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A THEORY OF INSURANCE POLICY INTERPRETATION

Kenneth S. Abraham*

The first principle of insurance law is captured by the maxim *contra proferentem*, which directs that ambiguities in a contract be interpreted "against the drafter,"¹ who is almost always the insurer.² Yet given the modern recognition that language is an inherently imperfect instrument for communicating meaning, insurance policy provisions are in a sense always ambiguous. Moreover, in addition to *contra profer-*

* Class of 1962 Professor of Law and John V. Ray Research Professor, University of Virginia School of Law. A.B. 1967, Indiana University; J.D. 1971, Yale. — Ed. I am grateful to participants in workshops at the Law Schools of Indiana University (Bloomington), the University of Michigan, and the University of Virginia for helpful comments on an earlier version of this article. In the interest of full disclosure, it should be noted that on occasion I have served as a consultant to attorneys representing policyholders in insurance coverage disputes.

1. See KENNETH S. ABRAHAM, *INSURANCE LAW AND REGULATION: CASES AND MATERIALS* 38-47 (2d ed. 1995) [hereinafter ABRAHAM, *INSURANCE LAW*]; 3 ARTHUR L. CORBIN, *CORBIN ON CONTRACTS* § 559 (1960 & Supp. 1996); E. ALLAN FARNSWORTH, *CONTRACTS* 518-19 (2d ed. 1990); ROBERT H. JERRY, II, *UNDERSTANDING INSURANCE LAW* § 25C, at 105 (1987); ROBERT E. KEETON & ALAN I. WIDISS, *INSURANCE LAW* § 6.3(a)(2) (Practitioner's ed. 1988); JEFFREY W. STEMPEL, *INTERPRETATION OF INSURANCE CONTRACTS: LAW AND STRATEGY FOR INSURERS AND POLICYHOLDERS* § 5.2, at 180-81 (1994).

2. In fact, insurance policies are so commonly drafted by insurance companies that the principle is routinely transformed into a rule that ambiguities in an insurance policy are to be interpreted in favor of coverage. See KEETON & WIDISS, *supra* note 1, § 6.3(a)(2), at 630 n.6 ("[W]here semantically possible the policy will be construed to achieve its manifest objective of indemnifying the insured against the type of losses to which the policy relates." (quoting *Spaid v. Cal-Western States Life Ins. Co.*, 182 Cal. Rptr. 3, 5 (Cal. Ct. App. 1982))); James M. Fischer, *Why Are Insurance Contracts Subject to Special Rules of Interpretation?: Text Versus Context*, 24 ARIZ. ST. L.J. 995, 1003 (1992) ("[T]o the general rule that the contract should be construed as a whole . . . we add the insurance rule that 'where two interpretations equally fair may be made, that which affords the greatest measure of protection to the insured will prevail.'" (quoting *Maxon v. Security Ins. Co.*, 29 Cal. Rptr. 586, 590 (Cal. Ct. App. 1963))); Peter Nash Swisher, *Judicial Interpretations of Contract Disputes: Toward a Realistic Middle Ground Approach*, 57 OHIO ST. L.J. 543, 567 (1996); Stephen J. Ware, *A Critique of the Reasonable Expectations Doctrine*, 56 U. CHI. L. REV. 1461, 1464-65 (1989) ("Virtually all courts follow this rule and construe ambiguities in an insurance contract against the insurer, in favor of coverage."); see also STEMPEL, *supra* note 1, § 5.2, at 184 (noting that the goal of risk spreading weighs in favor of finding coverage "absent clear language to the contrary" when involving *contra proferentem*).

entem, policyholders may invoke such allied doctrines as waiver, estoppel, and the rule that the reasonable expectations of the insured should be honored even if those expectations are unambiguously contradicted by fine-print provisions in the policy.³ *Contra proferentem* and these other doctrines are so frequently invoked by the courts in insurance cases⁴ that the casual observer might well suppose that the *true* first principle of insurance law is that insurance disputes are generally resolved in favor of coverage. Indeed, in light of all these pro-coverage legal doctrines, it is surprising that insurers ever win disputes involving the meaning of policy provisions.

But of course insurers very often win coverage disputes, including those in which a policy provision is allegedly ambiguous. *Contra proferentem* is not merely a label for pro-coverage results reached for other reasons. Rather, the process of interpreting insurance policies cannot be adequately understood without recognizing the way in which *contra proferentem* helps to explain decisions both for and against policyholders. Similarly, by their own terms the doctrines of waiver and estoppel and the expectations principle have nothing to do with "interpretation" as it is normally understood. These doctrines direct that under specific circumstances the meaning of even clear policy language must be disregarded, not interpreted. But there remains a vague sense on the part of many observers of insurance law that these doctrines, which create rights "at variance" with policy provisions,⁵ nevertheless have something to do with interpretation, though precisely what has always been difficult to articulate.

In this article I analyze and explain how the courts actually employ *contra proferentem* and its allied doctrines in interpreting insurance policies by uncovering the factors that I believe most influence the process of interpretation. This effort exposes some of the difficulties that the courts have encountered in employing *contra proferentem* as the doctrine has evolved. I suggest, further, that the rise of the allied doctrines creating rights at variance with policy provisions at least in part reflects the courts' effort to grapple directly with the problems that they have been able to address only incompletely and indirectly under the rubric of *contra proferentem*. So conceived the allied doctrines are not, strictly

3. See KEETON & WIDISS, *supra* note 1, §§ 6.1(a)-(b), at 614-21.

4. To make a rough estimate of just how frequently *contra proferentem* alone is invoked, I performed a Westlaw search within the "Insurance" topic, in the state database alone, for opinions containing the term "ambig!" in the same paragraph as "policy" or "language" or "provision" or "provisions." The search disclosed 4416 opinions containing this language decided between 1980 and 1995.

5. See KEETON & WIDISS, *supra* note 1, §§ 6.1(a)-(b), at 614-15.

speaking, a *feature* of the interpretive process, but a *consequence* of that process.

To summarize my argument briefly, I contend that the misleadingly simple notion that ambiguous policy provisions should be interpreted in favor of coverage is comprised of two separate features: the linguistic standard against which the ambiguity of the disputed policy provision is judged, and the strength of policyholders' demand for the coverage that would be afforded by a pro-coverage interpretation of the policy provision in question. To complicate matters further, there are two ways to employ each of these two separate features. Consequently, what I call the "traditional" conception of *contra proferentem* is just one of four possible approaches to the interpretation of an arguably ambiguous policy provision. Although the courts typically talk as if they are applying the traditional conception, in fact they sometimes apply one of the other three.

Although my effort to understand how *contra proferentem* works is largely descriptive, it also has a normative component. The normative implication of my analysis is that courts are likely to get themselves into a variety of difficulties when they depart from the traditional conception of *contra proferentem*. Therefore, courts probably would do well to get back to basics and put out of the way many of the complicated considerations that have implicitly influenced their interpretation of insurance policies. At the same time, courts determined to depart from the traditional conception should be more candid about the scope and limits of their departures. I suggest a number of ways in which such courts could make their approaches more open and workable.

I. THE PURPOSE OF *CONTRA PROFERENTEM*

To understand what the courts are actually doing when they interpret ambiguous policy provisions, it is useful to first consider the normative basis of the doctrine. After identifying the purpose (or purposes) of *contra proferentem*, we can then attempt to analyze the manner in which the doctrine functions.

Why might the law require that ambiguous insurance policy provisions be interpreted in favor of coverage? The justification that the courts typically offer is that the drafter of an ambiguous policy provision should bear responsibility for ambiguity because the drafter has control over the language used in the policy.⁶ The notion of control as the basis for responsibility, however, is itself ambiguous. On the one

6. See, e.g., *Vargas v. Insurance Co. of N. Am.*, 651 F.2d 838, 841 (2d Cir. 1981).

hand, the notion may imply that ambiguous policy provisions are the result of faulty behavior by the insurer and that *contra proferentem* imposes something like liability for negligent drafting. On this view, *contra proferentem* imposes liability on insurers for employing unreasonably unclear policy provisions — provisions which do not have an optimal degree of clarity.⁷

On the other hand, the notion of control as the courts use it in their justifications for *contra proferentem* may imply responsibility without necessarily implying fault. This understanding of the connection between control and responsibility makes *contra proferentem* more closely resemble a version of strict liability. Like strict liability generally, imposing liability on insurers for including ambiguous provisions in their policies whether or not such provisions are unreasonably unclear might serve purposes that include, but extend beyond, those served by imposing liability only for unreasonably unclear policy provisions. For example, because of the difficulty and cost of determining the optimal degree of clarity in policy provisions, a strict liability standard may be superior to negligence in terms of both cost and accuracy. Furthermore, it seems likely that insurers in general rather than policyholders will be better bearers of the cost of the irreducible component of ambiguity that remains after optimal clarity is achieved.⁸

Whether the notion that control warrants responsibility is understood as negligence or as strict liability, however, there is missing from this bare notion a connection between the “breach” of employing an ambiguous policy provision and the harm that results from that breach. There are a number of possible connections. In contract-law terms, the application of *contra proferentem* to an ambiguous policy provision might be understood as the awarding of expectation damages for breach of the “promise” of coverage afforded by the ambiguous provision.⁹

7. Technically speaking, the optimal degree of clarity would minimize the sum of maldrafting costs plus maldrafting avoidance costs. Maldrafting costs consist primarily of the losses resulting from reliance by policyholders on the “false” promise of coverage afforded by ambiguous policy provisions. Maldrafting avoidance costs consist primarily of the drafting costs necessary to reduce or eliminate ambiguities.

8. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 107 (4th ed. 1992) (noting that *contra proferentem* assures policyholders that they have coverage if they misinterpret an ambiguous policy provision).

9. One might also understand the invocation of *contra proferentem* as ordering specific performance. Like expectation damages, specific performance is intended to compensate the expectation interest of the promisee. See L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages* (pt. 1), 46 *YALE L.J.* 52, 54 (1936) (arguing that both specific performance and expectation damages protect the expectation interest by seeking to “put the plaintiff in as good a position as he would have occupied had the defendant performed his promise”); Alan Schwartz, *The Case for Specific Per-*

This answer highlights the distinction between expectation and reliance damages. Why interpret an ambiguous policy provision against the drafter unless the policyholder would have behaved differently had he known that the loss in question was not insured? The same issue can be expressed in tort-law terms as a question of causation: Why is the policyholder not required to show that the coverage claimed could have (perhaps even would have) been purchased elsewhere?

In contract law, the generic answer to this kind of question is that reliance is often difficult and costly to prove,¹⁰ and that promisees are systematically undercompensated for the losses they suffer from breaches by promisors.¹¹ To encourage reliance, contract law typically dispenses with the requirement that it be proved. The same might be true of reliance by policyholders on the "promise" of coverage afforded by ambiguous policy provisions. If policyholders generally rely on these kinds of promises, it may be sensible to dispense with the requirement that reliance be proved — especially if such proof would be difficult and expensive.

In tort law similar answers are given when proof of causation is not required, though the causation requirement is relaxed much less fre-

formance, 89 YALE L.J. 271, 272 (1979) (noting that specific performance is ordered when damages are inadequate to protect the expectation interest). Of course in the insurance context the two remedies are not merely equivalent — they are identical.

10. See Fuller & Perdue, *supra* note 9, at 60 (noting, in reference to the reliance interest in foregone opportunities, that "the impossibility of subjecting this type of reliance to any kind of measurement may justify a categorical rule granting the value of the expectancy as the most effective way of compensating for such losses"); Michael B. Kelly, *The Phantom Reliance Interest in Contract Damages*, 1992 WIS. L. REV. 1755, 1761; Stewart Macaulay, *The Reliance Interest and the World Outside the Law Schools' Doors*, 1991 WIS. L. REV. 247, 249-50; W. David Slawson, *The Role of Reliance in Contract Damages*, 76 CORNELL L. REV. 197, 220-22 (1990).

11. See George M. Cohen, *The Fault Lines in Contract Damages*, 80 VA. L. REV. 1225, 1249-50 (1994) ("Both advocates and critics of the reliance measure have pointed to the fact that the expenditure measure courts most often use when awarding reliance damages only imperfectly compensates the promisee's 'reliance interest' because lost opportunities are not included . . ."); Slawson, *supra* note 10, at 219 ("Even by their own measure, reliance damages undercompensate in practice . . . [The plaintiff] is actually compensated only for his out-of-pocket expenses and receives nothing for his lost opportunities.").

Even expectation damages frequently do not achieve the compensation goal. See Macaulay, *supra* note 10, at 250 ("[R]equiring damages to be foreseeable and proved with reasonable certainty means that courts often will not protect all of a person's reasonable expectations."); Schwartz, *supra* note 9, at 274-78 (arguing that all contract damages are so often undercompensatory that the availability of specific performance should be greatly expanded). For a criticism of this concern with undercompensation, see Cohen, *supra*, at 1310-11 (arguing that "damages are undercompensatory when undercompensation is necessary to provide the parties with better incentives to take precautions or to mitigate; that is, compensation is an incidental concern").

quently than its contract analogue, reliance. When proof of individual causation is expensive and difficult, but it is clear that the defendant harmed an indeterminate group of victims, individual proof sometimes is not required.¹² Moreover, when the defendant is more likely to have access to evidence that could *disprove* causation than the plaintiff is to have access to evidence that could *prove* causation, the burden of proof may be shifted.¹³ And it is increasingly recognized in tort-law theory that proof of causation, far from being a moral or logical imperative, is just one simple and useful way of adding up the costs that a system designed to promote optimal deterrence of loss should take into account in deciding when to impose liability.¹⁴ The analogy to *contra proferentem* is that ambiguous policy provisions often harm policyholders even when pinpointing how is difficult. Requiring proof of causation therefore could be both expensive and counterproductive — if the losses of policyholders who would be denied coverage because they relied on ambiguous provisions but could not *prove* reliance would exceed the gains of those who at present receive coverage under *contra proferentem* even though they did not rely. By further analogy to tort law, it might follow that, when insurers have it within their power to disprove causation, they should be allowed to escape liability by doing so — perhaps by showing that the policyholder claiming coverage did not rely on the ambiguous provision.

12. See, e.g., *Michie v. Great Lakes Steel Div.*, 495 F.2d 213, 218 (6th Cir. 1974) (finding that when a plaintiff cannot reasonably be expected to prove the portion of a single harm caused by each independent tortfeasor, defendants will be held jointly and severally liable unless a defendant can prove the portion of harm for which it is responsible); *Sindell v. Abbott Labs.*, 607 P.2d 924 (Cal. 1980) (holding that when a plaintiff could not identify the individual manufacturer of the DES that caused her injury, each individual defendant would be liable for a share of the judgment proportional to its market share unless it could disprove causation).

13. See *Michie*, 495 F.2d at 218; *Summers v. Tice*, 199 P.2d 1, 4 (Cal. 1948); *Ybarra v. Spangard*, 154 P.2d 687, 690 (Cal. 1944). In *Summers v. Tice*, the court held that when two defendants acted negligently and the act of one caused the plaintiff harm, each defendant bore the burden of disproving causation, and in the absence of such proof they were jointly and severally liable:

When we consider the relative position of the parties and the results that would flow if plaintiff was required to pin the injury on one of the defendants only, a requirement that the burden of proof on that subject be shifted to defendants becomes manifest. . . . Ordinarily defendants are in a far better position to offer evidence to determine which one caused the injury.

Summers, 199 P.2d at 4.

14. See Guido Calabresi, *Concerning Cause and the Law of Torts: An Essay for Harry Kalven, Jr.*, 43 U. CHI. L. REV. 69, 85 (1975); Steven Shavell, *An Analysis of Causation and the Scope of Liability in the Law of Torts*, 9 J. LEGAL STUD. 463, 465-66 (1980).

This analysis provides plausible but empirically speculative justifications for *contra proferentem*. The question is whether (and if so, to what extent) the courts have employed *contra proferentem* in accordance with these justifications. In Parts II and III, I describe the factors that have influenced decisions in which *contra proferentem* is invoked and attempt to show the ways in which these factors are and are not congruent with the normative case for *contra proferentem*. In Part IV, I explain the way in which the allied doctrines of waiver, estoppel, and the reasonable expectations principle mesh with this analysis. Finally, in Part V, I explore the difficulties that would be faced by courts should they candidly and explicitly depart from the traditional conception of *contra proferentem*, and examine several devices that the courts might employ to cabin these departures.

II. THE TWO DIMENSIONS OF *CONTRA PROFERENTEM*

Because so much turns on whether a disputed policy provision is ambiguous, the first step in understanding insurance policy interpretation must be to discover the standards employed in assessing ambiguity. In my view the ambiguity decision seems so result-oriented to casual observers primarily because this decision involves two different and infrequently expressed dimensions of assessment. Moreover, not only do different courts subscribe to different standards in making these two assessments: the same courts also apply different standards from case to case. The first dimension of assessment is what I call the "linguistic standard of care"; the second dimension involves the degree of policyholder demand for the coverage in question.

A. *The Linguistic Standard of Care*

The first inquiry courts make to determine whether to invoke *contra proferentem* in one sense involves exactly what one would expect: scrutiny of the language of the policy provision whose meaning is at issue. The hornbook rule is that a policy provision is ambiguous if it is reasonably susceptible to two meanings.¹⁵ But in fact courts do not always apply this test. On some occasions, without saying so, courts take into account an additional, slightly different factor: whether the insurer could have feasibly made the relevant policy language unambiguous. To distinguish between these two approaches I will use the same terms I used in identifying the normative case for *contra proferentem* — strict liability and negligence. These terms have the decided advantage of be-

15. See STEMPER, *supra* note 1, § 5.3, at 186.

ing almost automatically understandable to the legal reader, both in themselves and in relation to each other. My use of these terms risks the disadvantage, however, of carrying some undesirable baggage and imprecision along with them. Despite this risk, in what follows I use the terms as shorthands, without necessarily intending to import into the analysis everything that the terms have come to mean in other settings.

