the insurer by committing the policyholder to an insurance policy based on premium price, coverage limits, and a few high-profile policy terms without substantial haggling over most terms. Although the insurer's edge from this structure is most pronounced in consumer lines of coverage, the advantage tends to prevail for commercial lines as well, unless the prospective policyholder is quite sophisticated and able to devote sufficient resources from inside the company or with outside resources (e.g., use of a broker who charges a



approach to insurance contract disputes provides that in order to further validate the reasonable expectations of the insured to coverage, such coverage will be liberally construed by the court, and any exclusion, exception, or limitation to coverage therefore must be clearly, expressly, and unambiguously stated in the insurance contract.<sup>173</sup>

This crucially important (but often overlooked) middle ground interpretive rule provides additional supplemental protection to the insured in further validating the insured's reasonable expectation of coverage. One example of this interpretive rule is found in the case of *Northwest Airlines Inc. v. Globe Indemnity Co.*,<sup>174</sup> a case involving the infamous D.B. Cooper who highjacked a Northwest Airlines airplane, demanded \$200,000 in ransom money, and then parachuted out of the airplane between Seattle, Washington and Portland, Oregon. But when the insurance company argued that this bizarre event was

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fee or commission) to the task of policy shopping and negotiation.

*Id.*

<sup>173</sup> See, e.g., *Weedo v. Stone-E-Brick Inc.*, 405 A.2d 788, 795 (N.J. 1979) (holding that any limitation in coverage must be described in clear and explicit language in the policy); Stempel, *supra* note 17, at 824 n.106.

Readers should not lose sight of the fact that, in the majority of cases, even in states enamored of the [Keeton] reasonable expectations approach, it appears that when insurers have drafted reasonably clear [exclusionary] language, it has been enforced by the courts. See, e.g., *New Hampshire Ins. Co. v. Power-O-Peat, Inc.*, 907 F.2d 58, 59 (8th Cir. 1990) (applying Minnesota law) (enforcing CGL exclusion for liability for advertising injury); *Foremost Ins. Co. v. Putzier*, 606 P.2d 987, 991 (Idaho 1980) (holding insurer exclusion for loss "arising out of riot, civil commotion or mob action" prevents coverage of promoter for loss suffered by concessionaires from unruly mob); *Cochran v. MFA Mut. Ins. Co.*, 271 N.W.2d 331, 333 (Neb. 1978) (upholding insurer exclusion of theft coverage unless "visible marks of forcible entry" present on exterior of vehicle when a car was taken with a "jiggle key" that left no marks).

*Id.*

See also *Farmers Alliance Mut. Ins. Co. v. Bakke*, 619 F.2d 885 (10th Cir. 1980) (applying New Mexico law); *Casey v. Transamerica Life Ins. & Annuity Co.*, 511 F.2d 577 (7th Cir. 1975) (applying Indiana law); *Royal Globe Ins. Co. v. Poirier*, 415 A.2d 882 (N.H. 1980); *Kronfeld v. Fidelity & Casualty Co.*, 385 N.Y.S.2d 552 (N.Y. App. Div. 1976); *Butche v. Ohio Casualty Ins. Co.*, 187 N.E.2d 20 (Ohio 1962). See generally 2 GEORGE J. COUCH, CYCLOPEDIA OF INSURANCE LAW § 15:93 (Mark S. Rhodes, rev. 2d ed. 1984) ("A risk that comes naturally within the terms of a policy is not deemed to be excluded unless the intent of the parties to exclude it appears clearly [in the policy].") (citing numerous case authority supporting this interpretive rule).

<sup>174</sup> 225 N.W.2d 831 (Minn. 1975).

never intended to be covered, nor could it possibly constitute a covered loss under the insurer's crime insurance policy, the court replied:

When that policy is read as a whole, we find it to be in the nature of a blanket or all-risk policy, as opposed to one which covers only specified risks. As defendant's counsel admitted in oral argument, mere unforeseeability of the manner in which the loss was sustained will not *per se* constitute grounds for the insurer to deny coverage. In the present case, where there is blanket coverage and the risk at issue was not excluded, the insurer must fulfill its contractual obligation to indemnify the insured.<sup>175</sup>

A second example involving this exclusionary interpretive rule involves the definition of "property damage" in property and liability insurance coverages. Although a number of courts have interpreted property damage in its traditional sense as applying only to physical loss or destruction of tangible property,<sup>176</sup> a number of recent middle ground judicial decisions have held that in the absence of a clear and unambiguous contractual limitation or exclusion in the policy, property damage should *not* be limited only to tangible physical loss, but can also include intangible property loss, economic loss, and diminution in value.<sup>177</sup> Due to this recurring coverage dispute between the insured on one

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<sup>175</sup> *Id.*; see also *Steamboat Dev. Corp. v. Bacjac Indus., Inc.*, 701 P.2d 127, 128 (Colo. Ct. App. 1985) (construction insurance contract) (an "all-risk" policy extends to risks not usually covered under other insurance, and recovery is allowed for all losses other than those resulting from a willful or fraudulent act of the insured, unless the policy contains specific provisions expressly excluding a particular loss from coverage); *Bryant v. Continental Ins. Co.*, 466 P.2d 201, 202 (Wash. Ct. App. 1970) (aircraft insurance contract) (the term "all risk" ordinarily covers every loss that may happen except by fraudulent acts of the insured, and it is not given a restrictive meaning). See generally 13 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 48:141 (Mark S. Rhodes, rev. 2d ed. 1982) (All-risk policy coverage "will, as a rule, be allowed for all fortuitous losses not resulting from [an insured's] misconduct or fraud, unless the policy contains a specific provision expressly excluding the loss from coverage.") (footnote omitted).

<sup>176</sup> See, e.g., *Qualls v. Country Mut. Ins. Co.*, 462 N.E.2d 1288 (Ill. App. Ct. 1984) (rejecting the argument that diminution in value is sufficient in itself to constitute property damage in a general liability insurance policy); see also *Weedo v. Stone-E-Brick, Inc.*, 405 A.2d 788 (N.J. 1979) (holding that comprehensive general liability policies are intended to protect the insured from liability for injury or damage to the persons or property of others, and they are not intended to pay the insured's purely economic losses).

<sup>177</sup> See, e.g., *McDowell-Wellman Engineering Co. v. Hartford Accident & Indem. Co.*, 711 F.2d 521 (3d Cir. 1983) (holding that the term "property damage" does not require actual physical damage but can include intangible damage such as the diminution in value of the tangible property); see also *Continental Casualty Co. v. Gilbane Bldg. Co.*, 461 N.E.2d 209 (Mass. 1984) (same holding); *Ohio Casualty Ins. Co. v. Terrace Enters., Inc.*, 260 N.W.2d 450

hand, who has a reasonable expectation of coverage, and the insurer on the other hand, with a desire to limit its scope of coverage for property damage, the definitional language within the Standard Commercial General Liability Insurance (CGL) Policy was subsequently revised by the insurance industry to expressly and unambiguously exclude recovery for property damage based upon intangible property loss, pure economic loss, or diminution in value.<sup>178</sup>

A third example of this exclusionary interpretive rule deals with the "pollution exclusion clause" in CGL policies relating to environmental losses. One of the greatest challenges facing the American liability insurance industry today deals with the major threat of pollution-related environmental liability. Like mass tort and mass property damage cases, these environmental pollution cases inevitably generate enormous legal disputes, often involving hundreds of millions of dollars, between the insured and the insurer, and among primary insurers, excess insurers, and reinsurers.<sup>179</sup> In the wake of this massive explosion of pollution-related litigation, many manufacturers and other commercial enterprises have sought to shift the financial burden of pollution liability claims onto their insurance companies under their comprehensive general liability insurance policies (now called commercial general liability insurance policies or CGL policies for short). Basically, the insureds vigorously contend that they have purchased coverage for pollution liability under their CGL policies and have a reasonable expectation to such coverage, and the insurance companies just as vigorously respond that they never intended to cover such risks.<sup>180</sup> Many liability insurance companies, in order to avoid such pollution liability claims, drafted and incorporated various pollution exclusion clauses into their CGL policies. According to insurance industry

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(Minn. 1977); 3 ROWLAND H. LONG, *THE LAW OF LIABILITY INSURANCE*, Appendix B § 6 (1981) ("There is nothing in the definition [of property damage] requiring physical injury or destruction to property. The guide to determination of coverage is the kind of property rather than the kind of injury.").

<sup>178</sup> See OSTRAGER & NEWMAN, *supra* note 17, § 7.03[b]. Most property and liability insurance companies are now defining property damage in their policies to mean "physical injury to or destruction of tangible property which occurs during the policy period." EMERIC FISCHER & PETER SWISHER, *PRINCIPLES OF INSURANCE LAW* 530-31 (2d ed. 1994).

<sup>179</sup> See, e.g., Kenneth S. Abraham, *Environmental Liability and the Limits of Insurance*, 88 COLUM. L. REV. 942, 942 (1988). Such liability may be based on the federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), 42 U.S.C. §§ 9601-9675 (1988), or liability also may be based on state pollution statutes or upon state common law principles such as nuisance. See, e.g., *New Jersey Dept. of Env'tl. Protection v. Ventron Corp.*, 468 A.2d 150, 157-61 (N.J. 1983). See generally OSTRAGER & NEWMAN, *supra* note 17, chs. 10.01-05.

<sup>180</sup> See, e.g., EMERIC FISCHER & PETER SWISHER, *PRINCIPLES OF INSURANCE LAW* 659-60, 678 (2d ed. 1994); see also Swisher, *supra* note 4, at 1070-73.

commentators, the liability insurance companies devised these pollution exclusion clauses to exclude all pollution coverage for pollution-related liability insurance claims except for those claims arising from causative events that are “sudden” and “accidental.” That is to say, the general exclusion for pollution liability claims was purportedly made, according to insurance industry commentators, subject to a narrow exception for claims resulting from polluting discharges that are both fortuitous or accidental and nonrecurrent, isolated in time, or truly “sudden.”<sup>181</sup>

Although a number of courts have interpreted CGL pollution exclusion clauses in this exclusionary manner,<sup>182</sup> a number of other courts have not.<sup>183</sup> This latter group has held instead that the “sudden and accidental” exception to the pollution exclusion clause is ambiguous, and therefore the pollution exclusion clause should be construed to have no independent meaning at all, since it is construed by these courts as a restatement of the policy “occurrence” clause, with its limitation of coverage based only upon injuries or damages that are either expected or intended from the standpoint of the insured.<sup>184</sup> Again,

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<sup>181</sup> See generally Nancer Ballard & Peter M. Manus, *Clearing Muddy Waters: Anatomy of the Comprehensive General Liability Pollution Exclusion*, 75 CORNELL L. REV. 610, 613–19 (1990); Scott D. Marrs, *Pollution Exclusion Clauses: Validity and Applicability*, 26 TORT & INS. L.J. 662 (1991); E. Joshua Rosenkranz, Note, *The Pollution Exclusion Clause Through the Looking Glass*, 74 GEO. L. REV. 1237, 1241–51 (1986).

<sup>182</sup> See, e.g., *United States Fidelity & Guar. Co. v. Morrison Grain Co.*, 734 F. Supp. 437, 449–50 (D. Kan. 1990), *aff'd*, 999 F.2d 489 (10th Cir. 1993); *Hayes v. Maryland Casualty Co.*, 688 F. Supp. 1513, 1515–16 (N.D. Fla. 1988); *Centennial Ins. Co. v. Lumbermen's Mut. Casualty Co.*, 677 F. Supp. 342, 348–50 (E.D. Pa. 1987); *International Minerals & Chem. Corp. v. Liberty Mut. Ins. Co.*, 522 N.E.2d 758, 765–69 (Ill. Ct. App. 1988), *appeal denied*, 530 N.E.2d 246 (Ill. 1988); *Barnet, Inc. v. Security Ins. Group*, 425 N.E.2d 201, 202–03 (Ind. Ct. App. 1981); *Lumbermen's Mut. Casualty Co. v. Belleville Ind.*, 555 N.E.2d 568, 572–73 (Mass. 1990), *cert. denied*, 502 U.S. 1073 (1992); *Technicon Elecs. Corp. v. American Home Assurance Co.*, 544 N.Y.S.2d 531, 533–34 (N.Y. 1989). Other judicial decisions are listed in *New Castle County v. Hartford Accident & Indemnity Co.*, 933 F.2d 1162, 1195 n.60 (3d Cir. 1991) (applying Delaware law), *cert. denied*, 507 U.S. 1030 (1993).

<sup>183</sup> See, e.g., *Pepper's Steel & Alloys Inc. v. United States Fidelity & Guar. Co.*, 668 F. Supp. 1541, 1550 (S.D. Fla. 1987); *Jonesville Prod. Inc. v. Transamerica Ins. Group*, 402 N.W.2d 46 (Mich. Ct. App. 1986); *Kipin Indus. v. American Universal Ins. Co.*, 535 N.E.2d 334, 338 (Ohio Ct. App. 1987); *Compass Ins. Co. v. Cravens, Dargan & Co.*, 748 P.2d 724, 726–27 (Wyo. 1988). Additional judicial decisions are listed in *New Castle County v. Hartford Accident and Indem. Co.*, 933 F.2d 1162, 1195 n.61 (3d Cir. 1991) (applying Delaware law), *cert. denied*, 507 U.S. 1030 (1993).

<sup>184</sup> See, e.g., *Claussen v. Aetna Casualty & Sur. Co.*, 380 S.E.2d 686, 687–88 (Ga. 1989); *Jackson Township Mun. Util. Auth. v. Hartford Accident & Indem. Co.*, 451 A.2d 990, 992–94 (N.J. Super. 1982); see also *New Castle County v. Hartford Accident & Indem. Co.*, 933 F.2d 1162, 1198 (3d Cir. 1991) (applying Delaware law, and holding the pollution exclusion clause

based upon this recurring coverage dispute between the insureds and insurers regarding CGL pollution exclusion clauses, and with a potential liability of staggering proportions, the insurance industry redrafted its CGL policy in 1986 to provide for a clear and unambiguous "absolute" pollution exclusion provision.<sup>185</sup>

This rule of liberally construing insurance coverage in the absence of clear and unambiguous exclusionary language in the policy can be found in many other areas of insurance contract law. For example, courts that apply a middle ground interpretive approach to insurance contracts have generally held that a tenant<sup>186</sup> or subcontractor<sup>187</sup> may constitute an unnamed co-insured for

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to be ambiguous.), *cert. denied*, 507 U.S. 1030 (1993). "[T]he authority appears to be evenly divided between the parties' competing constructions of the pollution exclusion clause, with about half the cases holding that the clause bars coverage, and with the other half holding that it does not." *Id.* at 1195. *But see* Northern Ins. Co. v. Aardvark Assoc. Inc., 942 F.2d 189, 192-93 (3d Cir. 1991) (applying Pennsylvania law, and holding that the pollution exclusion clause is not ambiguous and bars coverage).

<sup>185</sup> See also *Budofsky v. Hartford Ins. Co.*, 556 N.Y.S.2d 438, 441 (Sup. Ct. 1990).

