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Kent D. Syverud
*University of Michigan Law School*

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# INSURANCE LAW OUT OF THE SHADOWS

*Kent D. Syverud**

INSURANCE LAW AND REGULATION: CASES AND MATERIALS. By *Kenneth S. Abraham.* Westbury, New York: The Foundation Press. 1990. Pp. xxxvii, 752. $36.95.

> If seashells are currency, we will have a detailed, intricate and comprehensive law of wampum; if seashells cease to be currency, the law of wampum will gradually die and be forgotten.
>
> — Grant Gilmore[1]

Judging by the curricula of law and business schools, insurance went the way of wampum during the 1970s and early 1980s. Business schools eliminated their insurance programs as they retired their insurance teachers, and law schools pushed insurance into the shadows as they came to spotlight constitutional law, interdisciplinary studies, and corporations. At least at my university, insurance law provoked about as much passion as the law of wampum: it might be detailed, intricate, and comprehensive, but why bother?

We should bother because, as Kenneth Abraham reminds us in the preface (p. xxi) and throughout his new coursebook on insurance law, insurance remains a big part of the currency of American courts and economic behavior. Insurance law mushroomed in the 1970s and 1980s by any measure except attention from law schools. Thousands of lawyers retooled themselves into insurance experts as courts struggled with numerous and complex coverage disputes, bad faith claims, and environmental cleanup suits. For legislatures and the public, "tort reform" increasingly came to mean liability insurance reform, and was pursued with a vengeance. And in the rest of the academy — among economists, sociologists, psychologists, and engineers — human response to risk and uncertainty became an important item on the research agenda.

Why did insurance fade from view at law schools (and, for that matter, in law reviews) as its importance everywhere else seemed to increase? Part of the answer must be that few law professors wanted to teach or write about it. One look at the leading treatise on insur-

* Assistant Professor, University of Michigan Law School. B.S.F.S. 1977, Georgetown University; J.D. 1981, M.A. 1983, University of Michigan. — Ed. I thank Leo Katz for helpful comments, and Francis A. Allen, whose essay, *In Praise of Book Reviews,* 79 MICH. L. REV. 557 (1981), persuaded me that a book review, even of a coursebook, might be a worthwhile endeavor for a scholar even if it is not the acme of scholarship.

1. G. GILMORE, THE DEATH OF CONTRACT 9 (1974).

ance law would have deterred most scholars, who would have found forty-three volumes of hopelessly complicated and convoluted state law doctrine, encrusted by layer upon layer of far-from-uniform state legislation and regulation.[2] An attempt to use it in answering a "simple" question would inevitably send one careening among the volumes and pocket parts, all the while being drawn deeper into the morass.

The available teaching materials, though by no means as daunting, did not exactly welcome the novice teacher weaned on interdisciplinary studies and federal and constitutional law. The insurance law coursebooks, which were often well written and researched, were also largely devoid of any reference to prevailing fashions in economic theory and jurisprudence. Small wonder that younger scholars were deflected to torts, contracts, and conflicts — subjects that at the very least had a *Restatement* and a set of recent law review articles to start from.

Of course, a group of hardy scholars persevered in teaching, thinking, and writing about insurance, with Professor Abraham and his colleague on the Virginia Law School faculty, Jeffrey O'Connell, by no means least among them. Professor Abraham's previous book, *Distributing Risk*,[3] an economic and jurisprudential analysis of insurance law, has done more to stimulate scholars' attention to insurance law than anything since the writings of Robert Keeton and Spencer Kimball.[4] It is cause for celebration that Professor Abraham's new coursebook, if used properly, promises to have the same effect on students in the classroom.

The oddest thing about this book is how *traditional* it will first appear to teachers and students who use it. The first three chapters ("Introduction," "Insurance Contract Formation and Meaning," and "Insurance Regulation") look, at first blush, like a faithfully abridged version of the contract interpretation and regulatory materials that once occupied two thirds of an insurance syllabus (and that, in my experience, often induced a stupor in all but the most compulsive law students). The insurance warranty, the rule of *"contra proferentem,"* the doctrine of reasonable expectations, and the regulatory definition of insurance — all this standard insurance law fare is confronted early.