1. *Strict Liability: The "Ordinary Reader" Standard*

The strict liability approach to ambiguity is the principal feature of the hornbook statement of *contra proferentem*, enunciated thousands of times by courts in every jurisdiction. If a policy provision is "ambiguous" — reasonably susceptible to more than one interpretation by the ordinary reader of the policy — then the provision is interpreted against the drafter and the interpretation more favorable to the insured governs, even if the provision could not reasonably be made less ambiguous. This strict liability standard circumvents a host of problems that would be posed by openly embracing a negligence standard. The most prominent of these would be the need to admit evidence regarding the alternative verbal formulations that might have been employed and the potentially numerous considerations that could reasonably have affected the choice among them.¹⁶

A strict liability standard may have a more important advantage as well. Suppose that the optimal standard of linguistic care were negligence rather than strict liability. If most ambiguous policy provisions would be adjudged negligent anyway, then use of a strict liability standard instead of a negligence standard would reduce the costs of decision at a relatively low rate of divergence from the negligence standard. The traditional conception may therefore both incur low transaction costs *and* be highly cost-effective in achieving the goal of identifying sub-optimal policy provisions.

The difficulty with the strict liability standard, however, is that it is opaque. It provides no guidance as to the criteria to be used in determining when a policy provision is or is not reasonably subject to two interpretations. The formulation presupposes something like an "I know

16. Drawing on the work of Lon Fuller, Professor James Henderson has described problems of this type as "polycentric," in that they "present innumerable analytical permutations to which the parties would logically be required to address themselves." As a consequence, "[m]eaningful participation in the [judicial] decision through formal proofs and argument . . . would be impossible. . . . Whatever the court might decide, its decision would not deserve to be called principled." James A. Henderson, Jr., *Judicial Review of Manufacturers' Conscious Design Choices: The Limits of Adjudication*, 73 COLUM. L. REV. 1531, 1536 (1973).

it when I see it" or "I know what the ordinary reader would understand" test,¹⁷ aided perhaps by some other aged maxims of interpretation.¹⁸ The difficulty of determining whether a contract provision is ambiguous simply by staring at the contract has led some courts in both general contract law and in insurance law to adopt the "modern" view that extrinsic evidence of the meaning that the parties attached to a con-

17. See, e.g., *Liggans R.V. Center v. John Deere Ins. Co.*, 575 So. 2d 567, 571 (Ala. 1991) (stating that insurance policy unambiguously distinguished between losses due to theft and losses due to false pretenses when "theft" is read as an ordinary person of average understanding would read the term); *McGreehan v. California State Auto. Assn.*, 1 Cal. Rptr. 2d 235, 238 (Cal. Ct. App. 1991) (using the understanding of the ordinary person in construing insurance contracts); *Allstate Ins. Co. v. Willison*, 885 P.2d 342, 344 (Colo. Ct. App. 1994) (stating that an insurance contract must be interpreted from the perspective of the ordinary reader); *Nugget Oil, Inc. v. Universal Sec. Ins. Co.*, 584 So. 2d 1068, 1070 (Fla. Dist. Ct. App. 1991) ("We are bound to assign to contract provisions the meaning that would be attached to them by an ordinary person of average understanding."); *West Trucking Line, Inc. v. Northland Ins. Co.*, 459 N.W.2d 262, 264 (Iowa 1990) (noting that because policyholders' underinsured motorist coverage unambiguously excluded property damage, the "policy language expressly limits the coverage to bodily injury damages and is easily understandable to an ordinary person"); *Meiners v. Aetna Casualty & Sur. Co.*, 645 A.2d 9, 10 (Me. 1994) ("A[n insurance] policy is ambiguous if an ordinary person in the shoes of the insured would not understand that the policy did not cover claims such as the [one being] brought." (quoting *Allstate Ins. Co. v. Elwell*, 513 A.2d 269, 271 (Me. 1986))); *Sellie v. North Dakota Ins. Guar. Assn.*, 494 N.W.2d 151, 157 (N.D. 1992) (holding that in a dispute between insurer and insured a court is concerned with what the "ordinary person's understanding of the policy would be" (quoting *Sparks v. Republic Natl. Life Ins. Co.*, 647 P.2d 1127, 1135 (Ariz. 1982))); *Pressman v. Aetna Casualty & Sur. Co.*, 574 A.2d 757, 760 (R.I. 1990) ("[T]he terms should be read in the same sense that the insurer had reason to believe would be the way they would be interpreted by the ordinary reader and purchaser.").

18. For example, courts occasionally employ the maxim "*inclusio unius est exclusio alterius*" or "*expressio unius est exclusio alterius*" (the inclusion or expression of one is the exclusion of another) to determine the meaning of ambiguous policy language. See, e.g., *Chicago Bd. Options Exch., Inc. v. Connecticut Gen. Life Ins. Co.*, 713 F.2d 254, 258 (7th Cir. 1983) (finding that under the maxim *expressio unius*, the omission of contractholders from a list of parties who need not consent to a contract term amendment, together with a provision apparently granting to the insurer an absolute right to amend, created an ambiguity in the policy); *Fidelity & Casualty Co. of New York v. Commander*, 231 F.2d 347, 351 (4th Cir. 1956); *Hensley v. Erie Ins. Co.*, 283 S.E.2d 227, 230 (W.Va. 1981) ("Not only does the rule of strict construction against the insurance company apply but the familiar rule that the specific inclusion of one subject excludes all others is also applicable."); cf. *Steven v. Fidelity & Casualty Co. of New York*, 27 Cal. Rptr. 172, 177-78 (Cal. 1962) (en banc) (noting that the invocation of *expressio unius* amounts to recognition of an ambiguity in the contract, but that the maxim should not be invoked to defeat the rule that ambiguous terms should be construed against the insurer because it is a legalistic concept that does not enter the understanding of the ordinary layman); *Marcolini v. Allstate Ins. Co.*, 278 A.2d 796, 799 (Conn. 1971) (holding the maxim *expressio unius* "should not be used to create an ambiguity").

tract term may be admitted not only after the term is determined to be ambiguous, but also in order to prove that the term is ambiguous.¹⁹

Unfortunately, this development merely shifts the locus of uncertainty. In the absence of criteria for assessing the purported ambiguity of a policy provision, extrinsic evidence may or may not aid resolution of the issue. In cases involving negotiated contract language, proof of a mutually "intended" meaning different from an "objective" meaning might serve as an effective test. In such cases evidence that the parties subjectively intended the disputed language to mean something different from its otherwise objective, unambiguous meaning may tend to show that the language is ambiguous. But in the insurance context, in which standard-form policy language is virtually always at issue, there is rarely a mutually intended "subjective" meaning, provable with extrinsic evidence, that differs from the otherwise unambiguous "objective" meaning of the policy language in question.²⁰ In short, strict liability either involves an almost completely intuitive judicial judgment about the susceptibility of disputed policy language to more than one interpretation, or masks the courts' use of a different, unarticulated standard.

2. *Negligence: The Perfectibility Standard*

If strict liability were always the standard employed in invoking *contra proferentem*, then insurers would win far fewer cases than they

19. See, e.g., *Taylor v. State Farm Mut. Auto. Ins. Co.*, 854 P.2d 1134, 1140-41 (Ariz. 1993) (en banc); *Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 442 P.2d 641, 645-46 (Cal. 1968); *Fire Ins. Exch. v. Rael*, 895 P.2d 1139, 1143 (Colo. Ct. App. 1995); *Denny's Restaurants, Inc. v. Security Union Title Ins. Co.*, 859 P.2d 619, 626 (Wash. Ct. App. 1993) (citing *Continental Ins. Co. v. Paccar, Inc.*, 634 P.2d 291 (Wash. 1981)). In *Pacific Gas*, the court stated:

The fact that the terms . . . appear clear to a judge does not preclude the possibility that the parties chose the language of the instrument to express different terms. . . . Accordingly, rational interpretation requires at least a preliminary consideration of all credible evidence offered to prove the intention of the parties. . . . If the court decides, after considering this evidence, that the language of a contract . . . is 'fairly susceptible of either one of the two interpretations contended for,' extrinsic evidence relevant to prove either of such meanings is admissible.

Pacific Gas, 442 P.2d at 645-46 (citations omitted).

20. Such problems exist in the general contract context as well. See Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261, 268-69 (1985). It is worth noting, however, that a number of prominent courts in recent insurance cases have consulted extrinsic evidence in an effort to discern the meaning of disputed policy provisions. See, e.g., *Montrose Chem. Corp. v. Admiral Ins. Co.*, 913 P.2d 878, 891 (Cal. 1995) (en banc) (using evidence of drafting history); *Morton Int'l., Inc. v. General Accident Ins. Co. of Am.*, 629 A.2d 831, 847-48 (N.J. 1993) (using evidence of representations made in the course of effort to secure regulatory approval of a provision).

do. I do not believe, however, that when insurers defeat ambiguity claims they do so because the court has capriciously decided not to invoke *contra proferentem*. Rather, in some of the cases in which courts employ strict liability discourse, a more limited form of liability that resembles a negligence standard actually guides the decisionmaking process. Because this standard remains unarticulated, its contours are not entirely clear. But in essence the standard seems to require not only that the policy provision at issue be susceptible to more than one reasonable interpretation, but also that it be feasible to perfect the policy language sufficiently to eliminate the ambiguity.