A typical "absolute" pollution exclusion now provides:

This policy does not apply . . . to bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any water course or body of water, *whether or not such discharge, dispersal, release or escape is sudden or accidental.*

*See, e.g., id.*

A more abbreviated version of this absolute pollution exclusion states: "This insurance does not apply to bodily injury, personal injury, or property damage arising out of pollution or contamination caused by the discharge or escape of any pollutants or contaminants." *See* OSTRAGER & NEWMAN, *supra* note 17, at 406-07 (7th ed. 1994). However, litigation in this complex area will continue well into the foreseeable future based upon present and future legal controversies involving thousands of pre-1986 CGL policy coverage disputes. *See generally* Henrick & Wiesel, *The New Commercial General Liability Forms: An Introduction and Critique*, 36 FED. INS. & CORP. COUNSEL Q. 319 (1986).

<sup>186</sup> *See, e.g., Monterey Corp. v. Hart*, 224 S.E.2d 142, 144 (Va. 1976); *Rizzuto v. Morris*, 592 P.2d 688, 691 (Wash. Ct. App. 1979) (both holding that an unnamed tenant "stands in the shoes" of the insured landlord for the purpose of defeating a subrogation action against the tenant, in the absence of any clear limitation or exclusion in the policy language).

<sup>187</sup> *See, e.g., Frank Briscoe Co. v. Georgia Sprinkler Co. Inc.*, 713 F.2d 1500, 1503-04 (11th Cir. 1983) (holding that an insurer was barred from maintaining a subrogation action against a subcontractor, because the subcontractor was an unnamed coinsured under the policy). *See generally* Jay M. Zitter, Annotation, *Insurance: Subrogation of Insurer Compensating Owner or Contractor for Loss Under "Builder's Risk" Policy Against*

purposes of defeating an insurer's subrogation action, unless there was clear and unambiguous exclusionary language in the insurance policy; and that sexual harrasment claims under a multi-peril liability insurance policy<sup>188</sup> or the transmission of a sexual disease under a homeowners insurance policy<sup>189</sup> likewise would be covered unless there is clear and unambiguous exclusionary language in the policy.

In summary, the middle ground interpretive approach to insurance coverage disputes continues to recognize the traditional insurance law doctrine holding that, in general, insurance contracts will be construed according to general principles of contract law, unless modified or regulated by state statute, or unless contrary to state public policy.<sup>190</sup> However, in order to validate the reasonable expectations of the insured to coverage, the middle ground interpretive view of insurance coverage disputes also recognizes a number of supplemental rules of construction in favor of the insured: (1) that insurance contracts will be construed and interpreted in their ordinary sense, rather than in a purely technical or legal sense, from the viewpoint of the untrained mind, or the "common layperson in the marketplace";<sup>191</sup> (2) that ambiguous insurance contracts will be construed liberally in favor of the insured, subject to extrinsic evidence, if any, to determine the parties' intent, and subject to a sophisticated policyholder defense;<sup>192</sup> (3) that based on the acts and

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*Allegedly Negligent Contractor or Subcontractor*, 22 A.L.R.4th 701 (1983) and cases cited therein.

<sup>188</sup> See, e.g., *Hamlin v. Western Nat'l Mut. Ins. Co.*, 461 N.W.2d 395, 398 (Minn. Ct. App. 1990) (holding that "personal injury" coverage is broader than "bodily injury" coverage, and may include an affront to one's reputation, such as defamation. However, the insurer in this case explicitly limited recovery in the policy to injury arising from torts that the insured did not allege); *NPS Corp. v. Insurance Co. of N. Am.*, 517 A.2d 1211, 1212-14 (N.J. Super. App. Div. 1986) (holding that the term "bodily injury" in the insurance policy included emotional and psychological consequences allegedly resulting from sexual harrasment, and thus the insurer was required to defend the insured in a sexual harrasment suit alleging emotional distress and mental anguish).

<sup>189</sup> See, e.g., *State Farm Fire & Casualty Co. v. Eddy*, 267 Cal. Rptr. 379, 382 (Cal. Ct. App. 1990) (holding that the infliction of genital herpes by voluntary sexual intercourse came under policy coverage for damages as a result of bodily injury, which included diseases); *North Star Mut. Ins. Co. v. R.W.*, 431 N.W.2d 138, 141 (Minn. Ct. App. 1989) (holding that the insurer had the duty to defend the insured who gave a woman genital herpes through consensual sexual intercourse since "the claim is arguably within the scope of coverage"); *S.S. v. State Farm Fire & Casualty Co.*, 808 S.W.2d 668 (Tex. Ct. App. 1991) (similar holding to the *Eddy* and *North Starcases*), *aff'd*, 858 S.W.2d 374 (Tex. 1993).

<sup>190</sup> See *supra* notes 73-97 and accompanying text.

<sup>191</sup> See *supra* notes 109-24 and accompanying text.

<sup>192</sup> See *supra* notes 125-43 and accompanying text.

representations made by the insurer or its agents, the legal doctrines of waiver, estoppel, election, and reformation of contract are also available to the insured and should be liberally construed to validate the insured's reasonable expectation of coverage,<sup>193</sup> and (4) that in order to further validate the reasonable expectations of the insured to coverage, any exclusion, exception, or limitation to coverage must be clearly, expressly, and unambiguously stated in the insurance contract.<sup>194</sup> These are not the only middle ground rules of insurance contract interpretation,<sup>195</sup> but arguably they are the most important supplemental rules of insurance contract interpretation.

A middle ground interpretive approach still allows for a great deal of judicial discretion in ascertaining and honoring the reasonable expectations of the insured to coverage, but within delineated parameters of interpretive rules that are supplemental to, rather than at variance with, the policy language within the insurance contract itself. A middle ground interpretive view of insurance contract disputes therefore recognizes the "text" of an insurance contract, and at the same time it also recognizes the "context" of honoring the reasonable expectations of the insured to coverage—without the necessity of expressly adopting Professor Keeton's noncontractual doctrine of reasonable expectations.<sup>196</sup>

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<sup>193</sup> See *supra* notes 144–69 and accompanying text.

<sup>194</sup> See *supra* notes 170–89 and accompanying text.

<sup>195</sup> For an extensive discussion of many additional supplementary rules of insurance contract construction and interpretation, see STEMPER, *supra* note 20.

<sup>196</sup> See STEMPER, *supra* note 20, at 358.

However, judicial use of the [Keeton] concept [of reasonable expectations] is often unclear and inconsistent. It appears to be most popular in only a weak or nonaggressive form that links its use to policy text or merely adds the policyholder's expectations to the list of other factors weighed in the course of rendering decision. Until current concerns about expanding tort liability, insurance availability, and rising costs are satisfactorily resolved, the [Keeton] reasonable expectations approach is unlikely to see another "growth spurt" as it did in the 1970s, although one might see a steadily increasing acceptance in the coming decades as a generation taught under the dominance of Prof. Keeton's scholarship begins to occupy the bench.

*Id.*

On the other hand, one might still question how future generations of the judiciary may in fact interpret insurance contract disputes. See *supra* notes 36–61 and accompanying text. Professor Stempel concludes that "In sum, the reasonable expectations principle, if not the doctrine, appears to be on the insurance scene to stay, and properly so." STEMPER, *supra* note 20, at 358. To Professor Stempel's lucid observation, this author would also add: "A contractually-based interpretation of insurance coverage disputes likewise appears to be on the

## V. ILLUSTRATIVE EXAMPLES OF THE MIDDLE GROUND APPROACH IN THE INTERPRETATION OF INSURANCE CONTRACT DISPUTES

It is beyond the scope of this Article to delineate every aspect of American insurance law where a judicial middle ground interpretive approach may be applied in analyzing and deciding insurance contract disputes. The selected topics discussed below, however, further illustrate how this middle ground interpretive approach successfully retains the best elements of a contractually based Formalistic approach, while at the same time adopting certain Functionalistic principles in order to validate the reasonable expectations of the insured to coverage.

### A. *Negotiating the Insurance Contract*

Since the insured frequently is an unsophisticated layperson or common man or woman in the marketplace,<sup>197</sup> and since insurance often is sold by appealing to the insured's peace of mind and his or her reasonable expectation of coverage,<sup>198</sup> the negotiation and formation of an insurance contract offers important examples of how a middle ground interpretive approach recognizes the contractual terms of the insurance policy, while still recognizing the reasonable expectation of the insured to coverage.

#### 1. *Conditional Receipt Coverage Disputes in Life Insurance Applications*

Whether or not a so-called "conditional receipt" for life insurance or a "binding receipt" for property or liability insurance constitutes temporary insurance or not—and under what conditions—has been subject to a great deal of insurance litigation. The interests of the insured who desires immediate protection against a risk of loss, and the needs of the insurer in attempting to

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insurance scene to stay, and properly so." Indeed, the Keeton reasonable expectations principle—if not the doctrine—can be readily subsumed into a middle ground interpretive approach of insurance contract disputes without varying significantly from the express terms of the policy language. *See supra* notes 73–196 and accompanying text; *see also infra* notes 197–315. Accordingly, under these middle ground supplemental rules of insurance contract interpretation, even those jurisdictions that have expressly adopted the Keeton reasonable expectation doctrine arguably ought to apply the Keeton doctrine only as a last resort, rather than as a primary mode of judicial interpretation. *See supra* notes 9, 24–34, 62, 164–65 and accompanying text.

<sup>197</sup> *See supra* notes 109–15 and accompanying text.

<sup>198</sup> *See supra* notes 144–46 and accompanying text.



limit an undesirable risk distribution, are both legitimate concerns.<sup>199</sup>

Binding receipts are almost always contracts of temporary insurance since liability and property insurance agents normally are general agents who have the power to bind their principal insurer to a temporary contract based upon their express or implied authority, absent any language of express limitation in the insurance contract.<sup>200</sup> For example, statements by general agents, such as "You're covered" or "I'll take care of it," have been held to constitute oral binders of temporary insurance.<sup>201</sup> Life insurance agents, on the other hand, normally are soliciting agents rather than general agents, and do not have the power to create coverage in a life insurance contract absent approval from their home office,<sup>202</sup> so life insurance agents normally can only give conditional receipts rather than binding receipts.<sup>203</sup>

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<sup>199</sup> See generally EMERIC FISCHER & PETER SWISHER, *PRINCIPLES OF INSURANCE LAW* 24-30 (2d ed. 1994); JERRY, *supra* note 43, at 148-55; KEETON & WIDISS, *supra* note 23, § 2.3, at 52-70.

<sup>200</sup> See, e.g., *State Auto. Mut. Ins. Co. v. Babcock*, 220 N.W.2d 717, 722 (Mich. Ct. App. 1974) (as a general rule a binder may be written or oral and founded upon the words or deeds of the agent).

<sup>201</sup> See, e.g., *American Universal Ins. Co. v. Kruse*, 306 F.2d 661, 664 (9th Cir. 1962) (applying Montana law); *Turner v. Worth Ins. Co.*, 472 P.2d 1, 2-3 (Ariz. 1970); *Julien v. Spring Lake Park Agency, Inc.*, 166 N.W.2d 355, 357 (Minn. 1969); L.A. Bradshaw, Annotation, *Temporary Automobile Insurance Pending Issuance of Policy*, 12 A.L.R.3d 1304 (1967).

<sup>202</sup> Life insurance agents, however, may still bind their principal insurer under the doctrine of apparent or ostensible authority. See, e.g., *Andrew Jackson Life Ins. Co. v. Williams*, 566 So. 2d 1172, 1181 (Miss. 1990) (holding that evidence was sufficient to support a jury finding that agents for a life insurer were cloaked with apparent authority to form an immediate binding contract with the insureds based upon the testimony of a life insurance company executive and agent, as well as the blatant failure by the insurer to provide notice to the insureds of any restrictions or limitations on its agents' authority to avert misleading or fraudulent misrepresentations); see also *Weaver v. Metropolitan Life Ins. Co.*, 545 F. Supp. 74, 78 (E.D. Mo. 1982) (ambiguous "sales aids" provided by the insurer gave the agent the apparent authority to make coverage promises to the insured that would bind his principal insurer).

<sup>203</sup> See, e.g., Arnold P. Anderson, *Life Insurance Conditional Receipts and Judicial Intervention*, 63 MARQ. L. REV. 593, 593 (1980); Alan I. Widiss, *Life Insurance Applications and Interim Coverage Disputes: Revisiting Controversies About Conditional Binding Receipts*, 75 IOWA L. REV. 1097, 1098 (1990); Note, *Life Insurance Policies and "Binding" Receipts: Is the Insurer Bound?*, 1968 UTAH L. REV. 448, 448; Comment, *Life Insurance Receipts: The Mystery of the Non-Binding Binder*, 63 YALE L.J. 523, 523 (1954).

Generally speaking, instead of unconditional temporary coverage, many life insurance companies offer applicants who pay a first premium deposit a "conditional receipt" commitment that if an applicant is an acceptable risk, the effective date of the coverage will precede the actual delivery of the policy to the applicant. In other words, the insurance company

To make matters more complicated, American courts generally have interpreted conditional receipt insurance coverage disputes as falling within one of three distinct categories: "approval" type conditional receipts; "satisfaction" type conditional receipts; or unconditional temporary or interim insurance.<sup>204</sup> On one hand, some courts have interpreted conditional receipts by strictly construing the language found within the life insurance application to constitute only an approval type conditional receipt, and these courts have held that no contract of insurance exists until the insurer actually approves of the insured as a satisfactory risk.<sup>205</sup> An approval type conditional receipt, however, provides illusory coverage since the applicant for insurance receives nothing upon its issuance, while still having to tender an initial premium payment.<sup>206</sup> On the other hand, a number of courts have held that the insured is entitled to unconditional temporary or interim insurance until the insurer properly notifies the applicant that his or her insurance application has been rejected by the insurer.<sup>207</sup> The judicial rationale for recognizing unconditional temporary or interim insurance coverage in conditional receipt controversies has been based upon one of three legal doctrines: (1) the reasonable expectations of the applicant to immediate interim coverage should be honored even though this may not be what the insurer actually intended;<sup>208</sup> (2) the insured is covered

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states that its coverage will be made retroactive to some point in time, such as when the application was made or when the medical examination was completed. *See* KEETON & WIDISS, *supra* note 23, at 151–53.

<sup>204</sup> *See, e.g.,* Simpson v. Prudential Ins. Co. of Am., 177 A.2d 417, 422–23 (Md. 1962); *see also* JERRY, *supra* note 43, at 151–53.

<sup>205</sup> *See, e.g.,* Union Life Ins. Co. v. Rhinehart, 315 S.W.2d 920, 922–23 (Ark. 1958); Woodmen of the World Life Ins. Soc’y v. Etheridge, 154 S.E.2d 369, 370–72 (Ga. 1967); *see also* C.T. Drechsler, Annotation, *Temporary Life, Accident, or Health Insurance Pending Approval or Issuance of Policy*, 2 A.L.R.2d 943, 964–67 (1948) and *Later Case Service*.

<sup>206</sup> *See* JERRY, *supra* note 43, at 151. Judge Learned Hand was an early vocal critic of the "approval" type conditional receipts, arguing that these life insurance applications preyed on "persons utterly unacquainted with the niceties of life insurance" who would "read it colloquially" and reasonably expect coverage. *Gaunt v. John Hancock Life Ins. Co.*, 160 F.2d 599, 601 (2d Cir.) (applying Connecticut law), *cert. denied*, 331 U.S. 849 (1947).