Most of the rest of the book is organized by line of insurance, with

2. *See* J. APPLEMAN, INSURANCE LAW AND PRACTICE (1941). By 1979, Appleman on insurance law had grown to 40 volumes, with three additional bound cumulative supplements and numerous pocket parts. Today, the treatise is updated by a legion of successors to the original author and occupies 58 volumes.

3. K. ABRAHAM, DISTRIBUTING RISK: INSURANCE, LEGAL THEORY, AND PUBLIC POLICY (1986).

4. *See, e.g.*, Keeton, *Insurance Law Rights at Variance with Policy Provisions* (pts. 1-2), 83 HARV. L. REV. 961, 1281 (1970); Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136 (1954); Kimball, *The Purpose of Insurance Regulation: A Preliminary Inquiry in the Theory of Insurance Law*, 45 MINN. L. REV. 471 (1961).

chapters devoted to fire and property insurance; life, health, and disability insurance; liability insurance; and automobile insurance. This organization leaves everyone clear on their bearings as they work through the course, but it is hardly revolutionary. A sense of the traditional is reinforced by Professor Abraham's retention of many of the "old chestnut" cases in insurance law, either in edited form in the text or, more often, in the form of a summary of the facts and issues in a note following a more recent authority.

Professor Abraham's coursebook departs from tradition, however, in three systematic and important ways. First and most notably, the cases and note materials throughout require the student to confront the economics of insurance law and regulation. One overarching theme is the related problems of adverse selection and moral hazard — the tendency of insurance (1) to attract purchasers who have reason to know they are more vulnerable than the general population to an insured risk (adverse selection) and (2) to reduce the incentives of insureds to take precautions against risks covered by an insurance policy (moral hazard). The insurer's difficulty in discovering information hidden by applicants for insurance, and in monitoring precautions taken by those who are issued policies (both, essentially, problems of imperfect information) may severely limit the insurability of many risks. These problems have been an important focus of work on insurance by economists and sociologists.[5] In law textbooks, however, adverse selection and moral hazard are often footnote material.

Adverse selection and moral hazard do not belong in the footnotes, and Professor Abraham uses traditional insurance law doctrine to show why. Thus, the very first case in the book, *Vlastos v. Sumitomo Marine & Fire Insurance Company*[6] (known in the trade both as "the janitor's residence case" and as the best recent opinion from which to teach the hoary doctrine of the insurance warranty), is preceded by a concise summary of the problem of adverse selection and moral hazard (pp. 3-5). The notes and cases which follow trace the evolution of insurance law doctrine from the strict enforcement of warranties to the increasingly lax definition of materiality in representations (pp. 10-27). It takes little effort in teaching this material to get students to identify early warranty doctrine as a method by which courts helped insurers manage adverse selection and moral hazard, and thereby fostered a market for insurance of some risks that might otherwise remain uninsurable. The casebook further challenges the student to ask whether those justifications for warranty doctrine (which originated in marine insurance, where precautions and routes were particularly dif-

5. For an overview of this literature as well as a major contribution to it, see C. HEIMER, REACTIVE RISK AND RATIONAL ACTION: MANAGING MORAL HAZARD IN INSURANCE CONTRACTS (1985).

6. 707 F.2d 775 (3d Cir. 1983) (reprinted at pp. 5-9).

ficult to monitor), remain valid in modern contexts, including health and life insurance for persons who suspect they are infected with the AIDS virus. The ensuing classroom discussion is often heated and enlightening.

Fortunately, the coursebook is not monomaniacal in applying economics to insurance law and insurance policies. The materials are designed to inspire hard thought about why a particular contract clause, regulation, or statute is written (and interpreted) in a particular way. The economics of risk and insurance often are invoked to provide part of the answer, but not to terminate the discussion. For example, the materials on health and disability insurance in Chapter Five work particularly well in presenting the welter of market and "public policy" forces that produce our troubled first-party insurance system for injuries and diseases (pp. 356-410). Throughout the book, Professor Abraham provides the text of relevant insurance policies and observations on the drafting process to guide the student's analysis.