Two versions of a perfectibility standard are embedded in the case law. The "hindsight" approach asks whether, at the time of the coverage dispute, the policy provision in question could have been perfected. For example, standard CGL (first "Comprehensive," then "Commercial" General Liability²¹) insurance policies for decades have covered liability payable "as damages" because of bodily injury or property damage. After CERCLA²² was enacted in 1980 and the Environmental Protection Agency began to order cleanup of waste deposit sites pursuant to its authority under the statute, many of the companies that were the recipients of cleanup orders claimed coverage under their CGL insurance policies for the costs of cleanup. In response to such claims, insurers argued that a policyholder incurring costs to comply with an administrative cleanup order or a judicial injunction had not been subjected to liability payable "as damages." Often the courts held, however, that cleanup costs incurred by policyholders in response to such orders are covered by CGL policies because (among other things) the phrase "as damages" is ambiguous.²³ These courts considered it irrelevant that at the time the applicable policies were sold, CERCLA had been neither enacted nor anticipated. The question in these cases was not whether the insurer could reasonably have foreseen the enactment of CERCLA, but whether, with hindsight, the phrase "as damages"

21. See ABRAHAM, INSURANCE LAW, *supra* note 1, at 448.

22. Comprehensive Environmental Response, Compensation and Liability Act of 1980, Pub. L. No. 96-510, 94 Stat. 2767 (codified as amended in scattered sections of 26, 33, 42, and 49 U.S.C.).

23. See, e.g., *AIU Ins. Co. v. Superior Court*, 799 P.2d 1253, 1278 (Cal. 1990); *United States Fidelity & Guar. Co. v. Specialty Coatings Co.*, 535 N.E.2d 1071, 1080 (Ill. App. Ct. 1989); *Hazen Paper Co. v. United States Fidelity & Guar. Co.*, 555 N.E.2d 576, 583 (Mass. 1990); *Minnesota Mining & Mfg. Co. v. Travelers Indem. Co.*, 457 N.W.2d 175, 179-81 (Minn. 1990); *C.D. Spangler Constr. Co. v. Industrial Crankshaft & Engg. Co.*, 388 S.E.2d 557, 569 (N.C. 1990).

could have been perfected so as to achieve the insurers' purported interpretation more clearly.²⁴

In contrast, a "foresight" perfectibility standard looks not only to the quality of the policy language in dispute, but also to the reasonableness of the insurer's failure — at the time the policy was drafted — to perfect that language. For example, occasionally a decision invoking *contra proferentem* notes how simple it would have been for the insurer to draft a clearer provision: "Where the risk is well known and there are terms reasonably apt and precise to describe it, the use of substantially less certain phraseology, upon which dictionaries and common understanding may fairly differ, is likely to result in interpretations favoring coverage rather than exclusion."²⁵ Although such reasoning does not expressly invoke a foresight perfectibility standard, it presupposes one. Otherwise it would be irrelevant that the risk was "known" and that the provision in question could have been drafted more clearly.²⁶

Openly formulating and applying a perfectibility standard — especially a foresight standard — would be a far more complex exercise than is required under strict liability. A strict liability standard is self-applying, even if it is not self-defining. But a perfectibility standard requires both definition and factual application to the policy provision at hand. On some occasions neither is difficult because the negligent drafting merely involves the failure of the insurer to include simple, straightforward language. For example, in *Vlastos v. Sumitomo Marine & Fire Insurance Company*,²⁷ the court dismissed the insurers' argument that the disputed policy provision was unambiguous in part because "the insurers easily could have precluded doubt by the addition of one word."²⁸

24. This test lies about midway between strict liability and negligence in the tort-law sense. The former does not require perfectibility, as does the hindsight-perfectibility test, but neither does the hindsight test require foresight, as does a pure negligence test.

25. *Pan American World Airways, Inc. v. Aetna Casualty & Sur. Co.*, 368 F. Supp. 1098, 1118 (S.D.N.Y. 1973), *aff'd.*, 505 F.2d 989 (2d Cir. 1974).

26. Similarly, when multiple CGL policies issued in different years potentially cover the same loss, insurers sometimes argue that the insured can claim coverage under only one of these policies or — if there are not only primary, but also excess policies — one of these years. There is evidence in the drafting history of the 1966 revision of the CGL policy, however, that insurers anticipated this issue and consciously decided not to address it in the revised version of the policy. *See Montrose Chem. Corp. v. Admiral Ins. Co.*, 913 P.2d 878, 891 (Cal. 1995) (en banc). The fact that the drafters anticipated this problem would of course be highly relevant under a foresight approach, but irrelevant under a hindsight approach.

27. 707 F.2d 775 (3d Cir. 1983).

28. 707 F.2d at 779. The policy at issue in *Vlastos* provided, "Warranted that the 3rd floor is occupied as [a] Janitor's residence." 707 F.2d at 776. The insurer denied

Making ambiguous policy language more clear, however, is not always a matter of merely adding a word or substituting a clear phrase for a vague one. Sometimes the problem is that the issue addressed by putatively ambiguous policy language is sufficiently complex, or involves enough permutations, that a much longer and more detailed provision would be required to improve upon the policy language that was actually employed. In this situation resolving the perfectibility issue would require a court to address the optimal length, complexity, and precision of the policy provision in question. For example, standard liability insurance policies impose on the insurer a duty to defend the insured against any suit alleging a liability that would fall within coverage if proved.²⁹ The policies do not indicate the scope of the insurer's duty when a complaint contains some counts alleging liability that would fall within coverage if proved, and other counts alleging liability that would not fall within coverage even if proved. Nor does the typical duty-to-defend provision indicate the scope of the insurer's duty when the allegations of the complaint against the insured, if proved, would fall within coverage, but facts extrinsic to the complaint indicate that there would not be coverage — for instance, because the actual, as distinguished from the alleged, conduct of the insured falls within an exclusion.³⁰ It is not surprising that when the ambiguity of policy provisions such as those embodying the duty to defend is at issue, the courts rarely acknowledge their use of an implicit negligence standard. Acknowledgement would threaten to make admissible such evidence as drafting standards within the insurance industry, factors that were and reasonably should have been taken into account in fashioning the policy language at issue, alternative verbal formulations that the drafters did and

coverage of a fire loss because the evidence showed that a massage parlor occupied a portion of the third floor along with the Janitor's residence. The court suggested that the addition of the word "solely" between "occupied" and "as" could easily have rendered the provision unambiguous. *See* 707 F.2d at 779.

29. The standard CGL insurance policy provides:

We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. . . . *We will have the right and duty to defend any "suit" seeking those damages.*

INSURANCE SERVICES OFFICE, INC., COMMERCIAL GENERAL LIABILITY POLICY (1984), *reprinted in* ABRAHAM, *INSURANCE LAW*, *supra* note 1, at 440 (emphasis added).

30. The most common such example involves cases in which the insured is alleged to have acted negligently (a covered liability) but in fact acted expecting or intending harm (for which coverage of liability is excluded). *See, e.g.,* *Montrose Chem. Corp. v. Superior Court*, 861 P.2d 1153 (Cal. 1993) (en banc).

should have considered, and the cost of the coverage afforded by those alternative formulations.

The prospect that insurance coverage suits would be encumbered by disputes over the significance of these sorts of evidence surely deters courts from openly embracing a negligence standard. What the courts have not done expressly, however, they have done by implication. Instead of interpreting the duty-to-defend provision in favor of coverage in every instance in which it might be read to afford this protection, courts have constructed a complex web of rules detailing the circumstances under which the insurer does and does not have a duty to defend.³¹

Interestingly, while courts occasionally acknowledge the perfectibility standard when they hold that a policy provision *is* ambiguous, they virtually never acknowledge their use of this standard when they hold that a disputed policy provision *is not* ambiguous. In the former situation, stating that the ambiguous policy provision could have been perfected merely adds weight to the decision. But in the latter situation, reference to the perfectibility standard would constitute an admission that, in fact, not all ambiguous policy provisions are interpreted against the drafter. The result is that, probably more often than they are willing to admit, courts consider a disputed policy provision to be reasonably susceptible to more than one meaning — “ambiguous” — but they rule that the provision is unambiguous. The difficulty that observers of insurance disputes encounter in accurately predicting when a court will invoke *contra proferentem* could be reduced measurably if those observers recognized that something like a perfectibility test is sometimes applied to claims that a provision is ambiguous. This recognition, however, only gets us half the way to an understanding of how *contra proferentem* operates in practice.