<sup>207</sup> *See* JERRY, *supra* note 43, at 152; KEETON & WIDISS, *supra* note 23, at 58–62.

<sup>208</sup> *See, e.g.,* Collister v. Nationwide Life Ins. Co., 388 A.2d 1346, 1353–54 (Pa. 1978) (holding that even though the terms of the life insurance application and conditional receipt unambiguously provided that no temporary contract for insurance was created, the terms of the contract would be ignored in favor of the insured's reasonable expectations of coverage), *cert. denied*, 439 U.S. 1089 (1979); *Gdovic v. Catholic Knights of St. George*, 453 A.2d 1040, 1042 (Pa. Super. 1982) (holding that although the insurer might not have intended to provide temporary interim insurance, nevertheless by accepting the applicant's premium the insurer had the burden of proof to show by clear and convincing evidence that the applicant did not have a

because the terms of the conditional receipt were ambiguous;<sup>209</sup> or (3) the terms of the conditional receipt are unconscionable and against state public policy.<sup>210</sup>

Other courts have adopted a more balanced middle ground analysis to conditional receipt coverage disputes through a satisfaction type interpretive approach that recognizes both the contractual language of the conditional receipt and the applicant's reasonable expectation of coverage. Under a satisfaction type conditional receipt, if the insurance company determines that the applicant is insurable as a standard risk, then the insurance relates back to the date of the application, but if the applicant is deemed to be uninsurable as a standard risk, then no contract of insurance arises.<sup>211</sup> The rationale underlying

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reasonable basis for believing that he or she was purchasing immediate interim insurance coverage); *see also* *Sanchez v. Connecticut Gen. Life Ins. Co.*, 681 P.2d 974, 977 (Colo. Ct. App. 1984) (holding that an insurer who wishes to avoid liability must not only use clear and unequivocal language evidencing its intent to limit temporary coverage, but it must also call such limiting conditions to the attention of the applicant that an ordinary layman would understand). *But see* *Grandpre v. Northwestern Nat'l Life Ins. Co.*, 261 N.W.2d 804, 807 (S.D. 1977) (holding that when a conditional receipt stated in boldface letters "IMPORTANT: This Receipt Does NOT Provide Any Insurance Until After Its Conditions Are Met," "the ordinary meaning of the words . . . would alert any ordinary person to understand what had to be completed before the temporary or interim insurance would be effective"); *Jacobson v. Kansas City Life Ins. Co.*, 652 P.2d 909, 911 (Utah 1982) (similar holding).

<sup>209</sup> *See, e.g.*, *DeFoure v. MFA Life Ins. Co.*, 596 S.W.2d 7, 9-10 (Ark. Ct. App. 1980) (holding that conditional receipts are subject to interpretation under the doctrine of ambiguities, and finding that an ambiguity existed in the conditional receipt as to when the appellant and her children were insurable); *Simms v. North Am. Co. for Life & Health Ins.*, 394 A.2d 710, 714-15 (Conn. 1978) (holding that a conditional receipt was ambiguous since the plaintiff could reasonably expect coverage to take effect on a certain date, and the insurer easily could have stated in exact language that the life insurance coverage would not take effect until the company actually determined that the applicant was a standard risk, but the insurer chose instead to use ambiguous language).

<sup>210</sup> *See, e.g.*, *Glamer v. Time Ins. Co.*, 465 N.W.2d 591, 595-96 (Minn. Ct. App. 1991) (holding that a provision in the conditional receipt was ambiguous, and even if the clause were given the interpretation asserted by the insurer, the conditional receipt was still unconscionable under Minnesota law; the court further applied the Keeton doctrine of reasonable expectations as adopted by the Minnesota courts).

<sup>211</sup> *See, e.g.*, *Smith v. North Am. Co. for Life & Health Ins.*, 775 F.2d 777, 778 (7th Cir. 1985) (applying Wisconsin law); *Hildebrand v. Franklin Life Ins. Co.*, 455 N.E.2d 553, 563 (Ill. App. Ct. 1983); *Simpson v. Prudential Ins. Co.*, 177 A.2d 417, 425 (Md. 1962); *Damm v. National Ins. Co.*, 200 N.W.2d 616, 619-20 (N.D. 1972); *Anderson v. Continental Ins. Co.*, 666 P.2d 245, 247 (Okla. Ct. App. 1983); *Grandpre v. Northwestern Nat'l Life Ins. Co.*, 261 N.W.2d 804, 808 (S.D. 1977); *Williams v. First Colony Life Ins. Co.*, 593 P.2d 534, 537 (Utah 1979).

this middle ground interpretive approach in conditional receipt coverage disputes was stated by an Illinois appellate court in the case of *Hildebrand v. Franklin Life Insurance Co.*:<sup>212</sup>

Without expressing a view on approval receipts and interim coverage, we conclude that an insurance company's good faith rejection of an applicant under a ["satisfaction" type conditional] receipt may have retroactive effect. This solution fairly balances the applicant's interest in prompt protection, if available, against the insurer's interest in accepting only risks which are insurable under its underwriting standards, gives some effect to all the terms used in the [conditional receipt] binder, and does not conflict with past decisions of the Illinois courts.<sup>213</sup>

This middle ground conditional receipt approach fairly balances the contractual language in the insurance application with the reasonable expectation of the applicant to coverage without expressly adopting any Functionalistic doctrinal bias in favor of either party. Alternatively, a middle ground court may also apply the legal doctrines of contract ambiguity<sup>214</sup> or unconscionability<sup>215</sup> to conditional receipt contract disputes.

Thus, as Professor Alan Widiss observes, if insurers are to avoid liability while life insurance applications are being processed, "it is absolutely essential that conditional receipts be written in unambiguous, clearly comprehensible terms and that sales representatives fully explain those provisions, as well as the choices available to applicants."<sup>216</sup>

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<sup>212</sup> 455 N.E.2d 553 (Ill. App. Ct. 1983).

<sup>213</sup> *Id.* at 563; see also *Simpson v. Prudential Ins. Co.*, 177 A.2d 417, 425 (Md. 1962); WINDT, *supra* note 20.

Other advantages that would accrue to the applicant from the ["satisfaction" type conditional receipt] analysis are (a) that the policy would become incontestable sooner, (b) that the policy would reach maturity earlier with corresponding acceleration of dividends and cash surrender, and (c) that if the insured's birthday fell between the date of the application and the date of approval, the premium would be computed at the lower rate.

*Id.* at 289 n.248.

<sup>214</sup> See *supra* notes 125-43, 209 and accompanying text.

<sup>215</sup> See *supra* notes 95-97, 210 and accompanying text.

<sup>216</sup> Alan I. Widiss, *Life Insurance Applications and Interim Coverage Disputes: Revisiting Controversies About Conditional Binding Receipts*, 75 IOWA L. REV. 1097, 1117 (1990). Professor Widiss further suggests that the interests of consumers "would be even better served by offering those customers who want interim protection the option of buying a temporary life insurance policy that would provide protection until either the coverage sought by

## 2. Insurer's Delay in Acting upon the Insurance Application

The courts also are deeply divided on the question of an insurer's liability for any unreasonable delay in acting upon an insurance application. Those courts applying a strict Formalistic contractual analysis to the issue of an insurer's unreasonable delay in acting on an insurance application have concluded that a "mere delay" in passing upon an application for insurance cannot be construed as acceptance by the insurer so as to support any contractual remedy.<sup>217</sup> The traditional rationale for this rather severe contractual rule is that an application for insurance is only a "mere offer" which must be accepted by the insurer before an insurance contract comes into being.<sup>218</sup> On the other hand, a number of state courts have recognized a separate tort action, referred to as the "negligent delay" theory. The negligent delay theory, generally stated, is that an insurance company is under a duty to act upon an application for insurance within a reasonable period of time, and a violation of that duty, with resultant damages, will subject the insurer to tort liability based upon its negligence.<sup>219</sup>

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the applicant goes into effect or the individual is notified that the application has been rejected." *Id.* at 1118.

<sup>217</sup> See, e.g., *Justice v. Prudential Life Ins. Co.*, 351 F.2d 462 (4th Cir. 1965) (applying Virginia law); see also *Usher v. Allstate Ins. Co.*, 218 N.W.2d 201 (Minn. 1974) (holding that there is no remedy in contract or tort for an insurer's unreasonable delay); *Cameron v. First Nat'l Bank*, 607 P.2d 1113, 1117 (Mont. 1980) ("It is a well-settled rule, established by the great weight of authority, that mere delay in passing upon an application for insurance cannot be construed as acceptance thereof by the insurer, so as to support an action *ex contractu*."); *Hayes v. Durham Life Ins. Co.*, 96 S.E.2d 109 (Va. 1957) (holding that "mere delay" on the part of the insurer in failing to act upon an application for insurance does not of itself create a contract, nor estop the insurer from denying that any contract was made, and retention of the premium by the insurer is immaterial).

<sup>218</sup> See, e.g., *Giddings v. Northwestern Mut. Life Ins. Co.*, 102 U.S. 108 (1880); see also Annotation 15 A.L.R. 1026 (1921); Annotation, *Rights and Remedies Arising Out of Delay in Passing upon an Application for Insurance*, 32 A.L.R.2d 487, 493 (1995); 1 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* §§ 7:24-:26 (Mark S. Rhodes, rev. 2d ed. 1984).

<sup>219</sup> See, e.g., *Traveler's Ins. Co. v. Anderson*, 210 F. Supp. 735, 738 (W.D. S.C. 1962) (applying South Carolina law); *Continental Life & Accident Co. v. Songer*, 603 P.2d 921, 929 (Ariz. Ct. App. 1979); *Independent Life & Accident Ins. Co. v. McKenzie*, 503 So. 2d 376, 378 (Fla. Dist. App. Ct. 1987); *Talbot v. County Life Ins. Co.*, 291 N.E.2d 830 (Ill. Ct. App. 1973); see also Kristine Karnezis, Annotation, *Liability of Insurer for Damages Resulting from Delay in Passing upon an Application for Life Insurance*, 1 A.L.R.4th 1202, 1229-30 (1980); Andrea G. Nadel, Annotation, *Liability of Insurer for Damages Resulting from Delay in Passing upon an Application for Health Insurance*, 18 A.L.R.4th 1115, 1132-34 (1982).

Between these two irreconcilable extremes a number of other state courts have adopted a realistic middle ground approach which, although it still retains a contractual analytical basis, also recognizes the reasonable expectation of the insured to coverage. This middle ground contractual approach holds that the retention of the premium by the insurer and the failure to reject the insurance application in a timely manner is tantamount to acceptance of the insurable risk and is an inconsistent rejection of the application offer.<sup>220</sup> Alternately, other middle ground courts have held that although acceptance of an insurance application may not be inferred from the insurer's delay in acting upon it, the insurer nevertheless may be estopped from denying acceptance, or may be held to have waived its acceptance of the application.<sup>221</sup> Once again, this middle ground interpretive view constitutes the better reasoned judicial approach since it still retains a contractual basis in the interpretation of insurance coverage disputes, but at the same time it honors the reasonable expectation of the

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Various courts during the past 75 years have considered the question of whether an action by an insured against a liability insurer for failing to settle a tort claim against a third party plaintiff is predicated on: (1) the breach of a contractual obligation; (2) a failure to exercise due care on behalf of its insured which warrants tort liability; or (3) both grounds. *See, e.g.,* Crisci v. Security Ins. Co., 426 P.2d 173 (Cal. 1967); *see also* KEETON & WIDISS, *supra* note 23, at 877-79; Milton R. Roberts, Annotation, *Insurer's Tort Liability for Consequential or Punitive Damages for Wrongful Failure or Refusal to Defend Insured*, 20 A.L.R.4th 23, 58 (1983). A number of middle ground courts have split on the issue of whether or not such tort liability is warranted, and to what extent. Although tort liability against an insurer is beyond the scope of this Article, it presently constitutes an alternative cause of action for a number of middle ground courts.

<sup>220</sup> This middle ground remedy is based on the theory that an unreasonable delay in acting on an insurance application, along with the retention of the premium, may imply an acceptance of the application, since retention of the premium under these circumstances is inconsistent with a rejection of the risk. *See, e.g.,* Harvey v. United Ins. Co., 245 P.2d 1185, 1188-91 (Kan. 1952); Cartwright v. Maccabees Mut. Life Ins. Co., 247 N.W.2d 298 (Mich. 1976); Szlapa v. National Traveler's Ins. Co., 233 N.W.2d 270 (Mich. Ct. App. 1975); Allen v. Metropolitan Life Ins. Co., 208 A.2d 638 (N.J. 1965); Peddicord v. Prudential Life Ins. Co., 498 P.2d 1388, 1390 (Okla. 1972); Brand v. International Investors Ins. Co., 521 P.2d 423, 426 (Okla. Ct. App. 1974); *see also* Kamezis, *supra* note 219, at 1223-27; Nadel, *supra* note 219, at 1126-29.

<sup>221</sup> *See, e.g.,* Depositors Trust Co. v. Farm Family Life Ins. Co., 445 A.2d 1014, 1019 (Me. 1982) ("An insurer's unreasonable delay in acting upon an application for a policy of insurance on which a premium has been paid is alone sufficient to estop the insurer from denying coverage, both because the insurer has sought to retain the premium without accepting the corresponding risk and because the insurer has significantly preempted the applicant from seeking coverage elsewhere."); Barnes v. Atlantic & Pacific Life Ins. Co., 325 So. 2d 143 (Ala. 1975); Moore v. Palmetto State Life Ins. Co., 73 S.E.2d 688 (S.C. 1952); *see also* Kamezis, *supra* note 219, at 1216-19; Nadel, *supra* note 219, at 1125.

insured to coverage when there is an unreasonable delay by the insurer in acting upon the insurance application.

### 3. *Misrepresentations by the Insured in the Insurance Application*

Misrepresentations made by the insured<sup>222</sup> in providing incorrect information in an insurance application have resulted in confusion and inconsistent treatment in a number of state courts and legislatures.<sup>223</sup> The courts have had a great deal of trouble in two crucial interpretive areas: (1)

<sup>222</sup> For misrepresentations of coverage by the insurer or its agents, courts often apply the doctrines of waiver and estoppel against the insurer. *See supra* notes 149–54, *infra* notes 243–47 and accompanying text; *see also* 4 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* §§ 26A:1–126 (Mark S. Rhodes, rev. 2d ed. 1984).

<sup>223</sup> *See, e.g.,* KEETON & WIDISS, *supra* note 23, at 569.

More than one commentator has used characterizations such as “confused”, “erroneous”, “misleading”, and “inconsistent” to describe the body of law (legislative provisions and the judicial decisions interpreting those laws or applying common law principles) that determines the rights of the parties to an insurance contract when it is subsequently discovered that an application for insurance coverage contained incorrect information.

*Id.*

*See also* PATTERSON, *supra* note 43, at 378–79, 382–85.

A representation is a statement made by the applicant for insurance or by someone acting for him and by his authority, to the prospective insurer, before the making of the contract of insurance . . . .

A representation has legal consequences only if it is relied upon and thus induces the insurer to make a contract which it would not otherwise have made. . . .

. . . .