The second important deviation from tradition in this coursebook is its thorough treatment of two important but often overlooked facets of modern insurance arrangements: coordination of coverage and reinsurance. The materials on coordination of coverage (which are somewhat distractingly divided between Chapter Five and Chapter Nine) are particularly important and particularly difficult to bring alive in the classroom. When several insurance policies (or other sources) arguably cover the same loss, courts invoke a complex set of rules — drawn from contract language, interinsurer agreements, statute, and judicial intuition — to allocate the overlapping liability. Professor Abraham's earlier scholarship assessed theories underlying attempts to coordinate insurance coverage;[7] the coursebook materials are a framework for presenting those ideas for class discussion. Chapter Five focuses on coordination in the health insurance context, while Chapter Nine primarily addresses coverage disputes among liability insurers.

It is difficult to overstate the amount of energy and money that has been expended on these issues in the past twenty years — in litigating, for example, which of a series of liability insurance policies issued over several decades to an insured covers a claim for injuries from an asbestos-related disease.[8] The casebook does an excellent job of presenting

7. K. ABRAHAM, *supra* note 3, at 133-72.

8. This asbestos coverage problem arises because the revised Comprehensive General Liability Policy covers bodily injuries and property damage that occur during the policy period. For long-latency illnesses such as asbestosis, it is unclear from the policy language whether the bodily injury occurs at the time of exposure (when one insurer's policy may be in force), at the time the victim manifests symptoms (when another insurer's policy may be in force), at the time the injury is diagnosed and medical expenses are incurred (still another insurer, of course), or at all three times. After years of litigation employing legions of lawyers, state courts still are hopelessly divided. The Abraham coursebook offers a concise overview of this issue through an excerpt of

what is at stake in these decisions, and of making students appreciate why global solutions are difficult. In a sentence, virtually every articulable purpose for insurance law — from promoting the principle of indemnity, to managing moral hazard, to reducing the transaction costs of negotiating an insurance contract, to expanding coverage for particular losses, to distributing losses more fairly — can be promoted through fine-tuning the legal and market devices of coordination. Professor Abraham is hopeful that out of this atomistic collection of private, bilateral arrangements and judicial opinions will emerge a system of coordination in which the courts' generally acknowledged (and limited) role will be to provide clear rules that supplement private arrangements only when markets fail. The goal is laudable, though I am not sanguine it will be achieved anytime soon. In any event, this material is the most intellectually challenging in the course, but also the hardest to teach and the most likely to bewilder students on a final examination.

The reinsurance materials in the final chapter of the book are a particularly welcome innovation. Reinsurance lurks unexamined beneath American insurance arrangements in much the same way liability insurance undergirds and makes possible American tort law. Through a reinsurance contract (called a treaty or a facultative agreement), a reinsurance company assumes all or some fraction of a risk (or book of risks) that another insurance company (the primary insurer) has covered by selling a policy to a customer. It is largely through reinsurance that the loss from a hurricane or the liability from a toxic waste dump is spread worldwide, and without reinsurance the American insurance market could not continue to support so many thousands of relatively small and thinly capitalized insurers. Reinsurers — many of which are foreign companies or syndicates — are therefore a powerful (and usually positive) force in structuring insurance markets in the United States.

Professor Abraham's coursebook is the first set of teaching materials I have seen in which reinsurance arrangements are explored in depth. This is done primarily through excerpts from the handful of reported cases that interpreted reinsurance contracts in disputes between primary insurance companies and reinsurers (pp. 718-27). Materials on reinsurer liability in the event of primary insurer insolvency also are included, although the case law again is sparse. It is worthwhile to teach this material, and not just because federal and state regulators and attorneys general have recently become fascinated by reinsurance. In a global economy many peculiar American methods for distributing risk, such as the way we impose, insure, and process legal liability, are under severe stress, and reinsurance markets are

Judge Sofaer's opinion in American Home Prod. Corp. v. Liberty Mut. Ins. Corp., 565 F. Supp. 1485 (S.D.N.Y. 1983), and notes following the case. Pp. 677-91.

likely to become (indeed, already are) major agents for change. An insurance course oriented toward the future will emphasize reinsurance, not just through the coursebook but also through supplementary materials.[9]

This coursebook's final departure from tradition will perhaps be its most welcome feature: the materials are mercifully brief. At 740 pages, almost all with large print and a single column, the text seems almost pithy compared to most coursebooks on insurance or other legal subjects. It is possible to teach from every one of those pages in a semester with relatively few breathless lectures sprinting across whole sections of material. At times, the brevity drives students to secondary sources for longer and more thorough explanations of how certain types of insurance work. This is particularly true, I found, with the materials on automobile insurance in Chapter Eight. Usually reference to a short list of books on reserve in the law library — with Jerry's *Understanding Insurance Law,*[10] Widiss' *Uninsured and Underinsured Motorist Insurance,*[11] and Windt's *Insurance Claims and Disputes*[12] near the top of it — will more than satisfy students' needs.