B. *The Policyholder Demand Standard*

The second dimension of assessment that influences the ambiguity decision involves the degree of policyholder demand for the coverage that would be supplied to the policyholder by a finding that the policy language in question is ambiguous. As in the case of the linguistic standard of care, there are two possible approaches to evaluating the degree

31. See KENNETH S. ABRAHAM, *DISTRIBUTING RISK: INSURANCE, LEGAL THEORY, AND PUBLIC POLICY* 195-203 (1986). The actual content of these rules appears to be determined at least as much by the policyholder-demand considerations that I describe in the next section as by the perfectibility standard. My point here is that strict liability is typically rejected as the governing standard.

of policyholder demand for the disputed coverage. Once the linguistic standard of care to which the court subscribes is shown to have been breached, the choice between these two approaches determines whether the policyholder is granted relief — that is, whether the policy provision in question is actually declared to be ambiguous.

1. *The Penalty Standard*

Under what might be called a *penalty* standard,³² the degree of policyholder demand for the coverage at issue is irrelevant to the ambiguity decision. Under a penalty standard the insured is entitled to the coverage afforded by a pro-coverage interpretation of the purportedly ambiguous policy provision, even if most policyholders would not want to pay for such coverage if given the choice. The standard thus accomplishes what its name suggests: it penalizes the insurer for including ambiguous language in its policy.

A leading example of the use of a penalty standard is *Rusthoven v. Commercial Standard Insurance Co.*,³³ in which the policy contained inconsistent policy provisions. Rusthoven was injured by an uninsured motorist while driving a vehicle owned by his employer. The employer's auto policy provided coverage of losses caused by uninsured motorists, and the premium was based on the employer's gross receipts. At the time of the accident there were 67 autos in the employer's fleet. The declarations (cover page) of the policy listed the amount of uninsured motorists coverage as \$25,000 per person. The policy provided that

[r]egardless of the number of covered autos, insureds, claims made or vehicles involved in the accident, the most we will pay for all damages resulting from any one accident is the limit of UNINSURED MOTORISTS INSURANCE shown in the declarations.³⁴

Elsewhere, however, the policy provided that "If there is more than one covered auto our limit of liability for any one accident is the *sum of the limits* applicable to each covered auto."³⁵ Rusthoven claimed coverage equal to the sum of the per person limits of liability — \$25,000 per per-

32. I have borrowed this term from default-rule theory in the contract-law literature. The term seems to have been used first in Ian Ayers & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 91 (1989).

33. 387 N.W.2d 642 (Minn. 1986).

34. 387 N.W.2d at 643.

35. 387 N.W.2d at 643 (emphasis added).

son — applicable to each covered auto (of which there were 67), or \$1,675,000.³⁶

It seems extremely unlikely that Rusthoven's employer, or Rusthoven, had he been given the choice, would have chosen to pay premiums to secure this amount of uninsured motorists coverage. Nonetheless, the court held that the policy language was ambiguous because it contained inconsistent provisions, and awarded Rusthoven that amount of coverage.³⁷ In traditional terms, the rationale for this approach is that the insurer, as drafter of the policy, has control over its language and should bear the consequences of failing to employ unambiguous language.³⁸ As I noted earlier, however, invoking *contra proferentem* under these circumstances amounts to the rejection of any requirement that there have been reliance by the policyholder or that the ambiguous provision have harmed the policyholder. Rather, under these circumstances the insurer pays a penalty for the ambiguity without regard to the degree of demand for the coverage afforded by an interpretation based on *contra proferentem*.

A penalty standard affords the insurer three choices: (1) the insurer may retain the provision as written, recognizing that it will face liability under the penalty standard; (2) the insurer may redraft the "offending" provision to eliminate its ambiguity; or (3) in at least some jurisdictions the insurer may attempt to remedy the ambiguity by dispelling policyholders' expectations regarding the meaning of the provision — for example, by pointing out the limitations on coverage the insurer intends the provision to effectuate. Recent contract-law literature suggests that the function of a penalty approach in filling contractual gaps is to force the party facing a potential penalty to reach an agreement on a substitute term with the other contracting party.³⁹ In the insurance setting, however, where industrywide standard-form contracts predominate, the first alternative is likely to be the cost-minimizing alternative until a sufficient number of insurers have paid a sufficient number of penalties to warrant investing in the cost of redrafting the policy provision in question.

36. See 387 N.W.2d at 644.

37. See 387 N.W.2d at 644-45.

38. See STEMPEL, *supra* note 1, § 5.9, at 206-07; Mark C. Rahdert, *Reasonable Expectations Reconsidered*, 18 CONN. L. REV. 323, 327-28 (1986).

39. For discussion and extensive references, see generally *Symposium on Default Rules and Contractual Consent*, 3 S. CAL. INTERDISCIPLINARY L.J. 1 (1993).

2. *The Majoritarian Standard*

An alternative approach imports a requirement that is missing under the penalty standard. This approach might be called a *majoritarian* standard,⁴⁰ under which, for a purportedly ambiguous policy provision to be interpreted in favor of coverage, the coverage must be such that the majority of policyholders would prefer to purchase it at an actuarially fair price. This standard is similar to the one that many contract-law theorists have argued should guide the gap-filling function of courts when they resolve disputes over matters that are not expressly resolved by contract terms: choose the contract provision to which the parties would have agreed had they negotiated over the issue in question.⁴¹ No doubt something like this standard often operates when there is a gap in an insurance policy.⁴² My contention, however, is that often the courts also implicitly take this approach in order to interpret express but ambiguous policy provisions.

One can glimpse occasional traces of this approach in the case law. For example, the "full" expectations principle directs that the reasonable expectations of the insured be honored, notwithstanding even clear, contrary policy language.⁴³ Courts in some states, however, apply a limited version of the expectations principle that applies only to the interpretation of ambiguous policy provisions.⁴⁴ Though phrased as a sword for the policyholder, this limited version actually is a shield for the insurer, for under the rule, the reasonable expectations of the policyholder limit the reach of *contra proferentem*. Under the rule, ambiguous policy provisions may not be interpreted against the insurer if the resulting coverage could not reasonably be expected.⁴⁵

One view is that this formulation is merely a restatement of the traditional rule that a policy provision is not ambiguous unless it is "reasonably" susceptible to more than one interpretation. But I think

40. See Ayers & Gertner, *supra* note 32, at 93.

41. For discussion of this notion, see Ayers & Gertner, *supra* note 32, at 87-91. For a similar argument in the insurance context, see Fischer, *supra* note 2, at 1001.

42. A prominent example is the body of rules that has developed the insurer's duty to settle claims against its insured under a liability insurance policy. See Kent R. Syverud, *The Duty to Settle*, 76 VA. L. REV. 1113 (1990).

43. See KEETON & WIDISS, *supra* note 1, § 6.3(a)(4), at 636.

44. See Roger C. Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L.J. 823, 835-36 & n.72 (1990).

45. See KEETON & WIDISS, *supra* note 1, § 6.3(a)(2), at 628 n.4 ("It seems likely that there has always been an implicit understanding that ambiguities, which in most cases might be resolved in more than just one or the other of two ways, would be resolved favorably to the insured's claim only if a reasonable person in the insured's position would have expected coverage.").

that the formulation is more than a mere restatement of the traditional rule. The articulated focus of the traditional rule tends to be the policy language itself. When courts invoking the traditional rule speak of policy language that is or is not reasonably susceptible to more than one interpretation, typically they mean that the disputed policy provision itself, usually standing alone, but at most in the light of the remaining policy language, will reasonably bear the policyholder's interpretation.⁴⁶ In contrast, the ambiguity decisions that invoke the expectations of the policyholder as a limit on the reach of *contra proferentem* often focus on matters beyond the policy language, such as the typical businessperson's unfamiliarity with the distinction between legal and equitable remedies,⁴⁷ the insured's concern that the failure to make a prompt report that it had made a new acquisition would create a gap in its coverage,⁴⁸ and the expectations of a pesticide manufacturer that its products liability insurance would not contain a coverage limitation for "pollution" that would apply to injuries resulting from the normal use of its product.⁴⁹

This focus on considerations lying outside the policy language comes close to the express adoption of a majoritarian standard. The restriction on the scope of *contra proferentem* embodied in the limited version of the reasonable expectations principle requires that policyholders believe that they are already protected by the coverage they claim the ambiguous policy provision affords them. If policyholders do believe that they already have the coverage in question, then the premiums they pay insurers probably already reflect this supposition: when I think I am buying an eight-cylinder car I naturally am willing to pay more than I would for the identical model with six cylinders. Demand thus affects price. The only distinction between this expectations-limited approach to *contra proferentem* and the majoritarian standard as I have defined it is that the former applies as long as policyholders expect that they have the coverage in question, whereas the latter applies only if, in addition, policyholders would be willing to pay an accurate price for that coverage.