The law of misrepresentation is frequently identified with the law of fraud. This is erroneous. The latter is only a part of the former. . . . Probably in most of the United States an innocent misrepresentation is available as a defense to an action brought upon a contract thus induced. Yet in many courts the confusion persists, with uncertainty in the law.

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. . . The law of misrepresentation has thus become unsettled and confused in many jurisdictions. The sources of this confusion are twofold. One is the failure to distinguish between fraud and innocent misrepresentation . . . . The other distinction often overlooked is that between statements of fact and statements of opinion.

*Id.*

defining what “materiality” actually means; and (2) making a distinction between an insured’s statement of fact, and an insured’s statement of opinion.<sup>224</sup>

It is a well recognized insurance law principle that insurers have a legal right and a legitimate interest in protecting themselves from issuing policy coverage on substandard or unacceptable risks, and therefore insurers generally possess the legal right to rescind coverage based upon any material misrepresentations of the insured in his or her insurance application.<sup>225</sup> Although most states today recognize that a material misrepresentation made by the insured in an application for insurance may be either a fraudulent or an innocent misrepresentation,<sup>226</sup> the courts have been at odds in defining what

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<sup>224</sup> See PATTERSON, *supra* note 43.

<sup>225</sup> See generally KEETON & WIDISS, *supra* note 23, at 527–37; JERRY, *supra* note 43; Jane M. Draper, Annotation, *Rescission or Cancellation of Insurance Policy for Insured’s Misrepresentation or Concealment of Information Concerning Human Immunodeficiency Virus (HIV), Acquired Immunodeficiency Syndrome (AIDS), or Related Health Problems*, 15 A.L.R.5th 92 (1993) (discussing misrepresentations or concealment of HIV, AIDS, and other related health problems); Jay M. Zitter, Annotation, *Fire Insurance: Failure to Disclose Prior Fires Affecting Insured’s Property As Ground for Avoidance Policy*, 4 A.L.R.5th 117 (1992) (discussing failure to disclose prior fires in property insurance applications); William H. Danne Jr., Annotation, *Modern Status of Rules Regarding Immateriality and Effect of False Statement by Insurance Applicant As to Previous Insurance Cancellations or Rejections*, 66 A.L.R.3d 749 (1975) (discussing misrepresentations of previous insurance cancellations); E.T. Tsai, Annotation, *Insured’s Lack of Knowledge of Adverse Health Conditions Affecting Applicability of “Good Health” Clause in Insurance Policy*, 30 A.L.R.3d 389 (1970) (discussing misrepresentation of “good health” clauses in insurance applications); see *infra* note 227. Compulsory insurance coverage that is mandated by state law—such as automobile liability insurance—places additional statutory limitations on an insurer’s right to rescind its contractual obligations based upon the misrepresentations of the insured in his or her automobile insurance application. See, e.g., Jay M. Zitter, Annotation, *Cancellation of Compulsory or “Financial Responsibility” Automobile Insurance*, 44 A.L.R.4th 13 (1986) (discussing an insurer’s right to cancel compulsory automobile insurance coverage).

<sup>226</sup> See, e.g., FLA. STAT. § 627.409 (1993); ILL. ANN. STAT. ch. 5, para. 154 (Smith-Hurd 1993); N.Y. INS. LAW § 3106 (McKinney 1993); VA. CODE ANN. § 38.2-309 (Michie 1993); see also PATTERSON, *supra* note 43, at 385 (“the doctrine that innocent misrepresentation of material fact [as well as fraudulent misrepresentation] suffices to make the policy voidable is still law by the decided weight of authority”); *Continental Assurance Co. v. Carroll*, 485 So. 2d 406 (Fla. 1986); *Kulikowski v. Roslyn Sav. Bank*, 503 N.Y.S.2d 863 (N.Y. App. Div. 1986); *Evans v. Occidental Life Ins. Co.*, 455 N.E.2d 678 (Ohio Ct. App. 1982). But see Banks McDowell, *The Misrepresentation Defense in Insurance: A Problem for Contract Theory*, 16 CONN. L. REV. 513 (1984) (arguing that only intentionally fraudulent misstatements by the insured should be a ground for rescinding the insurer’s contractual obligation in order to validate the insured’s reasonable expectation of coverage).



actually constitutes such a “material” misrepresentation.<sup>227</sup>

Some courts have interpreted the test of materiality under a traditional and subjective “particular insurer” standard: Would this *particular* insurer, had it known the truth of the insured’s misrepresentation, have charged a substantially higher premium or refused to cover the risk of loss?<sup>228</sup> Other courts, however, have adopted the better-reasoned objective test of materiality under a “reasonably prudent insurer” standard: Would a *reasonably prudent* insurer in the community, had it known the truth of the insured’s misrepresentation, have charged a substantially higher premium or refused to cover the risk of loss?<sup>229</sup>

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<sup>227</sup> See, e.g., KEETON & WIDISS, *supra* note 23, at 570.

An insurer is entitled to relief on the basis that an insured provided incorrect information in an insurance application, when it is proved (1) that the information was not correct, (2) that the information received was important either to the insurer’s decision to insure or to the terms of the insurance contract, (that is, the information was “material”), and (3) that the insurer in fact relied on the incorrect information.

*Id.*

See also JERRY, *supra* note 43, at 527.

A representation is a statement, either oral or written, made by the insured to the insurer which forms at least part of the basis on which the insurer decides to enter into the contract. If a representation (1) is untrue or misleading, (2) is material to the risk, and (3) is relied upon by the insurer in agreeing to issue the policy at a specified premium, the insurer can void the policy or refuse a claim for payment of proceeds on account of the misrepresentation (unless the policy has become incontestible).

*Id.*

<sup>228</sup> See, e.g., *New York Life Ins. Co. v. Kuhlenschmidt*, 33 N.E.2d 340 (Ind. 1941); *Fagen v. National Home Life Ins. Co.*, 473 So. 2d 918 (La. Ct. App. 1985); see also VANCE, *supra* note 43, at 375–76, 407; 7 WIGMORE ON EVIDENCE § 1946 (1978 rev. ed.). This “particular insurer” test of materiality, however, could reward a capricious “particular insurer” who might employ some questionable or unreasonable underwriting standards not shared by other “prudent insurers in the community.” See EMERIC FISCHER & PETER SWISHER, *PRINCIPLES OF INSURANCE LAW* 319–20 (2d ed. 1994).

<sup>229</sup> See, e.g., *Nappier v. Allstate Ins. Co.*, 961 F.2d 168, 170 (11th Cir. 1992) (“A material misrepresentation is one that would influence a prudent insurer in deciding whether to assume the risk of providing coverage.”); *Penn Mut. Life Ins. Co. v. Mechanics’ Sav. Bank & Trust Co.*, 72 F. 413, 430 (6th Cir. 1896) (“Are you able to say, from your knowledge of the practice and usage among life insurance companies generally, that information of this fact would have enhanced the premium to be charged, or would have led to a rejection of the risk?”); 18 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 69:120 (Mark S. Rhodes, rev. 2d ed. 1983) (stating a clear preference for this middle ground prudent insurer objective

This middle ground interpretive view of a “reasonably prudent” insurer continues to recognize the contractual implications of a fraudulent or an innocent material misrepresentation in an insurance application, but at the same time it protects the reasonable expectations of the insured to coverage against possible rescission by a capricious or unreasonable “particular insurer.”<sup>230</sup>

A second important and much-litigated issue involving insurance coverage disputes is whether an insured has misrepresented a statement of fact or merely given his or her good faith opinion in an insurance application. For example, if an insurer asks an applicant if he or she is in “good health” and the applicant, unaware that he or she has a serious latent illness, answers “yes,” may the insurer rescind its contract based upon the applicant’s innocent—but material—misrepresentation? Once again, the courts are deeply split on this issue. Some courts have held that a good health provision in an insurance application means “precisely what it says,” that the insured must be in good health as a condition precedent to the insurer’s liability.<sup>231</sup> Other courts, however, have adopted a

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rule, rather than the traditional particular insurer subjective rule); *see also* *Oakes v. Blue Cross & Blue Shield, Inc.*, 317 S.E.2d 315 (Ga. Ct. App. 1984); *Burnham v. Bankers Life & Casualty Co.*, 470 P.2d 261 (Utah 1970).

<sup>230</sup> *See* JERRY, *supra* note 43, at 531–32.

As between the two tests, the objective [reasonably prudent insurer] test is more consistent with general contract law, the rules of which are generally premised on what a reasonable person in the shoes of the contracting party would believe the other party’s manifestations mean in context.

*Id.*

Arguably, a Functionalistic approach to this materiality issue would be either to ignore the underlying contractual implications in favor of honoring the reasonable expectations of the insured to coverage, or perhaps to limit the insurer’s rescission rights only to fraudulent misrepresentations. *See, e.g., McDowell, supra* note 226.

<sup>231</sup> *See, e.g., Ruwitch v. William Penn Life Assurance Co.*, 966 F.2d 1234 (8th Cir.) (applying Missouri law) (holding that the “good health” clause in the life insurance application was a condition precedent to coverage and allowed the insurer to rescind the contract, even though the insured applicant was unaware that he had colon cancer), *cert. denied*, 506 U.S. 919 (1992); *Leach v. Miller’s Life Ins. Co.*, 400 F.2d 179 (5th Cir. 1968) (applying Mississippi law) (holding that the requirement that the insured be in good health was a condition precedent to coverage, and it was immaterial that the applicant did not know that he had cirrhosis of the liver); *see also Huffman v. State Capital Life Ins. Co.*, 174 S.E.2d 17 (N.C. Ct. App. 1970); *American Nat’l Life Ins. Co. v. John R. Corley Co.*, 73 S.W.2d 598 (Tex. Ct. Civ. App. 1934); *Grover v. John Hancock Mut. Life Ins. Co.*, 125 A.2d 571 (Vt. 1956).

Under this strict contractual interpretation of a “good health” clause in an insurance application, good health would mean the applicant’s *actual* good health in fact, and under this traditional doctrine the insured’s knowledge of any latent illness is “entirely immaterial.” *See*

better reasoned middle ground approach that seeks to honor the reasonable expectation of the applicant to coverage by holding that the good health test should not be based on the factual accuracy of the applicant's representation, but it should be based on the applicant's opinion and good faith belief in his or her representation of sound health.<sup>232</sup> A number of middle ground courts also have held that representations in most insurance applications need be only "substantially correct" rather than being literally true, in order to protect the reasonable expectations of the applicant to coverage.<sup>233</sup>

Finally, a number of courts have adopted the so-called *Stipcich* doctrine, holding that an insured has an affirmative duty to disclose to the insurer any changes that materially affect the risk of loss that come to the knowledge of the insured after the application for insurance has been completed but before the insurance policy has been delivered.<sup>234</sup> The rationale underlying *Stipcich* is that:

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*generally* Tsai, *supra* note 225, at 406–10; 1 JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 154 (rev. ed. 1981).

<sup>232</sup> See, e.g., *Harte v. United Benefit Life Ins. Co.*, 424 P.2d 329 (Cal. 1967) (holding that a "good health" provision does not bar recovery under a life insurance policy where the applicant believes in good faith that he is in good health since it is the insured's own knowledge of the state of his or her health which is decisive); *National Life & Accident Ins. Co. v. Lee*, 166 S.E. 253 (Ga. Ct. App. 1932) (holding that the good health test is not the accuracy, but the good faith of the insured's representation of sound health); *National Aid Life Ass'n v. Persing*, 63 P.2d 35 (Okla. 1935) (holding that an expression of good health as used in an application for life insurance means apparent good health without any ostensible or known symptoms of the disorder); see also *Metropolitan Life Ins. Co. v. Devore*, 424 P.2d 321 (Cal. 1967); *Lynch v. Metropolitan Life Ins. Co.*, 235 A.2d 406 (Pa. 1967); *Madsen v. Metropolitan Life Ins. Co.*, 156 A.2d 203 (R.I. 1959); *United States Ins. Co. v. Stanley*, 289 S.E.2d 407 (S.C. 1982); *Sharp v. Richmond Life Ins. Co.*, 183 S.E.2d 132 (Va. 1971); Tsai, *supra* note 225, at 397–401.

<sup>233</sup> See, e.g., *Holtzclaw v. Bankers Mut. Ins. Co.*, 448 N.E.2d 55 (Ind. Ct. App. 1983); *Whitehead v. Fleet Towing Co.*, 442 N.E.2d 1362 (Ill. App. Ct. 1982); see also JERRY, *supra* note 43, at 528–30.

<sup>234</sup> *Stipcich v. Metropolitan Life Ins. Co.*, 277 U.S. 311 (1928). Although the *Stipcich* doctrine has been applied most frequently to life and health insurance disputes, it has also been applied to other types of insurance as well, such as property and liability insurance. See, e.g., *Western Fire Ins. Co. v. Moss*, 298 N.E.2d 304 (Ill. App. Ct. 1973); see also 9 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 38:21 (Mark S. Rhodes, rev. 2d ed. 1985) ("there is a continuing duty on the part of the applicant to disclose newly discovered matters arising between the application for, and the confirmation of, the contract where they come to the applicant's knowledge and render his former answers no longer true"); 12A JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 7275 (rev. ed. 1981) ("the insured is under a duty to disclose to the insurer all facts affecting the risk which arise after the application and before the contract has been consummated"). See *generally* KEETON & WIDISS, *supra* note 23, at 574–76; JERRY, *supra* note 43, at 536–37.

[E]ven the most unsophisticated person must know that in answering the questionnaire and submitting it to the insurer he is furnishing the data on the basis of which the company will decide whether, by issuing a policy, it wishes to insure him. If, while the company deliberates, he discovers facts which make portions of his application no longer true, the most elementary spirit of fair dealing would seem to require him to make a full disclosure. If he fails to do so the company may, despite its acceptance of the application, decline to issue a policy, or if a policy has been issued, it has a valid defense to a suit upon it.<sup>235</sup>

Although many courts have applied the Stipcich doctrine by operation of law,<sup>236</sup> the better reasoned middle ground approach would be that a court, in order to validate the reasonable expectations of the insured to coverage, apply the Stipcich doctrine only when such a requirement is clearly, expressly, and unambiguously stated in the insurance application.<sup>237</sup> For example, in the case of *Cosby v. Transamerica Occidental Life Insurance Co.*,<sup>238</sup> a federal district court held that the Stipcich doctrine would apply to an insured who failed to inform his insurer of a change in his health and his hospitalization for a brain tumor that occurred after the insurance application had been completed, but before the insurance contract had been accepted by the insurer. However, in this particular case the insurance application contained the following express language: "All of the statements and answers given in this application to the best of my knowledge and belief *continue to be true and complete as of the date of delivery of the policy.*"<sup>239</sup> Thus, the applicant was bound by this contractual limitation that was clearly, expressly, and unambiguously stated in the insurance application. Other middle ground courts likewise have held that unless an insurer specifically requests information, a prospective insured is under no duty to volunteer it.<sup>240</sup>

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<sup>235</sup> *Stipcich*, 277 U.S. at 316–17 (citations omitted); *see also* Massachusetts Mut. Life Ins. Co. v. O'Brien, 5 F.3d 1117 (7th Cir. 1993) (applying Illinois law); MacKenzie v. Prudential Ins. Co., 411 F.2d 781 (6th Cir. 1969) (applying Kentucky law); Mayes v. Massachusetts Mut. Life Ins. Co., 608 S.W.2d 612 (Tex. 1980); United States Life Ins. Co. v. Coulson, 560 S.W.2d 211 (Tex. Civ. App. 1977).