But thank heaven Professor Abraham resisted "the anxiety about 'completeness' that often transforms modern coursebooks into encyclopedias at the expense of their pedagogical utility."[13] A brief coursebook on insurance not only focuses attention on a manageable set of ideas and applications, but leaves some time and energy to read and discuss additional materials selected by each teacher to capture his or her own interests and perspective on the subject. I supplemented the Abraham casebook every sixth class with additional readings that included Viviana Zelizer's history of child life insurance in the United States,[14] the California ballot pamphlet that accompanied Proposition 103 (a consumer initiative to roll back property/casualty insurance rates),[15] Michael Trebilcock's survey of the world's no-fault compensation programs,[16] Laurence Ross' account of the processing of automobile insurance claims,[17] and Jeffrey O'Connell's proposals for

9. For a brief and readable introduction to the subject, see INSURANCE INFORMATION INSTITUTE, REINSURANCE: FUNDAMENTALS AND NEW CHALLENGES (2d ed. 1989). Two essential references for the teacher are K. GERATHEWOHL, REINSURANCE PRINCIPLES AND PRACTICE (J. La Bonté trans. 1980) and R. STRAIN, REINSURANCE (1980).

10. R. JERRY, UNDERSTANDING INSURANCE LAW (1987).

11. A. WIDISS, UNINSURED AND UNDERINSURED MOTORIST INSURANCE (2d ed. 1990).

12. A. WINDT, INSURANCE CLAIMS AND DISPUTES (2d ed. 1988).

13. Allen, *supra* *, at 559.

14. V. ZELIZER, PRICING THE PRICELESS CHILD 113-37 (1985).

15. CALIFORNIA SECRETARY OF STATE, CALIFORNIA BALLOT PAMPHLET: GENERAL ELECTION—NOV. 8, 1988.

16. Trebilcock, *Incentive Issues in the Design of 'No-Fault' Compensation Systems,* 39 U. TORONTO L.J. 19 (1989).

17. L. ROSS, SETTLED OUT OF COURT: THE SOCIAL PROCESS OF INSURANCE CLAIMS ADJUSTMENT (2d ed. 1980).

automobile insurance reform.[18] At least for me, the ensuing open discussion on these days nicely complemented the more rigorous treatment required in working through the Abraham materials. Few others would choose the same set of supplementary readings, and surely in many schools a focus on a state's unique laws and experiences would be appropriate. But a choice should be made, and some additional materials selected, if teachers hope to make their course "their own" in a way that will capture the students' imagination.

I wish more young legal scholars would appreciate what must be the least zealously guarded secret of the law school world: Insurance law can be a lot of fun. Students come to the course out of a sense of duty to their future careers, expecting to be bored. With a little imagination, a teacher can confront those low expectations with an endless series of challenging puzzles from insurance law doctrine — puzzles that are obviously important and relevant to daily life, that call upon all the tools of the well-trained advocate, and that highlight the remarkable ways this society assigns and redistributes risks. The teacher is drawn in as well, for regardless of his or her perspective — as a practitioner, an economist, a historian, a scholar of regulation, or a social critic — the answers rarely seem pat, and always bear further reflection on reteaching.

Kenneth Abraham's coursebook will go a long way toward broadcasting this secret in the law schools. It is a teachable set of materials that permits the instructor to fascinate students without overwhelming them with minutiae. It permits scholars who want to teach more than doctrine — who are interested in economics and jurisprudence — to integrate their thinking into the course without overwhelming its coherence or general interest to students. And, with a little luck, it may pique the interest of enough students and future scholars to finally bring insurance law out of the law school shadows and into the spotlight it already enjoys in the rest of the legal world.

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18. O'Connell & Joost, *Giving Motorists a Choice Between Fault and No-Fault Insurance*, 72 VA. L. REV. 61 (1986).