46. See *Rusthoven v. Commercial Standard Ins. Co.*, 387 N.W.2d 642 (Minn. 1986).

47. See *Minnesota Mining and Mfg. Co. v. Travelers Indem. Co.*, 457 N.W.2d 175, 181 (Minn. 1990).

48. See *Cooper Cos. Inc. v. Transcontinental Ins. Co.*, 37 Cal. Rptr. 2d 508, 515 (Cal. Ct. App. 1995).

49. See *Great Lakes Chem. Co. v. International Surplus Lines Ins. Co.*, 638 N.E.2d 847, 851 (Ind. Ct. App. 1994).

Most of the time, however, this is likely to be a distinction without a difference. In most cases in which policyholders expect that they have the coverage in question they probably also already are paying for it, because of the interaction between demand and price. Admittedly, however, there may be cases in which policyholders suppose they have the coverage in question, the insurer supposes otherwise and has not charged for it, and policyholders would not be willing to pay as much as the insurer would have charged for providing that coverage if the insurer knew that it would be required to do so. In this situation the limited version of the expectations principle would require that *contra proferentem* be invoked, even though the majoritarian standard as I have defined it would not be satisfied.

But the courts are only rarely in a position to find the facts that would be necessary to distinguish between these two slightly different approaches. To draw such a distinction, a court would have to be able to determine whether the majority of policyholders does or does not reasonably expect the coverage in question, whether these policyholders are or are not already paying for the coverage they reasonably expect, and whether these policyholders would or would not be willing to pay an accurate price for that coverage if they knew that they had to choose whether to purchase it.

The courts make no such determinations. Interestingly, to the extent that they even admit that these considerations are relevant, in practice the courts treat them as questions of law. They address these considerations in an empirically casual manner or as a matter of logic, as if somehow this treatment justifies dispensing with the factual predicates of a finding regarding the coverage expectations of most policyholders. The result is that the courts often simply assert that the policyholder's proposed interpretation of a contested policy provision is reasonable, that the provision is therefore ambiguous, and that *contra proferentem* applies. In contrast, when courts conclude that the majoritarian standard has not been satisfied, they either invoke the expectations limit on the scope of *contra proferentem*, or simply state that the disputed policy provision is not ambiguous. In these cases the unarticulated majoritarian standard, not the degree of linguistic clarity of the disputed provision, decides the issue.

An insurer seeking to minimize costs under a majoritarian standard is even less likely to redraft the provision than under a penalty standard, because policyholders are likely to be paying for the coverage in ques-

tion already.⁵⁰ In this situation it obviously would not be in the insurer's interest to redraft so as to eliminate coverage. Yet the insurer also would have little to gain and something to lose by redrafting so as to clarify that there is coverage of the kind at issue. This is because some insureds will claim coverage under the existing provision, but some will be misled by it and make no claims. In contrast, for the same premiums the insurer would probably receive more claims under a redrafted and clarified policy provision. Thus, although ambiguities in insurance policies are likely to persist for some time when they provide coverage for which the majority of policyholders would not be willing to pay an actuarially fair premium, ambiguities will persist to an even greater extent when the majoritarian standard is in fact satisfied.

III. THE APPROACHES COMBINED

The courts employ either of two linguistic standards of care and either of two policyholder-demand standards in assessing the ambiguity of insurance policy provisions. It turns out, therefore, that there are four possible conceptions of *contra proferentem* rather than merely one. The four possibilities are reflected in the following matrix. Each cell represents one of the different possible approaches to the interpretation of arguably ambiguous policy language.

Negligence Majoritarian Standard	Negligence Penalty Standard
Strict Liability Majoritarian Standard	Strict Liability Penalty Standard

In the following analysis I discuss each of these four approaches, building from the most narrow to the most broad, and therefore leaving the traditional conception of *contra proferentem* — the lower right cell — until last. This strategy of presentation helps to explain most clearly the

50. An insurer faced with a judicial finding of ambiguity in a case in which the majoritarian standard is satisfied — i.e., where policyholders already are likely to be paying for the coverage in question — has the same three choices noted earlier: (1) retain the provision as written and risk future liability; (2) redraft; or (3) in some jurisdictions, remedy the ambiguity by dispelling policyholders' expectations regarding the meaning of the provision.

reason for unacknowledged departures from the traditional conception, as well as the overall normative appeal of the traditional approach.

A. *Negligence Liability with a Majoritarian Standard*

This narrowest of the four approaches is expressly limited to the situation in which *contra proferentem* has the most obvious normative appeal. Here the policy provision whose meaning is disputed is perfectible, and the majority of policyholders would be willing to pay for the coverage that would be provided by *contra proferentem*. Indeed, under a number of circumstances there is a synergy between the two features of this conception. On the one hand, policyholders may suppose that they have the coverage in question, and as a consequence they may have been paying premium rates that have already compensated the insurer for that coverage. In this situation even the insurer that is unaware of the potential ambiguity of the disputed policy provision cannot reasonably object to the application of *contra proferentem* because it has been paid for the broader coverage afforded by the doctrine. Moreover, at least sometimes the insurer will not be innocently unaware of the potential ambiguity. Rather, the insurer's argument that the policy provision is not susceptible to two reasonable interpretations will be disingenuous. On the other hand, if policyholders desire the coverage in question and the insurer has not been charging for it, then invoking *contra proferentem* will be market enhancing, given that the insurer has been missing the opportunity to sell coverage for which there is demand. In this latter situation one might even say that the insurer has been negligent not only in drafting ambiguous policy language, but also in failing to provide and charge for the coverage in question.

The majoritarian standard has normative appeal not only when the majority of policyholders would wish to purchase the coverage that invocation of *contra proferentem* would provide, but also when they would not. In rare cases a court may actually state that the policy provision in question is linguistically ambiguous but that because the proposed interpretation would not accord with the objectively reasonable expectations of the majority of policyholders, it will not be interpreted in favor of coverage. For example, in the recent and much-discussed decision of *Owens-Illinois, Inc. v. United Insurance Co.*,⁵¹ the Supreme Court of New Jersey was asked by a policyholder to impose joint and several coverage responsibility on the policyholder's insurers over a period of years for the policyholder's asbestos-related liabilities on the

51. 650 A.2d 974 (N.J. 1994).

ground that the policies were ambiguous as to the method of allocating coverage responsibility among these "triggered" policies.⁵² The court first posed the question, "Does the Language of the Policies Resolve the Allocation Issue?" and next answered, "We are unable to find the answer to allocation in the language of the policies," but then rejected both the policyholder's and the insurer's proposed interpretations, instead fashioning what the court termed the most "efficient" approach.⁵³ The court directed a special master to provide the coverage that, in effect, policyholders would have selected had they been able to make the choice. This degree of candor, however, is unusual.

B. *Strict Liability with a Majoritarian Standard*

This approach has much the same normative appeal as the first, except that the policy language in question need not be reasonably perfectible to invoke *contra proferentem*. Of course, it does not follow that the language in question is not reasonably perfectible. This approach simply does not require an inquiry into that issue. The difference between this approach and the first, therefore, is that under this approach, *contra proferentem* applies not only to policy provisions that are perfectible, but also to those that are not. What can be gained by applying *contra proferentem* to this additional increment of nonperfectible policy provisions?

There are three arguments for including this increment within the sweep of *contra proferentem*. First, as I noted above, the move to strict liability reduces litigation costs by making the perfectibility issue irrelevant in coverage disputes. Second, the ambiguous policy language itself — as distinguished from some independent expectation — may have led some policyholders to assume that they were provided coverage by the language in question and to rely to their detriment on that assumption. For example, had the policyholder known that the policy precluded the coverage in question, the policyholder might have purchased the coverage elsewhere if it had been available, or may have taken precautionary measures that could have avoided the loss for which it now claims coverage. Finally, suppose that the vast majority of ambiguous policy provisions are in fact perfectible, but that distinguishing those that are perfectible from those that are not is an unreliable process. In

52. In the language of this field, a CGL insurance policy is "triggered" if bodily injury or property damage falling within the terms of coverage occurred "during the policy period." See KENNETH S. ABRAHAM, ENVIRONMENTAL LIABILITY INSURANCE LAW 91-102 (1991) [hereinafter ABRAHAM, ENVIRONMENTAL LIABILITY].

53. *Owens-Illinois*, 650 A.2d at 988-96.

that case a rule that classified all such provisions as ambiguous could produce a lower rate of error (i.e., the percentage of cases in which a nonperfectible policy provision is held to be ambiguous) than the rate of error under a negligence test itself (i.e., the percentage of cases in which a perfectible policy provision is held not to be ambiguous). Even assuming that the theoretically optimal linguistic standard is negligence rather than strict liability, because of the risk of error in adjudicating the negligence issue a strict liability standard may in this way generate more accurate determinations than negligence.

Moreover, an approach that expressly adhered to strict liability, but then silently departed from that standard in cases of very obvious nonperfectibility, would produce an even lower rate of error, as judged from the standpoint of the theoretically optimal negligence standard. One might describe such cases as involving a finding of non-perfectibility by judicial notice to distinguish them from cases that would require evidence even to support a finding of nonperfectibility as a matter of law.

C. *Negligence Liability with a Penalty Standard*

This approach is the mirror image of strict liability with a majoritarian standard. The approach captures all the cases in which a policy provision is perfectible and the majority of policyholders would purchase the coverage at issue, plus the increment of cases in which the relevant policy provision is perfectible but the majority of policyholders would not wish to purchase the coverage in question. Admittedly, on the surface this approach lacks the appeal of the two that employ a majoritarian standard because under this approach the policyholder probably gets something for nothing. That is, when the majority of policyholders would not purchase the coverage in question, it is unlikely that market conditions have been permitting or would permit the insurer to charge for this coverage even while ambiguously declining to provide it.