<sup>236</sup> The *Stipcich* Court further stated that the failure of the insurance company to stipulate in the application or the policy that disclosure by the insured was required did not relieve the applicant of the duty to do so. *Stipcich*, 277 U.S. at 318; *see also supra* notes 234–35 and authority cited therein.

<sup>237</sup> *See, e.g., supra* notes 170–89 and accompanying text.

<sup>238</sup> 860 F. Supp. 830 (N.D. Ga. 1993) (applying Georgia law).

<sup>239</sup> *Id.* at 832 (emphasis added).

<sup>240</sup> *See, e.g.,* Allstate Ins. Co., Inc. v. Shirah, 466 So. 2d 940 (Ala. 1985); Graham v. Aetna Ins. Co., 132 S.E.2d 273 (S.C. 1963); US Life Credit Ins. Co. v. McAfee, 630 P.2d 450 (Wash. Ct. App. 1981); *see also* JERRY, *supra* note 43, at 540.

### B. *May Coverage Be Extended by Waiver and Estoppel?*

Although a large majority of state courts have stated that the doctrines of waiver and estoppel cannot be used to extend coverage that was expressly excluded in the insurance policy,<sup>241</sup> there are important exceptions to this general rule.<sup>242</sup>

First, a number of courts have held that an insurer will be estopped from denying coverage whenever its agent, in selling the policy, misrepresents the scope of coverage to the insured and the insured justifiably relies on the agent's misrepresentations to his or her detriment.<sup>243</sup> A major problem with this expansion of coverage doctrine based upon an agent's misrepresentations, however, is that under a middle ground contractual approach, the insured also is under the duty to read his or her policy as a reasonable layperson would

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The *Stipich* rule has much to commend it. The insurer, through the application, is free to ask questions on any matter it deems relevant to the risk. It is fair for the insured to presume in the usual case that information not requested by the insurer is immaterial. Basic estoppel concepts also support the *Stipich* rule: the insurer that has failed to ask the proper questions should be estopped to deny that the insured has concealed material facts that would have caused the insurer to make a different underwriting decision.

*Id.*

<sup>241</sup> See, e.g., *Midwest Office Technology, Inc. v. American Alliance Ins. Co.*, 437 N.W.2d 555 (Iowa 1989) (holding that estoppel is a defense to forfeiture of an insurance policy, but that it does not extend coverage); *Utica Mut. Ins. Co. v. Klein & Son, Inc.*, 460 N.W.2d 763 (Wis. Ct. App. 1990) (holding that an insurer cannot waive a coverage clause of an exclusionary nature); see also *Lloyd v. State Farm Mut. Auto. Ins. Co.*, 860 P.2d 1300, 1305 (Ariz. Ct. App. 1992); *Topeka Tent & Awning Co. v. Glens Falls Ins. Co.*, 774 P.2d 984, 986 (Kan. Ct. App. 1989); *Design Data Corp. v. Maryland Casualty Co.*, 503 N.W.2d 552, 560 (Neb. 1993); *Hybud Equip. Corp. v. Sphere Drake Ins. Co.*, 597 N.E.2d 1096, 1104 (Ohio 1992), *cert. denied*, 507 U.S. 987 (1993); *Shannon v. Shannon*, 442 N.W.2d 25, 33 (Wis. 1989); *supra* notes 158–60 and accompanying text.

<sup>242</sup> Author Allan Windt states that “[t]he coverage afforded by an insurance policy should be extended by estoppel whenever the insurer’s actions prior to its final coverage denial are justifiably relied on by the insured to his or her prejudice. The elements of justifiable reliance and prejudice, however, must always be present.” WINDT, *supra* note 20, at 461–62.

<sup>243</sup> See, e.g., *Roberts v. Maine Bonding & Casualty Co.*, 404 A.2d 238 (Me. 1979); *Industro Motive Corp. v. Morris Agency*, 256 N.W.2d 607 (Mich. Ct. App. 1977); *Scott v. Transport Indem. Co.*, 513 So. 2d 889 (Miss. 1987). *But see* *St. Paul Fire & Marine Ins. Co. v. Albany Sch. Dist.*, 763 P.2d 1255 (Wyo. 1988) (holding that an agent’s misrepresentations cannot expand coverage pursuant to waiver or estoppel doctrines).

understand it.<sup>244</sup> Thus, under a middle ground interpretive approach, policy coverage would be extended under waiver and estoppel principles based upon an agent's misrepresentation, and in order to validate the insured's expectation of coverage, only when the insurance policy, with all its limitations and exclusions to coverage, was not made available to the insured;<sup>245</sup> or when the policy language was misleading or ambiguous.<sup>246</sup> Alternately, the insured also may sue the insurer and its agent for such misrepresentations in a separate legal action based on fraud or negligence.<sup>247</sup>

Second, an insurance company may be estopped from denying coverage based upon its failure to properly issue a reservation of rights letter, whenever the insured can demonstrate that he or she was prejudiced based upon the insurer's actions.<sup>248</sup> The public policy rationale underlying this middle ground extension of coverage for an insurer's failure to properly issue a reservation of rights notice is once again to honor both the parties' contractual intent and the

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<sup>244</sup> See *Farmers & Merchants Bank v. Home Ins. Co.*, 514 So. 2d 825 (Ala. 1987); *Pete's Satire, Inc. v. Commercial Union Ins. Co.*, 698 P.2d 1388, 1391 (Colo. Ct. App. 1985) (holding that since the insured was required to read his policy, and since the policy stated that it could not be modified orally by the agent, the agent's misrepresentations could not serve to expand the policy coverage), *aff'd*, 739 P.2d 239 (Colo. 1987); *Sarnafil Inc. v. Peerless Ins. Co.*, 636 N.E.2d 247 (Mass. 1994); *Ostroff v. Keystone Ins. Co.*, 515 A.2d 584, 590 (Pa. Super Ct. 1986) (holding that reliance on an agent to provide coverage is unreasonable if it is contradicted by a clear and unambiguous clause in the policy itself); see also *supra* notes 22, 110-15 and accompanying text.

<sup>245</sup> See, e.g., *Shepard v. Keystone Ins. Co.*, 743 F. Supp. 429, 433 (D. Md. 1990) (holding that an insured cannot justifiably rely on an agent's misrepresentations after the insured has received a copy of the policy); *General Ins. Co. of Am. v. Truly Nolen, Inc.*, 664 P.2d 686, 689 (Ariz. Ct. App. 1983) (holding that an insured may assert estoppel against an insurer to extend coverage beyond the terms of the written policy when the insured does not receive a copy of the insurance policy prior to the time that loss occurs).

<sup>246</sup> See *supra* notes 125-43 and accompanying text; see also *Guy v. National Old Line Ins. Co.*, 164 S.E.2d 905 (S.C. 1968).

<sup>247</sup> See, e.g., *Terry v. Avemco Ins. Co.*, 663 F. Supp. 39, 41 (D. Colo. 1987) (holding that an insurer could be sued in negligence for failing to provide the coverage requested by the insured, even though the insured failed to read his policy); *Guy v. National Old Line Ins. Co.*, 164 S.E.2d 905, 907 (S.C. 1968) (holding that a fraud action is available if the insured read his policy but the policy provisions were so unclear and confusing that an ordinary layperson could not determine from the policy language if the agent's misrepresentations of coverage were in fact false); see also *Reserve Ins. Co. v. Pisciotto*, 640 P.2d 764 (Cal. 1982); *Walters v. First Nat'l Bank*, 433 N.E.2d 608 (Ohio 1982).

<sup>248</sup> See, e.g., *O'Neill Investigations Inc. v. Illinois Employers Ins. Co.*, 636 P.2d 1170 (Alaska 1981); *Centennial Ins. Co. v. Tom Gustafson Indus.*, 401 So. 2d 1143 (Fla. Dist. Ct. App. 1981); *State Farm Mut. Auto. Ins. Co. v. Kay*, 487 P.2d 852 (Utah 1971).

insured's reasonable expectation of coverage.<sup>249</sup>

Third, although a large majority of courts have held that coverage under an insurance policy cannot be created or enlarged by waiver,<sup>250</sup> nevertheless waiver may still be utilized to preserve existing insurance coverage when: (1) an insurer retains an unearned policy premium and thereby waives its right to rescind the policy;<sup>251</sup> (2) an insurer fails to rescind its policy coverage within a "reasonable time" after learning of such grounds for rescission;<sup>252</sup> (3) an

<sup>249</sup> See, e.g., WINDT, *supra* note 20.

The typical situation in which prejudice will be present is when the insurance company defends the insured until a judgment is entered without advising of a conflict of interest between the insured and the company regarding the manner in which the insured's defense should be conducted. Specifically, in the event an insurer

1. Becomes aware of the potential applicability of a policy defense, the existence of which creates a conflict of interest
2. Fails to properly reserve its rights
3. Conducts the insured's defense until judgment without providing the counsel necessary in a conflict of interest situation
4. Attempts to disclaim based on that policy defense the insurer should be estopped from so denying coverage.

*Id.*

<sup>250</sup> See, e.g., *Utica Mut. Ins. Co. v. Klein & Son, Inc.*, 460 N.W.2d 763, 767 (Wis. 1990) (holding that an insurer cannot waive a coverage clause of either an inclusionary or exclusionary nature that goes to the scope of the coverage assumed, however a forfeiture clause furnishing a ground for forfeiture of coverage or defeasance of liability can be waived); see also *Alan Corp. v. International Surplus Lines Ins. Co.*, 22 F.3d 339 (1st Cir. 1994) (applying Massachusetts law); *Topeka Tent & Awning Co. v. Glens Falls Ins. Co.*, 774 P.2d 984 (Kan. Ct. App. 1989); *Kitchen v. Automobile Ins. Co.*, 445 A.2d 552 (Pa. Super. Ct. 1982); *Bortz v. Merrimac Mut. Ins. Co.*, 286 N.W.2d 16 (Wis. Ct. App. 1979); *supra* notes 150–52 and accompanying text.

<sup>251</sup> See, e.g., *Dusich v. Horley*, 525 So. 2d 507, 509 (Fla. Dist. Ct. App. 1988) (holding that an insurer may be precluded from rescinding its contract when the insured's premium check is dishonored by the bank, and the insurer fails to notify the insured of this fact within a reasonable amount of time); *Dairyland Ins. Co. v. Kammerer*, 327 N.W.2d 618, 621 (Neb. 1982) (holding that the insurer was precluded from rescinding its contract based upon its knowledge of the insured's misrepresentation, and its retention of a portion of the premium paid by the insured).

<sup>252</sup> Examples of this middle ground "reasonable time" waiver doctrine include: *Foremost Guar. Corp. v. Meritor Sav. Bank*, 910 F.2d 118, 129 (4th Cir. 1990) (applying Virginia law); *Verex Assurance Co. Ins. v. John Hanson Sav. & Loan Inc.*, 816 F.2d 1296, 1302 (9th Cir. 1987) (applying Oregon law); see also *National Union Fire Ins. Co. v. Sahlen*, 807 F. Supp. 743, 747–48 (S.D. Fla. 1992) (holding that an insurer is precluded from rescinding its insurance policy only if the insured was prejudiced by the insurer's unreasonable delay in seeking rescission), *aff'd*, 999 F.2d 1532 (11th Cir. 1993).

insurer accepts a late premium payment or ratifies policy coverage in some other manner, although it has legitimate legal grounds to cancel the policy;<sup>253</sup> (4) an insurer elects to make a policy cancellation at some subsequent date rather than cancelling the policy immediately;<sup>254</sup> or (5) an insurer pays an insured's claim prior to receiving a proof of loss statement from the insured.<sup>255</sup>

Thus, a liberal construction and application of various waiver and estoppel doctrines by a number of middle ground courts in an insurance law context continues to recognize the legitimate contractual obligations of the parties as well as the reasonable expectation of the insured to coverage—but without the necessity of adopting an unpredictable, subjective, and highly questionable noncontractual alternative.

### C. Insurance Causation Issues

#### 1. Proximate Cause in Insurance Law

It is perhaps fitting that Benjamin Cardozo, who has confused and humbled generations of American law students with his discussion of proximate cause in the landmark tort case of *Palsgraf v. Long Island R. Co.*<sup>256</sup> would be the same judge to discuss the doctrine of proximate cause in insurance contract disputes. For example, in *Bird v. St. Paul Fire & Marine Ins. Co.*,<sup>257</sup> Judge Cardozo wrote:

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<sup>253</sup> See, e.g., *State Farm Mut. Ins. Co. v. Brockhurst*, 453 F.2d 533, 536 (10th Cir. 1977) (applying Kansas law); *Rice v. Reliance Standard Life Ins. Co.*, 512 F. Supp. 1011, 1013 (D. Del. 1981) (holding that a jury could infer that the insurer waived the terms of its policy regarding premium payments through the insurer's long-standing custom of accepting late premium payments); *Mixson v. Allstate Ins. Co.*, 388 So. 2d 608, 609 (Fla. Dist. Ct. App. 1980) (insurer waived its right to cancel the policy by accepting the insured's late premium payment).

<sup>254</sup> See, e.g., *State Farm Fire & Casualty Co. v. Farmers Ins. Exch.*, 264 N.W.2d 62, 63 (Mich. Ct. App. 1978).

<sup>255</sup> See, e.g., *Mutual Benefit Health & Accident Ins. Ass'n v. Reed*, 242 S.E.2d 731, 733 (Ga. Ct. App. 1978); *United States Fidelity & Guar. Co. v. Whitefield*, 355 So. 2d 307, 310 (Miss. 1978); see also STEMPER, *supra* note 20, at 209–38 (1994). See generally WINDT, *supra* note 20, at 468–73.

<sup>256</sup> 162 N.E. 99 (N.Y. 1928). For those readers who have successfully repressed *Palsgraf* from their first-year law school torts class experience, this case dealt with a plaintiff who was allegedly injured by the “domino effect” of an explosion, the resulting panic of a crowd, and a falling weight scale at a railroad station. In my own first-year torts class in 1971, Professor Prosser told us that although he had studied the doctrine of proximate cause for well over fifty years, he still did not fully understand it. He added that it would, however, be on our final exam.

<sup>257</sup> 120 N.E. 86 (N.Y. 1918).



General definitions of a proximate cause give little aid [in interpreting insurance contract disputes]. Our guide is the reasonable expectation and purpose of the ordinary business man when making an ordinary business contract. . . .

...

Precedents are not lacking for the recognition of the [remoteness] element as a factor in causation. This is true even in the law of torts where there is a tendency to go farther back in the search for causes than there is in the law of contracts. . . . [But other traditional insurance law precedent holds that] “[i]n an action on a policy, the *causa proxima* is alone considered in ascertaining the cause of loss” . . . .

. . . Proximity and remoteness are relative and changing concepts.