Nonetheless, under this approach there is a synergy between the linguistic and demand dimensions of *contra proferentem* that gives it an appeal that is lacking under strict liability with a majoritarian standard. Here the insurer has employed a policy provision that is perfectible. For this reason the insurer could have avoided liability simply by perfecting the provision, and it can do so in the future. Application of *contra proferentem* therefore serves as a simple signal to the insurer that the provision should be perfected, and ordinarily such application should be unobjectionable unless redrafting costs are prohibitively high.

This approach also can generate some of the same benefits as strict liability with a majoritarian standard. The approach entails lower litigation costs because it avoids the need to assess the degree of policyholder demand for the relevant coverage. Because of the probable difficulty of making such assessments accurately, this approach also may entail lower error costs, especially if in the vast majority of litigated cases the majoritarian standard would be satisfied but it would be difficult to prove this fact.

Finally, recall that under strict liability with a majoritarian standard the courts might take "judicial notice" of the obvious nonperfectibility of an ambiguous policy provision and thereby reduce the rate of error under that approach. A corresponding move might be made under negligence liability with a penalty standard, by taking judicial notice of the occasional obvious failure of a linguistically ambiguous policy provision to satisfy the majoritarian standard, and declining to invoke *contra proferentem* to interpret that provision. In this manner the rate of error — as compared to negligence liability with a majoritarian standard — could be reduced even further.

D. *Strict Liability with a Penalty Standard: The Traditional Conception*

The traditional conception of *contra proferentem* goes further than any of the other approaches standing alone, but no further than what the other approaches could do in combination. The traditional conception imposes coverage responsibility when the policy provision whose meaning is in dispute is perfectible and when the majority of policyholders would have purchased the coverage in question. But under the traditional conception of *contra proferentem* an ambiguous policy provision also results in coverage when the policy provision at issue could not reasonably be perfected and when the majority of policyholders would not have purchased the coverage in question. Consequently, the case for the traditional conception must be that it combines the advantages of the other three, narrower approaches to *contra proferentem*. In doing so, however, it also risks disadvantages. I discuss both below.

1. *Advantages*

The traditional conception has a number of advantages. The transaction-cost case for the traditional conception is obvious: by dispensing with the kinds of inquiries that would be necessary to satisfy the perfectibility and majoritarian standards, the traditional conception makes the ambiguity decision simple, straightforward, and inexpensive. By

employing a strict liability standard the traditional conception also assures coverage in any case in which a policyholder has been misled by ambiguous language and thereby suffered a loss that otherwise would have been insured or avoided. Furthermore, the traditional conception assures coverage to the minority of policyholders who have detrimentally relied on the policy provision in question, either because had they known there was no coverage they would have purchased the coverage in question elsewhere, or because they believed that in fact they did purchase this coverage.

Moreover, the traditional conception has the potential to reduce the costs of error in achieving the aims of the other approaches. To apply the negligence and majoritarian standards accurately, a court would often have to be presented with substantial amounts of information, much of it difficult to obtain and difficult to sort through. If it is a fair presumption that most linguistically imperfect policy provisions are reasonably perfectible, and that the majority of policyholders would be willing to pay an accurate premium for the coverage that would be afforded by a pro-coverage interpretation of the majority of such provisions, then the traditional conception will produce results that are a close approximation of the ideal, without incurring the transaction and other costs that accompany the alternatives to the traditional conception.

Finally, for the reasons noted earlier, insurers have incentives that promote the persistence of ambiguous policy provisions even in the face of *contra proferentem*. The traditional conception imposes the risk of irremediable ambiguity on the enterprises that are most likely to be the superior bearer of that risk — insurance companies, which are in the business of risk bearing.

2. Disadvantages

The principal argument against the traditional conception is that it is simplistic in its disregard of otherwise normatively relevant considerations. The question is whether this disadvantage is worth its advantages. For example, if most policy provisions that fail the “ordinary reader” test are not reasonably perfectible, or if the majority of policyholders do not wish to purchase the coverage afforded them by applying the traditional conception, then error costs probably are higher under the traditional conception than under the others.⁵⁴ In addition, the penalty standard employed by the traditional conception may generate ei-

54. Whether the error costs generated by the traditional conception are higher under these circumstances still depends, however, on the error rate associated with each of the other approaches. The traditional conception may still be superior on this score,

ther of two other undesirable results. On the one hand, all policyholders may receive the coverage resulting from the penalty standard and be charged accordingly, even though the majority may not desire this coverage. Unless the majority is itself mistaken in supposing that the coverage in question is not worth purchasing at an accurate price, this consequence is undesirable. On the other hand, at other times demand for coverage generally may be sufficiently elastic and the cost of the judicially added coverage sufficiently high that insurers find it preferable — because policyholders find it preferable — to circumvent the issue entirely by removing the offending policy provision from the policy altogether, thereby declining to provide not only the judicially added coverage, but the narrower coverage that insurers had intended to provide and that the majority of policyholders had wished to purchase.

Under this scenario *contra proferentem* ultimately results in the availability of less coverage than would have been afforded in its absence.⁵⁵ Expressed in more vernacular terms, the paradox is that for policyholders who wish to purchase half a loaf of coverage for half a premium, the threat posed by the traditional conception may result in insureds being offered either a full loaf of coverage for a full premium, or no loaf at all.⁵⁶

even when the vast majority of disputed provisions are not perfectible or desired by most policyholders, if the other approaches also are very inaccurate.

55. I once argued that this is precisely what occurred in connection with the so-called qualified pollution exclusion in CGL insurance policies written between about 1970 and 1985. See Kenneth S. Abraham, *Environmental Liability and the Limits of Insurance*, 88 COLUM. L. REV. 942, 961-66 (1988). That exclusion contained an exception for discharges of pollutants that were "sudden and accidental." Some courts held this phrase to be ambiguous and (under the traditional conception) therefore interpreted it to cover unexpected, gradual discharges. I argued that these interpretations resulted in the insurance industry's revision of the standard-form policy to remove virtually *all* pollution coverage from all CGL policies written beginning in 1986. In effect, insurers seem to have concluded that if they could not rely on policy provisions that they believed limited coverage to liability for short-term, abrupt pollution, they would not insure against pollution liability at all. I implied that the judicial decisions holding the "sudden and accidental" exception to the pollution exclusion to be ambiguous were incorrectly decided. In retrospect, I continue to think that I accurately described the attitude and motives of the insurance industry, but I have since concluded that the proper interpretation of the pre-1986 pollution exclusion is a more complicated question than I thought at the time. This view is based in part on the representations that the insurance industry made to state insurance commissioners when it sought approval of the exclusion in the early 1970s. For discussion of the timing and nature of these representations, see ABRAHAM, ENVIRONMENTAL LIABILITY, *supra* note 52, at 145-60.

56. Cf. Michael B. Rappaport, *The Ambiguity Rule and Insurance Law: Why Insurance Contracts Should Not Be Construed Against the Drafter*, 30 GA. L. REV. 171, 237 (1995).

E. Assessment

In theory the courts could select any of the four alternative approaches to *contra proferentem*. In my view, however, the key issue is which of the two polar approaches should prevail: (1) the approach that has the most obvious normative appeal — negligence with a majoritarian standard, or (2) the traditional conception — strict liability with a penalty standard. This is the key choice because either of the two intermediate approaches can only be superior if the advantages of the linguistic and demand dimensions typically are not congruent. For example, negligence liability with a penalty standard could be superior to the other approaches only if the transaction and error costs of the negligence standard were tolerable. Similarly, strict liability with a majoritarian standard could be superior to the other approaches only if the transaction and error costs of the majoritarian standard were tolerable. Neither of these states of affairs seems likely because the transaction and error costs of the negligence and majoritarian standards, respectively, normally will be high.

Consequently, the issue is which polar alternative the courts should choose. They could reject the traditional conception as overbroad and instead inquire expressly and openly, on a case-by-case basis, into the perfectibility and degree of demand for coverage under policy provisions that do not satisfy the ordinary-reader test. In the alternative, they could adhere to the traditional conception and tolerate its occasional excesses. I believe that the problems of evidentiary manageability that would arise under any of the alternatives to the traditional conception probably are not worth the potential gain that would result from employing them. Nonetheless, in Part V below I analyze these problems and suggest some devices that the courts could adopt to attempt to resolve them.

In the end I think that the courts themselves have recognized that if an overt choice must be made between the traditional conception and any of the alternatives, then the traditional conception is superior. That is why the courts almost always formally adhere to the traditional conception, even when they silently depart from it. But having made that formal choice, some courts then have tried to have it both ways, ordinarily adhering to the traditional conception in both form and substance, while making exceptions to it when they can take what amounts to “judicial notice” that the policy provision in dispute is not reasonably perfectible, or that providing the coverage at issue would violate the majoritarian standard. In taking this approach the courts have avoided the evidentiary and other difficulties they would encounter in applying the negligence and majoritarian standards across the board. Otherwise,

the traditional conception prevails. This approach may produce substantively optimal results, but it also generates confusion about what the courts really are doing in this field.