. . . Between these extremes there is a borderline where [the trier of fact] must solve the doubt.<sup>258</sup>

Accordingly, although a number of courts continue to recognize the traditional approach that the cause of an insured loss is the immediate cause of the injury as opposed to the proximate cause of the injury,<sup>259</sup> other middle ground courts today are more willing to interpret a covered loss in an insurance policy as a “direct loss” rather than a “remote loss” whenever such a construction is fairly indicated in order to honor the reasonable expectation of the insured to coverage, and whenever the proximate cause of such loss is the dominant cause, rather than the most immediate cause.<sup>260</sup>

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<sup>258</sup> *Id.* at 87–88 (citations omitted). Cardozo likewise applied a middle ground judicial approach to honor the reasonable expectations of ordinary business men and women in insurance coverage disputes involving the interpretation of the highly technical terms accidental means and accidental results in insurance policies. *See supra* notes 116–17 and accompanying text.

<sup>259</sup> *See, e.g.,* *Obvey v. Continental Ins. Co.*, 613 F. Supp. 726, 728–29 (N.D. Ga. 1985); *National Fire Ins. Co. v. Valero Energy Corp.*, 777 S.W.2d 501, 505 (Tex. Ct. App. 1989).

This apparently constitutes the majority view. *See generally* WINDT, *supra* note 20, at 389–92.

<sup>260</sup> *See, e.g.,* *Allstate Ins. Co. v. Smith*, 929 F.2d 447, 451 (9th Cir. 1991) (the “efficient cause” of loss, not the immediate loss, controls the coverage issue); *John Drennon & Sons Co. v. New Hampshire Ins. Co.*, 637 S.W.2d 339, 341 (Mo. Ct. App. 1982) (The direct cause of an event is that which in a natural and continuous sequence, unbroken by any new cause, produces the event and without which the event would not have occurred. “Direct” as used in an insurance policy relates to causal connection and is to be interpreted as the immediate or proximate cause as distinguished from the remote cause. A cause is proximate if it is the efficient cause which sets in motion the chain of circumstances leading up to the damage, and which in a natural, continuous sequence, unbroken by a new and independent cause, produced the damage. The product of two or more concurrent and contributing causes is the direct result of each, although neither is the sole cause); *Granchelli v. Traveler’s Ins. Co.*, 561 N.Y.S.2d 944, 944 (App. Div. 1990) (“direct loss” is equivalent to proximate cause); *Graham v. Public*

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Employees Mut. Ins. Co., 656 P.2d 1077, 1081 (Wash. 1983) (Where a peril specifically insured against sets other causes in motion which, in an unbroken sequence and connection between the act and final loss, produce the result for which recovery is sought, the insured peril is regarded as the proximate cause of the entire loss. It is the efficient or predominant cause which sets into motion the chain of events producing the loss which is regarded as the proximate cause, not necessarily the last act in a chain of events); *see also* STEMPEL, *supra* note 20, at 436–37.

[C]ourts are often unclear about what they mean by terms like “efficient” proximate cause. Is an efficient cause the least remote cause contributing to the loss? The least remote cause capable of bringing about the event on its own? The most dominant cause in the chain of causation? The dominant cause capable of alone bringing about the event? . . . The better-reasoned decisions implicitly use dominance analysis in preference to proximity analysis where they find a loss caused by an event viewed as most important even though it is significantly more remote from the loss than other nontrivial causes.

*Id.*

Indeed, in order to validate the reasonable expectation of the insured to coverage, some middle ground courts have applied either the “immediate cause” rule *or* the “dominant cause” rule according to which rule would provide coverage in a particular insurance contract dispute. *See, e.g.,* Key Tronic Corp. v. Aetna Fire Underwriters Ins. Co., 881 P.2d 201, 206 (Wash. 1994); *see* WINDT, *supra* note 20, at 392.

[W]hether a court applies the immediate cause rule [or the dominant cause rule] might depend upon whether one is considering a “cause” that would exclude coverage or one that would create coverage. If the policy language is ambiguous, a court should adopt the immediate cause rule when the rule would serve to render an exclusion inapplicable, even though the court would apply a different rule when applying a policy provision extending coverage.

*Id.*

*See also* STEMPEL, *supra* note 20, at 437.

The common thread running through these decisions appears to be one in which courts are more attracted to a strict proximity view and focus on the cause physically nearest the loss (the last event in the causal chain) where this benefits the policyholder in a coverage dispute, either by bringing the claim within the scope of the policy or avoiding the potential application of an exclusion. Conversely, where the causes physically closest to the loss are uncovered, courts will implicitly or expressly use dominance analysis to find a more remote but covered peril to constitute the “efficient proximate cause” of the loss. Not surprisingly, the tendency is more pronounced where the potentially excluding policy language is arguably ambiguous.

*Id.*

## 2. Multiple Concurrent Causation

The courts have utilized three different approaches in insurance causation issues involving multiple concurrent causation. On one extreme, some courts still apply a traditional Formalistic approach which tends to restrict coverage in most concurrent causation situations. Under this traditional approach, if a covered cause combines with an excluded cause to produce the loss, then the insured cannot recover under the policy based on the rationale that an insurer should not be held responsible for any loss caused by an excluded peril.<sup>261</sup> The weakness of this traditional approach, however, is that the reasonable expectations of the insured to coverage—even under a “common insured in the marketplace” interpretation<sup>262</sup>—are easily frustrated and abrogated.

On the other extreme, some other courts have adopted the so-called California Rule holding that when loss occurs through the concurrence of covered and excluded risks, the insurer would be liable for the entire loss so long as at least one of the covered risks was a proximate cause of the loss.<sup>263</sup> The advantage of this liberalized rule is that when various causes combine to produce an insured loss, a “dominant” or “predominant” cause need not be shown, only a minimally sufficient “proximate” or legal cause. The disadvantage of this liberal rule, however, is that the insurer probably never intended to provide such broad coverage under its policy.<sup>264</sup>

A more realistic middle ground approach to concurrent causation, in order to validate both the insurer’s contractual rights and obligations as well as the insured’s reasonable expectation of coverage, is to require the finding of a covered dominant or predominant cause in any concurrent causation controversy. Under this middle ground approach, if multiple concurrent causes exist, and if the dominant or predominant cause is a covered peril, then

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<sup>261</sup> See, e.g., *Lydick v. Insurance Co. of N. Am.*, 187 N.W.2d 602, 605 (Neb. 1971) (holding that the “general rule” is if a [covered hazard] combines with a hazard expressly excluded from the policy coverage to produce a loss, the insured may not recover); see also *Graff v. Farmer’s Home Ins. Co.*, 317 N.W.2d 741 (Neb. 1982).

<sup>262</sup> See *supra* notes 109–24 and accompanying text.

<sup>263</sup> See, e.g., *Safeco Ins. Co. v. Guyton*, 692 F.2d 551 (9th Cir. 1982) (applying California law); *State Farm Auto. Ins. Co. v. Partridge*, 109 Cal. Rptr. 811 (Cal. 1973); *Sabella v. Wisler*, 27 Cal. Rptr. 689 (Cal. 1963); see also *Mattis v. State Farm Fire & Casualty Co.*, 454 N.E.2d 1156 (Ill. 1983); *Benke v. Mukwonago Vernon Mut. Ins. Co.*, 329 N.W.2d 243 (Wis. 1982).

<sup>264</sup> See generally *JERRY*, *supra* note 43, § 67[d][1]. Recently, however, the California Supreme Court under Chief Justice Malcolm Lucas’s conservative majority has adopted a more middle ground predominant cause approach involving issues of concurrent causation. See, e.g., *State Farm Fire & Casualty Co. v. Von der Lieth*, 2 Cal. Rptr. 2d 183 (Cal. 1991); *Garvey v. State Farm Fire & Casualty Co.*, 257 Cal. Rptr. 292 (Cal. 1989); see also *supra* note 61; *infra* note 265 and accompanying text.

coverage would exist for the entire loss, even though other concurrent causes were not covered under the policy.<sup>265</sup>

For example, in *Shirone, Inc. v. Insurance Co. of North America*,<sup>266</sup> the insured's cattle were killed during a violent storm that produced high winds, damp snow, and muddy field conditions. The insurance policy insured livestock against death by windstorm, but did not provide coverage for any loss caused by "dampness of the atmosphere or extremes of temperature." Expert witnesses testified that the cattle died due to a combination of concurrent causes—including wind, cold temperature, snow, muddy conditions, lack of adequate wind protection, and the size and age of the cattle. The jury found that the windstorm was the dominant, efficient, and proximate cause of the loss, notwithstanding the contributions of the other noncovered factors, and this jury verdict was affirmed on appeal.<sup>267</sup> *Shirone* thus serves as a good illustration of the realistic middle ground predominant cause approach regarding concurrent causation issues in insurance law coverage disputes.

This middle ground concurrent causation approach is therefore justified, not only because it honors the reasonable expectation of the policyholder to coverage and disallows the insurer any unconscionable advantage, but it is also based on the rationale of liberally resolving any ambiguities regarding coverage in favor of the insured, and strictly construing such ambiguities against the insurer.<sup>268</sup>

### 3. Establishing a Causal Nexus to the Covered Loss

As numerous middle ground courts have found coverage based upon more liberalized concepts of proximate cause<sup>269</sup> and concurrent causation<sup>270</sup> in an

<sup>265</sup> See, e.g., *Goodman v. Fireman's Fund Ins. Co.*, 600 F.2d 1040 (4th Cir. 1979) (applying Maryland law); *Ovbey v. Continental Ins. Co.*, 613 F. Supp. 726 (N.D. Ga. 1985), *aff'd*, 782 F.2d 178 (11th Cir. 1986); *Garvey v. State Farm Fire & Casualty Co.*, 257 Cal. Rptr. 292 (Cal. 1989); *Grace v. Lititz Mut. Ins. Co.*, 257 So. 2d 217 (Miss. 1972); *Hahn v. MFA Ins. Co.*, 616 S.W.2d 574 (Mo. Ct. App. 1981); *Yunker v. Republic-Franklin Ins. Co.*, 442 N.E.2d 108 (Ohio Ct. App. 1982); *King v. North River Ins. Co.*, 297 S.E.2d 637 (S.C. 1982).

If neither cause was dominant, loss will probably be attributed to the cause that would result in coverage. See, e.g., *Wasecu Mut. Ins. Co. v. Noska*, 331 N.W.2d 917, 920–23 (Minn. 1983); *Aetna Casualty & Sur. Co. v. Lumbermens Mut. Casualty Co.*, 527 N.Y.S.2d 143, 145 (App. Div. 1988); see also *supra* note 259 and accompanying text.

<sup>266</sup> 570 F.2d 715 (8th Cir. 1978).

<sup>267</sup> *Id.*

<sup>268</sup> See also *supra* notes 125–43 and accompanying text. See generally JERRY, *supra* note 43, § 67; KEETON & WIDISS, *supra* note 23, § 5.5; Lashner, *supra* note 30.

<sup>269</sup> See *supra* notes 259–60 and accompanying text.

<sup>270</sup> See *supra* notes 265–68 and accompanying text.

insurance law context, a number of other middle ground courts, in order to honor the reasonable expectations of the insured to coverage while at the same time honoring the parties' contractual rights and obligations, have also adopted a realistic middle ground approach of requiring only a minimal or "sufficient" causal nexus to a covered loss, rather than requiring a more traditional or "substantial" causal nexus.

For example, in fire and property insurance coverage disputes, the courts are split as to whether or not damage by heat, smoke, or soot would come within fire insurance coverage as a direct loss caused by fire.<sup>271</sup> While some courts interpret a direct loss caused by fire to require actual ignition, burning, or charring,<sup>272</sup> the better-reasoned middle ground view also allows recovery for smoke and soot damage as a direct loss caused by fire.<sup>273</sup> The courts are also split on whether or not coverage is available for loss caused by a "friendly"<sup>274</sup> rather than a "hostile"<sup>275</sup> fire. Even though the word "fire" as used in an insurance policy, in the absence of contractual language showing a contrary intent,<sup>276</sup> is construed according to its ordinary meaning,<sup>277</sup> and is

<sup>271</sup> "As to whether or when damages caused by heat, smoke, or soot without external ignition may be recovered under the usual form of [a] fire [insurance] policy, the decisions are not altogether in agreement." A.M. Vann, Annotation, *Loss by Heat, Smoke, or Soot Without External Ignition As Within Standard Fire Insurance Policy*, 17 A.L.R.3d 1155, 1157 (1968); see also 5 JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 3084 (rev. ed. 1970).

<sup>272</sup> See, e.g., *Washington State Hop Producers Inc. v. Harbor Ins. Co.*, 660 P.2d 768 (Wash. Ct. App. 1983) (holding that there was no evidence of any flame or glow to constitute a "direct" loss by fire when 253 bales of hops stored in plaintiff's warehouse were damaged by "browning"). See generally Vann, *supra* note 271.

<sup>273</sup> See, e.g., *Marshall Produce Co. v. St. Paul Fire & Marine Ins. Co.*, 98 N.W.2d 280 (Minn. 1959) (finding that smoke damage where the fire has not touched the object was a covered loss when the fire is the direct and proximate cause of the smoke); see also 10A GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 42:31 (Mark S. Rhodes, rev. 2d ed. 1984); VANCE, *supra* note 43, at 866.

<sup>274</sup> A "friendly" fire is defined as a fire lighted and contained in a usual or ordinary place for a fire, such as a furnace, stove, incinerator, or the like. See *Owens v. Milwaukee Ins. Co.*, 123 N.E.2d 645, 646 (Ind. 1955); *Barcalo Mfg. Co. v. Firemen's Mut. Ins. Co.*, 263 N.Y.S.2d 807, 809 (App. Div. 1965). See generally 10A GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 42:14 (Mark S. Rhodes, rev. 2d ed. 1984); VANCE, *supra* note 43, at 869-71.

<sup>275</sup> A "hostile" fire is defined as being a fire which is unexpected and in a place where a fire is not ordinarily maintained. See *Owens*, 123 N.E.2d at 646; *Barcalo*, 263 N.Y.S.2d at 809; VANCE, *supra* note 43, at 869-71; 10A GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 42:15 (Mark S. Rhodes, rev. 2d ed. 1984).

<sup>276</sup> See *supra* notes 170-89 and accompanying text.

<sup>277</sup> See *supra* notes 109-24 and accompanying text.

normally defined as combustion accompanied by visible heat or light,<sup>278</sup> a number of courts still recognize an ill-conceived traditional insurance law principle that only hostile fires are covered under a fire insurance policy, regardless of any consumer expectation to coverage for *any* fire loss.<sup>279</sup> A better-reasoned middle ground approach would be to reject the “friendly versus hostile fire” dichotomy either because such terminology is ambiguous,<sup>280</sup> or because in the absence of any express limitation or exclusion to coverage that is clearly and unambiguously stated in the insurance contract,<sup>281</sup> the friendly versus hostile fire doctrine should not be utilized.<sup>282</sup>

A second example of how various middle ground courts find a sufficient causal nexus to the covered loss in fire and property insurance policies is where coverage is provided for any loss by explosion, even though there is a policy exclusion for “water damage.”<sup>283</sup> Again, the term “explosion” generally is

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<sup>278</sup> See, e.g., *Hartford Fire Ins. Co. v. Electrical Dist.*, 452 P.2d 539 (Ariz. Ct. App. 1969). See generally 10A GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 42:13 (Mark S. Rhodes, rev. 2d ed. 1984).

<sup>279</sup> See, e.g., *Levert-St. John Inc. v. Birmingham Fire & Casualty Co.*, 137 So. 2d 494 (La. Ct. App. 1961) (where a welder’s arc ignited pure hydrogen gas and an explosion followed, and the insurance policy excluded loss by explosion where no fire resulted, the trial court properly dismissed the action since the explosion was caused by a “friendly fire”—the welder’s arc—and so loss resulted from the explosion rather than the fire); see also *Pacific Fidelity Ins. Co. v. C.C. Anderson Co.*, 47 F. Supp. 90 (D. Idaho 1942); *Spare v. Glen Falls Ins. Co.*, 75 A.2d 64 (Conn. 1950); *Youse v. Employee’s Fire Ins. Co.*, 238 P.2d 472 (Kan. 1951). See generally 10A GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* §§ 42:13–42 (Mark S. Rhodes, rev. 2d ed. 1984); Vann, *supra* note 272.

<sup>280</sup> See, e.g., *Sadlowski v. Liberty Mut. Ins. Co.*, 487 A.2d 1146 (Del. Super. 1984) (holding that language in a homeowner’s policy covering “direct loss caused by fire” was ambiguous, and would be interpreted in accordance with the reasonable expectations of the insured, rather than using the “friendly vs. hostile fire” doctrine for determining coverage); see also *supra* notes 125–43 and accompanying text.

<sup>281</sup> See generally *supra* notes 170–88 and accompanying text.

<sup>282</sup> See, e.g., *Schulze & Burch Biscuit Co. v. American Protection Ins. Co.*, 421 N.E.2d 331 (Ill. Ct. App. 1981) (holding that replacement of a baker’s oven that was seriously damaged by abnormal internal temperatures would be allowed under an insured’s fire insurance coverage despite the insurer’s contention of the friendly vs. hostile fire doctrine); see also KEETON & WIDISS, *supra* note 23, at 486–91.

<sup>283</sup> See, e.g., *Chicago, R.I. & P.R. Co. v. Aetna Ins. Co.*, 308 P.2d 119 (Kan. 1957) (where concrete sides of a grain elevator were disintegrated due to flood waters which caused the grain to expand and gases to form, damage was caused by an explosion within the policy terms rather than coming under a water damage exclusion); *Hartford Fire Ins. Co. v. Bulch*, 350 P.2d 514 (Okla. 1960) (where water damage resulted from a hot water system, and the break in a copper water pipe resulted from excessive temperature and pressure, the damage was due to an explosion rather than to water damage). See generally L.S. Tellier, Annotation, *Coverage of*

interpreted from the viewpoint of the ordinary and reasonable insured, rather than being interpreted in a highly technical or legal sense.<sup>284</sup>

A third example of this middle ground interpretive approach using a minimal or "sufficient" causal nexus involves automobile liability insurance and loss "arising out of the ownership, maintenance, or use" of such automobile or another insured vehicle.<sup>285</sup> Although earlier courts applied a severely restricted interpretation of the word "use" of an automobile to mean the actual "operation" of the vehicle,<sup>286</sup> most middle ground courts today have not applied such a strict interpretive standard. A majority of courts have held that the use of an automobile is not necessarily synonymous with "driving" or "operating" the vehicle, and it is sufficient to show only that the accident "was connected with," "grew out of," or "flowed from" the use of the automobile.<sup>287</sup>

The courts are split, however, as to whether a "substantial" causal nexus involving the use of an automobile is required, or only a minimal or sufficient causal nexus is required in order to honor the insured's expectation of coverage.<sup>288</sup> For example, some middle ground courts have held that when a

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*Clause of Fire Policy Insuring Against Explosion*, 28 A.L.R.2d 995 (1953); 5 JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* §§ 3085-3087.25 (rev. ed. 1970).

<sup>284</sup> See *supra* notes 118-19 and accompanying text.

<sup>285</sup> See, e.g., *Richland Knox Mut. Ins. Co. v. Kallen*, 376 F.2d 360 (6th Cir. 1967) (applying Michigan law); *Waseca Mut. Ins. Co. v. Noska*, 331 N.W.2d 917 (Minn. 1983); *Farmers Fire Ins. Co. v. Kingsbury*, 461 N.Y.S.2d 226 (N.Y. Sup. Ct. 1983), *aff'd*, 481 N.Y.S.2d 469 (N.Y. App. Div. 1984). See generally Insurance Services Office, *Sample Personal Automobile Insurance Policy*, Insuring Agreement Part A, Section 1 (1983). The phrase "arising out of the ownership, maintenance, or use" of a vehicle is utilized to define coverage in automobile insurance policies, but this same term is utilized to exclude coverage in homeowners' insurance policies and in other nonvehicular insurance policies. Thus, very often, this legal question of interpretation hinges on whether the automobile insurer or the homeowners' insurer ultimately will be liable to the insured.

<sup>286</sup> See, e.g., *Kienstra v. Madison County Mut. Auto. Ins. Co.*, 44 N.E.2d 944 (Ill. App. Ct. 1942) (defining "use" as the "operation" of the vehicle).

<sup>287</sup> See, e.g., *Unigard Mut. Ins. Co. v. Abbott*, 732 F.2d 1414 (9th Cir. 1984) (applying Montana law); *State Farm Mut. Ins. Co. v. Smith*, 691 P.2d 1289 (Idaho Ct. App. 1984); *Plaxo v. United States Fidelity & Guar. Co.*, 166 S.E.2d 799 (S.C. 1969). See generally Larry D. Scheafer, Annotation, *Automobile Liability Insurance: What Are Accidents or Injuries "Arising Out of Ownership, Maintenance, or Use" of Insured Vehicle*, 15 A.L.R.4th 10 (1982).

<sup>288</sup> Compare *Lumbermen's Mut. Casualty Co. v. Logan*, 451 N.Y.S.2d 804 (N.Y. App. Div. 1982) (holding that an automobile insurer was not liable to its insured for an accident "arising out of the ownership, maintenance, or use" of the automobile when the injury resulted from the insured's fall in an icy automobile parking lot) with *Novak v. Government Employees*

plaintiff is injured as a result of an object thrown from an automobile, only a minimal or sufficient causal nexus is required to find coverage under loss "arising out of the ownership, maintenance, or use" of the vehicle.<sup>289</sup> Other middle ground courts, however, have required a more substantial causal nexus between the thrown object and the use of the vehicle.<sup>290</sup> Still other courts have held that if the vehicle is moving and the speed of the car contributes to the impact of the thrown object, then there would be a sufficient causal nexus with the use of the vehicle.<sup>291</sup> This same causal conundrum is illustrated in the issue of whether the accidental discharge of a firearm in an automobile constitutes the use of that vehicle.<sup>292</sup> Insurance coverage disputes involving the "ownership, maintenance, or use" of an automobile thus continue to serve as a litigator's dream come true or, alternately, a litigator's worst nightmare.<sup>293</sup>

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Ins. Co., 424 So. 2d 178 (Fla. Dist. Ct. App. 1983) (holding that an insured was covered for loss "arising out of the ownership, maintenance or use" of her automobile when she was shot in her driveway after refusing an assailant's request to give her a ride).

<sup>289</sup> See, e.g., *National Am. Ins. Co. v. Ins. Co. of N. Am.*, 140 Cal. Rptr. 828 (Cal. Ct. App. 1977) (holding that a minimal causal connection had been established when a teenage boy threw an egg from the window of a moving automobile which struck a pedestrian in the eye, causing loss of the eye, and the grievous injury was exacerbated by the automobile's 40 mile per hour speed); see also *Valdes v. Smalley*, 303 So. 2d 342 (Fla. Dist. Ct. App. 1974), *cert. denied*, 341 So. 2d 975 (Fla. 1974) (beer mug thrown from a moving vehicle that struck and killed a pedestrian); *Westchester Fire Ins. Co. v. Continental Ins. Co.*, 312 A.2d 664 (N.J. Super. 1973) (stick thrown from a moving vehicle that struck and injured a bicyclist), *aff'd*, 319 A.2d 732 (N.J. 1974).

<sup>290</sup> See, e.g., *Richland Knox Mut. Ins. Co. v. Kallen*, 376 F.2d 360 (6th Cir. 1967) (applying Michigan law) (an attempt to throw a firecracker from the rear of an automobile had no causal connection with the use of the automobile); *Mazon v. Farmers Ins. Exch.*, 491 P.2d 455 (Ariz. 1971) (no causal connection was found between a stone thrown by an unknown person in an unidentified car and the "ownership, maintenance or use" of that vehicle); *Government Employees Ins. Co. v. Melton*, 357 F. Supp. 416 (S.C. 1972) (applying South Carolina law) (no sufficient causal nexus was found between throwing a bottle from the rear of a pickup truck and the use of the vehicle), *aff'd*, 473 F.2d 909 (4th Cir. 1973).

<sup>291</sup> See, e.g., *National Am. Ins. Co. v. Ins. Co. of N. Am.*, 140 Cal. Rptr. 828 (Cal. Ct. App. 1977); *Farm Bureau Ins. Co. v. Evans*, 637 P.2d 491, 494 (Kan. 1981) (firecracker thrown from the backseat of a parked station wagon was not causally connected to the use of the automobile). See generally 12 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 45:56 (Mark S. Rhodes, rev. 2d ed. 1984) and cases cited therein.

<sup>292</sup> Compare *Southeastern Fidelity Ins. Co. v. Stevens*, 236 S.E.2d 550 (Ga. Ct. App. 1977) and *Fidelity & Casualty Co. v. Lott*, 273 F.2d 500 (5th Cir. 1950) (applying Texas law) (both finding coverage) with *United States Fidelity & Guar. Co. v. Western Fire Ins. Co.*, 450 S.W.2d 491 (Ky. 1970) and *State Farm Mut. Auto. Ins. Co. v. Centennial Ins. Co.*, 543 P.2d 645 (Wash. Ct. App. 1975) (both finding no coverage).

<sup>293</sup> See generally *Scheafer*, *supra* note 287; *Swisher*, *supra* note 4, at 1066-70; 12



#### D. Coverage Issues Involving an Insured's Intentional Acts

Because insurance normally is intended to cover only accidental or unintended losses, any losses that are intentionally caused by an insured generally are not covered in property<sup>294</sup> and liability<sup>295</sup> insurance policies. Likewise in life, health, and accident insurance policies an "accidental" death generally is defined as death that is not expected or intended from the standpoint of the insured.<sup>296</sup> A number of middle ground courts, however, have moderated these doctrines significantly.

First, the courts are widely split regarding the judicial interpretation of what constitutes an accidental<sup>297</sup> death in life, health, and accident insurance coverage disputes. On one hand, a number of courts continue to employ the traditional or "classic tort" doctrine that if an injury or death was reasonably foreseeable as a natural consequence of an intentional act, then it could not be

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GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 45:53--:57 (Mark S. Rhodes, rev. 2d ed. 1984); George Sayres, *Coverage Problems Relating to the Policy Term "Arising Out of the Use" of a Vehicle*, 36 *INS. COUNSEL J.* 253 (1969).

<sup>294</sup> See, e.g., *Neises v. Solomon State Bank*, 696 P.2d 372 (Kan. 1985); *St. Paul Fire & Marine Ins. Co. v. Cuminsky*, 665 P.2d 223 (Mont. 1983); see also JERRY, *supra* note 43, at 302-04 ("If the insured intentionally causes damage to his own property, the loss is not covered. The public policy supporting this exclusion is identical to that which supports the insurable interest requirement. Insureds should not receive coverage for destroying their own property. Otherwise, insureds would have an incentive in many instances to destroy their property and collect the proceeds.").

<sup>295</sup> See generally KEETON & WIDISS, *supra* note 23, at 493, 518-33 ("Losses which are intentionally caused by an insured generally are not covered by liability insurance."); OSTRAGER & NEWMAN, *supra* note 17, at 306-25; James L. Rigelhaupt, Annotation, *Construction and Application of Provision of Liability Insurance Policy Expressly Excluding Injuries Intended or Expected by Insured*, 31 *A.L.R.4th* 957 (1984); Annotation, *Liability Insurance: Assault As an "Accident," or Injuries Therefrom As "Accidentally" Sustained, Within Coverage Clause*, 72 *A.L.R.3d* 1090 (1976); Annotation, *Coverage Under Uninsured Motorist Clause of Injury Inflicted Intentionally*, 72 *A.L.R.3d* 1161 (1976); W.E. Shipley, Annotation, *Liability Insurance As Covering Accident Injury Due to Wanton or Willful Misconduct or Gross Negligence*, 20 *A.L.R.3d* 320 (1968).

<sup>296</sup> See generally 1B JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* §§ 451-62 (rev. ed. 1981); 10 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* §§ 41:15--:17 (Mark S. Rhodes, rev. 2d ed. 1982).

<sup>297</sup> In the absence of an express statutory or contractual definition, the word "accident" or "accidental" used in life, health, or accident insurance policies generally is given its ordinary and popular meaning as something that happens suddenly or unexpectedly without any intentional design on the part of the insured or the person injured. See generally 10 GEORGE J. COUCH, *CYCLOPEDIA OF INSURANCE LAW* §§ 41:7--:8 (Mark S. Rhodes, rev. 2d ed. 1982).

an accidental death.<sup>298</sup> On the other hand, a growing number of middle ground courts have adopted a more liberal definition of what constitutes an accidental death, holding that where an insured commits a voluntary act not intending to cause himself harm, this act would constitute an accidental death within the terms of the policy coverage.<sup>299</sup> In practice, however, these two interpretive approaches are difficult to apply.<sup>300</sup>

One rather bizzare example of this interpretive dichotomy regarding what

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<sup>298</sup> Courts applying this approach tend to look at the insured's voluntary acts from an objective "reasonable insured" viewpoint. *See, e.g.*, *Jones v. Fireman's Fund Am. Life Ins. Co.*, 731 S.W.2d 532 (Tenn. Ct. App. 1986) (holding that there was no accidental death by a handgun during an ensuing struggle since the death was a foreseeable consequence of a deliberate act when the husband aimed the pistol at wife's head); *Nicholas v. Providential Life & Accident Ins. Co.*, 457 S.W.2d 536 (Tenn. Ct. App. 1970) (playing "Russian roulette" with a loaded pistol does not constitute an accidental death since the consequence of the insured's act is foreseeable); *see also* *Wooden v. John Hancock Life Ins. Co.*, 139 S.E.2d 801 (Va. 1965) (holding that if the death of the insured, although in a sense unforeseen and unexpected, results directly from the insured's voluntary act or misconduct, or if the insured provokes an act which causes death or injury, it is not an accidental death, even though the result may be accidental). *See generally* 1B JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 453 (rev. ed. 1981). *But cf.* *Cockrell v. Life Ins. Co.*, 692 F.2d 1164 (8th Cir. 1982) (applying Arkansas law) (pointing out that Arkansas courts have declined to adopt the "classic tort" concept that one intends the natural and foreseeable consequence of one's deliberate acts so as to bar recovery for unintended results).

<sup>299</sup> Courts applying this approach tend to look upon the insured's voluntary acts from a subjective "particular insured" viewpoint. *See, e.g.*, *New York Life Ins. Co. v. Harrington*, 299 F.2d 803 (9th Cir. 1962) (applying California law) (The insured shot and killed himself by placing a loaded gun to his temple and pulling the trigger, mistakenly thinking that the safety catch was engaged. The court ruled his death was accidental.); *Knight v. Metropolitan Life Ins. Co.*, 437 P.2d 416 (Ariz. 1968) (The insured died after a voluntary dive from atop the Coolidge Dam in Arizona, a height of more than 139 feet. He had previously made dives from heights of 25, 40, 50, and 75 feet from diving boards, ship decks, rocky ledges, and box canyons, and he stated (correctly) that the Coolidge Dam venture would be his last dive. The court ruled the insured's death was accidental.). *See generally* COUCH, *supra* note 296, § 41:16.

<sup>300</sup> *Compare* *Bias v. Advantage Int'l, Inc.* 905 F.2d 1558 (D.C. Cir.) (applying D.C. law) (holding that an insurance agent was not liable for failing to procure insurance coverage on basketball star Len Bias, since Bias's death from cocaine intoxication was a foreseeable consequence of a deliberate act and not an accidental death), *cert. denied*, 498 U.S. 958 (1990) with *Marsh v. Metropolitan Life Ins. Co.*, 388 N.E.2d 1121 (Ill. App. Ct. 1979) (holding that an insured's death by a self-administered overdose of heroin was an accidental death).

One approach to resolving this interpretive conundrum might be through the so-called "damn fool doctrine" for incredibly foolish conduct. The damn fool doctrine is embodied in the statement that insurance coverage "is not provided for acts which are simply too ill conceived to warrant allowing the actor to transfer the risk of such conduct to an insurer." KEETON & WIDISS, *supra* note 23, at 539-41.

constitutes an insured's accidental death is found in a number of life insurance coverage disputes involving beneficiaries of insureds who died as a result of intentionally "hanging" themselves in order to create an asphyxial state for a heightened autoerotic experience.<sup>301</sup> Not surprisingly, a number of courts have held that these intentional acts would not constitute an accidental death because death was a foreseeable consequence of the insured's deliberate act of self-induced asphyxiation.<sup>302</sup> Other courts, however, have applied a liberalized middle ground approach to these cases, holding that even though the insured committed voluntary autoerotic asphyxia, he did not intend to ultimately kill himself by hanging.<sup>303</sup>

Likewise, an insured's intentional act does not always preclude recovery in property insurance contract disputes involving property intentionally destroyed by one of the co-owners. For a number of years in most jurisdictions, the interpretive rule was that an innocent co-insured could not recover for property loss intentionally caused by another co-insured.<sup>304</sup> However, a growing number of middle ground courts in recent years have allowed recovery to an

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<sup>301</sup> Life insurance disputes involving autoerotic asphyxiation apparently are not isolated cases judging from the A.L.R. Annotation discussing this bizarre topic. *See, e.g.*, Alan Stephens, Annotation, *Accident or Life Insurance: Death by Autoerotic Asphyxiation As Accidental*, 62 A.L.R.4th 823 (1988); *see also* COUCH, *supra* note 296, § 41:16.

<sup>302</sup> *See, e.g.*, Sigler v. Mut. Life Ins. Co., 663 F.2d 49 (8th Cir. 1981) (applying Iowa law) (holding that since a reasonable person would have recognized that an insured's act of "hanging" himself to create an asphyxial state for a heightened masturbating experience could have resulted in his death, this was not an accident, and recovery was barred under the policy exclusion for intentional acts); *see also* International Underwriters Inc. v. Home Ins. Co., 662 F.2d 1084 (4th Cir. 1981) (applying Virginia law) (same holding); Runge v. Metropolitan Life Ins. Co., 537 F.2d 1157 (4th Cir. 1976) (applying Virginia law) (same holding).

<sup>303</sup> *See, e.g.*, Connecticut Gen. Life Ins. Co. v. Tommie, 619 S.W.2d 199 (Tex. Civ. App. 1981) (holding that based upon the testimony of two physicians the insured's death by autoerotic asphyxiation was unforeseeable and unintended, and therefore the insured's death was accidental); Kennedy v. Washington Nat'l Ins. Co., 401 N.W.2d 842 (Wis. 1987) (holding that the insured, an orthopedic surgeon, knew of the medical risks of asphyxiation, and although his conduct was bizarre and unusual, his death was unintended and accidental); *see also supra* note 300. *But cf.* International Underwriters Inc. v. Home Ins. Co., 662 F.2d 1084 (4th Cir. 1981) (holding that notwithstanding the insured, an engineer, utilized a "fail safe" device to prevent death by autoerotic asphyxiation that malfunctioned, the insured's death was not an accident since it still was the foreseeable consequence of the insured's deliberate act).

<sup>304</sup> *See, e.g.*, Short v. Oklahoma Farmers Union Ins. Co., 619 P.2d 588 (Okla. 1980); Western Fire Ins. Co. v. Sanchez, 671 S.W.2d 666 (Tex. Civ. App. 1984); Rockingham Mut. Ins. Co. v. Hummel, 250 S.E.2d 774 (Va. 1979). The rationale for this traditional rule is that since the coinsureds own their property jointly and have a joint interest in the property insurance policy, they also have a joint obligation to preserve the property and not to defraud the insurer. *See* JERRY, *supra* note 43, at 303.

innocent co-insured for loss intentionally caused by another co-insured under the interpretive doctrine that an insurance contract between an insurer and co-insureds is severable rather than joint, and the unilateral intentional act of one co-insured should not divest the innocent co-insured of his or her separate contractual rights under the property insurance contract.<sup>305</sup>

Finally, a number of courts have found that an "intentional" act does not always bar recovery in various liability insurance contract disputes. Although many courts interpret accidental and intentional conduct in liability insurance coverage disputes from the standpoint of the insured,<sup>306</sup> a number of other middle ground courts, to broaden liability insurance coverage to protect injured third party plaintiffs, also have interpreted accidental or intentional conduct from the standpoint of the injured party.<sup>307</sup> For example, in liability insurance coverage disputes, a number of middle ground courts have found coverage when the insured: intentionally shot and wounded another person;<sup>308</sup> assaulted and injured another person with a motor vehicle;<sup>309</sup> defamed another person or intentionally caused emotional distress;<sup>310</sup> and intentionally polluted the environment.<sup>311</sup> The underlying rationale for this middle ground view of

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<sup>305</sup> See, e.g., *American Economy Ins. Co. v. Liggett*, 426 N.E.2d 136 (Ind. Ct. App. 1981); *Hildebrand v. Holyoke Mut. Fire Ins. Co.*, 386 A.2d 329 (Maine 1978); *Howell v. Ohio Casualty Ins. Co.*, 327 A.2d 240 (N.J. Super. 1974); *Lovell v. Rowan Mut. Fire Ins. Co.*, 274 S.E.2d 170 (N.C. 1981); *Hedteke v. Sentry Ins. Co.*, 326 N.W.2d 727 (Wis. 1982); see also *JERRY*, *supra* note 43, at 303-04.

<sup>306</sup> See, e.g., *Aetna Casualty & Sur. Co. v. Freyer*, 411 N.E.2d 1157 (Ill. App. Ct. 1980); *Great Nat'l Ins. Co. v. Legg*, 444 S.W.2d 324 (Tex. Civ. App. 1969).

<sup>307</sup> See, e.g., *Haser v. Maryland Casualty Co.*, 53 N.W.2d 508 (N.D. 1952); *Fox Wisconsin Corp. v. Century Indem. Co.*, 263 N.W. 567 (Wis. 1935). See generally *KEETON & WIDISS*, *supra* note 23, at 510-13, 518-44.

<sup>308</sup> See, e.g., *Vanguard Ins. Co. v. Cantrell*, 503 P.2d 962 (Ariz. Ct. App. 1972); *Colonial Penn Ins. Co. v. Hart*, 291 S.E.2d 410 (Ga. Ct. App. 1982); *State Farm Fire & Casualty Co. v. Muth*, 207 N.W.2d 364 (Neb. 1973). *But cf.* *Armstrong v. Security Ins. Co.*, 288 So. 2d 134 (Ala. 1973); *Draffen v. Allstate Ins. Co.*, 407 So. 2d 1063 (Fla. Dist. Ct. App. 1981); *Bay State Ins. Co. v. Wilson*, 451 N.E.2d 880 (Ill. 1983).

<sup>309</sup> See, e.g., *Indiana Lumbermen's Mut. Ins. Co. v. Brandum*, 419 N.E.2d 246 (Ind. Ct. App. 1981); *Cincinnati Ins. Co. v. Mosley*, 322 N.E.2d 693 (Ohio Ct. App. 1974); *Peterson v. Western Casualty & Sur. Co.*, 93 N.W.2d 433 (Wis. 1958). *But cf.* *Boyd v. Great Cent. Ins. Co.*, 401 So. 2d 19 (Ala. 1981); *Wigginton v. Lumbermens Mut. Casualty Co.*, 169 So. 2d 170 (La. Ct. App. 1964); *Dochod v. Central Mut. Ins. Co.*, 264 N.W.2d 122 (Mich. Ct. App. 1978).

<sup>310</sup> See, e.g., *Runyan v. Continental Casualty Co.*, 233 F. Supp. 214 (D. Or. 1964); *Trinity Universal Ins. Co. v. Bethancourt*, 331 S.W.2d 943 (Tex. Civ. App. 1959). *But cf.* *Continental Casualty Co. v. Schaubel*, 380 So. 2d 483 (Fla. Dist. Ct. App.), *cert. denied*, 389 So. 2d 1114 (Fla. 1980); *Shapiro v. Glens Falls Ins. Co.*, 383 N.Y.S.2d 263 (N.Y. 1976).

<sup>311</sup> See, e.g., *Steyer v. Westvaco Corp.*, 450 F. Supp. 384 (D. Md. 1978); *Aetna Casualty & Sur. Co. v. Martin Bros. Container & Timber Prod. Corp.*, 256 F. Supp. 145 (D. Or. 1966);

expanding liability insurance coverage within a contractual framework is based upon a number of interrelated factors: (1) that an exclusion for intentional injury in a liability insurance policy is inherently ambiguous;<sup>312</sup> (2) that the words “expected” and “intended” are not synonymous for purposes of construing an intentional injury exclusion provision in a liability insurance policy;<sup>313</sup> and (3) that the “classic tort” doctrine<sup>314</sup> of looking at the foreseeable consequences of the insured’s intentional act are not appropriate in an insurance law context since an insured must have had the specific intent to cause the specific type of injuries suffered.<sup>315</sup>

These illustrative examples of a realistic middle ground approach to the interpretation of insurance contract disputes further demonstrate how middle ground courts are able to honor the reasonable expectations of the insured to coverage, but within contractually based parameters and interpretive rules that are supplemental to, rather than at variance with, the policy language of the insurance contract itself, and without the necessity of adopting an unpredictable and unsatisfactory noncontractual doctrine of reasonable expectations.

## VI. CONCLUSION

Reports of the demise of a contractually based judicial resolution of insurance coverage disputes have been greatly exaggerated. The application of underlying contractual remedies, defenses, and limitations by many judges in the interpretation of insurance contract disputes remains alive and well today, and a large number of American courts continue to utilize an insurance-as-contract baseline for resolving such disputes. However, a traditional Formalistic contractual approach to insurance coverage disputes has been justly criticized for not adequately addressing the reasonable expectations of the insured to coverage, and for not recognizing that insurance policies often

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*see also* OSTRAGER & NEWMAN, *supra* note 17, at 306–25. *But cf.* Ashland Oil Inc. v. Miller Oil Purchasing Co., 678 F.2d 1293 (5th Cir. 1982) (applying Louisiana law).

<sup>312</sup> *See, e.g.*, American Ins. Co. v. Saulnier, 242 F. Supp. 257 (D. Conn. 1965); Home Ins. Co. v. Neilsen, 332 N.E.2d 240 (Ind. Ct. App. 1975); Gowing v. Great Plains Mut. Ins. Co., 483 P.2d 1072 (Kan. 1971); Dochod v. Central Mut. Ins. Co., 264 N.W.2d 122 (Mich. Ct. App. 1978); *see also supra* notes 125–43 and accompanying text.

<sup>313</sup> *See, e.g.*, Carter Lake v. Aetna Casualty & Sur. Co., 604 F.2d 1052 (8th Cir. 1979) (applying Iowa law); Bay State Ins. Co. v. Wilson, 451 N.E.2d 880 (Ill. 1983); Northwestern Nat’l Casualty Co. v. Phalen, 597 P.2d 720 (Mont. 1979).

<sup>314</sup> *See supra* note 298 and accompanying text.

<sup>315</sup> *See, e.g.*, Home Ins. Co. v. Neilsen, 332 N.E.2d 240 (Ind. Ct. App. 1975); Foxley & Co. v. United States Fidelity & Guar. Co., 277 N.W.2d 686 (Neb. 1979); Pachucki v. Republic Ins. Co., 278 N.W.2d 898 (Wis. 1979). *See generally* Rigelhaupt, *supra* note 295.

constitute adhesion contracts that are seldom read by the insured. On the other hand, the Functionalistic noncontractual Keeton doctrine of reasonable expectations also has been justly criticized for varying from the express terms of the insurance contract, and for being applied by the courts in an inconsistent and uneven manner.

A better-reasoned middle ground interpretive approach to insurance contract disputes should be utilized by more American courts. This middle ground interpretive approach continues to recognize the traditional insurance law doctrine holding that, in general, insurance contracts should be construed according to general principles of contract law, unless modified or regulated by state statute, or unless contrary to state public policy. However, in order to validate the reasonable expectations of the insured to coverage, this middle ground interpretive view of insurance coverage disputes further recognizes a number of supplemental rules of construction in favor of the insured: (1) that insurance contracts will be construed and interpreted in their ordinary sense, rather than in a purely technical or legal sense; (2) that ambiguous insurance contracts will be construed liberally in favor of the insured and construed strictly against the insurer; (3) that based on the acts and representations made by the insurer or its agents, the doctrines of waiver, estoppel, election, and reformation of contract are available to the insured and should be liberally construed to validate the insured's reasonable expectation of coverage; and (4) that in order to further validate the reasonable expectations of the insured to coverage, any exclusion, exception, or limitation to coverage must be clearly, expressly, and unambiguously stated in the insurance contract. These are not the only middle ground supplemental rules of insurance contract interpretation, but arguably they constitute the most important supplemental rules.

A middle ground interpretive approach still allows for a great deal of judicial discretion in ascertaining and honoring the reasonable expectations of the insured to coverage, but within certain delineated parameters and interpretive rules that are supplemental to, rather than at variance with, the policy language within the insurance contract itself. A middle ground interpretive approach to insurance contract disputes therefore recognizes the "text" of an insurance contract, while at the same time it also recognizes the "context" of honoring the reasonable expectations of the insured to coverage—but without the necessity of adopting Professor Keeton's noncontractual doctrine of reasonable expectations at variance with the language in the insurance policy. A middle ground interpretive approach to insurance contract disputes therefore adopts the principle—if not the doctrine—of an insured's reasonable expectation to coverage, while at the same time remaining relatively true to, and consistent with, its underlying contractual roots, rationales, and defenses. It is a middle ground interpretive approach that successfully

reconciles the competing doctrines of Legal Formalism and Legal Functionalism in an insurance law context.