IV. RIGHTS AT VARIANCE WITH POLICY PROVISIONS

The portrait I have sketched cannot be complete without considering the relation between *contra proferentem* and certain other doctrines that also affect the meaning of insurance policy provisions. Professor (now Judge) Robert Keeton's famous identification of this category of doctrines creating "rights at variance" with policy provisions⁵⁷ distinguishes in effect between the *interpretation* of insurance policy language and the *application* of legal doctrines to that policy language. In Keeton's view such doctrines as the expectations principle, waiver, estoppel, and others act upon the policy language and render that language inapplicable or more limited than it would be if it were merely interpreted.⁵⁸ I want to suggest that the development of these rights at variance with policy provisions can be explained at least in part, if not entirely, by the difficulties that courts face in the interpretive arena.

The core of the problem arises in cases in which the policy provision in question could not reasonably have been perfected, *but* the majority of policyholders would want and would be willing to pay for the coverage that would be afforded by a finding that the relevant provision is ambiguous. In such cases, the absence of the coverage claimed by the policyholder is likely to trouble courts because most policyholders probably believe that they already have this coverage, and in any event they would be willing to pay an accurate price for it. For a court that adheres to the traditional conception of *contra proferentem* — which applies strict liability and makes the question of perfectibility irrelevant — the result is easy: the provision in question is ambiguous.

In contrast, for any court that has formally adhered to *contra proferentem* but in fact has employed a negligence standard, the choice is not so easy. One option is to invoke *contra proferentem* and hold the policy provision ambiguous. This option, however, requires rejecting

57. See Robert E. Keeton, *Insurance Law Rights at Variance With Policy Provisions* (pt. 1), 83 HARV. L. REV. 961, 961-63 (1970); see also KEETON & WIDISS, *supra* note 1, § 6.1(a), at 614-16.

58. See KEETON & WIDISS, *supra* note 1, § 6.1(a), at 615 (stating that these doctrines represent "concepts that have continued to become increasingly significant in the resolution of insurance disputes involving claimants who seek to assert rights which are not in accord with the provisions of the applicable insurance contract"). Although the validity of this kind of distinction between mere interpretation and the giving of legal effect to policy language is open to question, I believe that my analysis does not depend on whether such a distinction is valid.

the court's own private conception of what *contra proferentem* is really all about. The second option for such a court is to hold that the policy provision is not ambiguous and, as a result, take its own medicine. The former option conflicts with the court's actual jurisprudence, yet the latter option leaves policyholders without coverage that the court believes they want and ought to have. Neither option is very attractive.

For such a court a more attractive alternative is to develop a doctrinal basis for finding that there is coverage, notwithstanding the "unambiguous" policy language. Traditionally this aim was achieved — when it could be achieved — through doctrines such as waiver and estoppel, which focus on specific factual interactions between particular policyholders and their insurers.⁵⁹ The legal significance of these interactions is that they trump policy language, but typically only in the particular context in which the individual policyholder-plaintiff finds himself. For traditional courts this limited kind of effect was probably all that seemed appropriate. As judicial lawmaking became more acceptable over time, however, the cases in which there was no viable claim of ambiguity, waiver, or estoppel, but in which the majority of policyholders expected that they were covered, gave rise to a tension that eventually was resolved by the expectations principle.

The key to understanding the role played by the expectations principle, I think, lies in its assurance that the *objectively* reasonable expectations of the policyholder as to coverage will be honored, notwithstanding contrary policy language.⁶⁰ The requirement that the expectations be objectively reasonable is significant not simply because it rejects a subjective test, but because objectively reasonable expectations are those that are likely to be held by the majority of policyholders. Thus, the expectations principle does for policyholders as a group what waiver and estoppel did for the individual policyholder-plaintiff: it affords them coverage under policy provisions that are reasonably clear under the circumstances, but not sufficiently clear, or at least not sufficiently obvious, to definitively communicate their meaning to the ordinary policyholder.

Of course, clarity for the ordinary policyholder depends not only on the words chosen to limit coverage, but also on the placement of those words within the policy. It is no surprise, then, that expectations principle cases tend to involve "fine print" exclusions, and that the courts invoking the expectations principle sometimes comment that the policyholder's expectation of coverage could be dispelled by pointing

59. See KEETON & WIDISS, *supra* note 1, § 6.1(b), at 617-18.

60. See Henderson, *supra* note 44, at 825.

out the offending provision or by highlighting it within the policy.⁶¹ The considerable uncertainty exhibited in the case law and commentary on this point,⁶² however, reflects yet another tension, which the expectations principle itself creates. Developed as an aid to the majority of policyholders, the expectations principle — softened by courts that permit dispelling individual expectations — may end up retaining the individualized focus of the doctrines of waiver and estoppel that the principle is supposed to supplant. Designed to remedy a problem arising out of the use of standardized policy language, the principle thus becomes un-

61. See, e.g., *Gordinier v. Aetna Casualty & Sur. Co.*, 742 P.2d 277, 285 (Ariz. 1987) (stating that “[t]he possibility remains that these [exclusions] limitations were called to [the insured’s] attention” and that “[i]f Aetna can prove this, we will enforce the limitation of coverage”); *State Farm Mut. Auto. Ins. Co. v. Bogart*, 717 P.2d 449, 457 (Ariz. 1986) (en banc) (“Such an eventuality is certainly one that should be clearly called to the attention of the insured.”); *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 174 (Cal. 1966) (en banc) (limitation on duty to defend would defeat the insured’s reasonable expectations because the limitation “is not ‘conspicuous’ since it appears only after a long and complicated page of fine print, and is itself in fine print”); *C & J Fertilizer, Inc. v. Allied Mut. Ins. Co.*, 227 N.W.2d 169, 177 (Iowa 1975) (substance of an exclusion was not explained to plaintiff); *Simon v. Continental Ins. Co.*, 724 S.W.2d 210, 212-13 (Ky. 1986) (automobile policy’s underinsured motorist limits, buried in a lengthy definitions section, defeated the reasonable expectations of the insured absent a clear and conspicuous manifestation of excluded coverage); *DiOrto v. New Jersey Mfrs. Ins. Co.*, 398 A.2d 1274, 1280 (N.J. 1979) (automobile policy coverage provisions and definitions regarding nonowned automobiles were placed clearly and conspicuously on the first page, and thus the insured could have no objectively reasonable expectation of the coverage sought); *Gerhardt v. Continental Ins. Co.*, 225 A.2d 328, 333 (N.J. 1966) (“If the company had acted fairly in the effort to exclude coverage . . . it would have given the insured clear notice to that effect on the face page . . . or by a slip attached to the face page . . .”); *Lehrhoff v. Aetna Casualty & Sur. Co.*, 638 A.2d 889, 892 (N.J. Super. Ct. App. Div. 1994) (“[R]easonable expectations of coverage raised by the declaration page cannot be contradicted by the policy’s boilerplate unless the declaration page itself clearly so warns the insured.”); *Hionis v. Northern Mut. Ins. Co.*, 327 A.2d 363, 365 (Pa. Super. Ct. 1974) (“Even where a policy is written in unambiguous terms, the burden of establishing the applicability of an exclusion or limitation involves proof that the insured was aware of the exclusion or limitation and that the effect thereof was explained to him.”).

62. For example, some courts have held that an insured’s reasonable expectations survive coverage limitations despite the insured’s apparent knowledge of the limitations. See, e.g., *Smith v. Westland Life Ins. Co.*, 539 P.2d 433, 441-42 (Cal. 1975) (en banc) (when reasonable expectation of coverage was created by the insurer’s acceptance of a premium with the application for coverage, if the insurer wishes to counter the expectation “it must not only use clear and unequivocal language evidencing its intent to limit temporary coverage . . . [and] call such limiting condition to the attention of the applicant,” but must also return the tendered premium); *Sparks v. St. Paul Ins. Co.*, 495 A.2d 406, 414-15 (N.J. 1985) (in most insurance contracts “consent can be inferred only to the extent that the policy language conforms to public expectations and commercially reasonable standards”; absent “proof of factual circumstances that would render such limited . . . coverage both reasonable and expected,” the policy limitation did not satisfy the objectively reasonable expectations of the purchaser).

available to policyholders who have been made individually aware of otherwise unexpected policy provisions. The effect of this approach is to destandardize policy language by affording coverage to the majority while denying it to the exceptional policyholder whose expectation has been specifically dispelled.

This distinction between approaches that do and do not permit proof that the policyholder's expectations were dispelled involves much more than the creation of an occasional exception to the expectations principle. The distinction reflects the difference between the tort and contract views of the normative basis of *contra proferentem* that I identified earlier. In tort-law terms, if the expectations principle applies only when the policyholder subjectively expected coverage, then the principle includes something like a requirement that the policyholder be harmed by a coverage-limiting policy provision. This requirement is closely analogous to the tort-law requirement that the defendant's wrong be a cause of the plaintiff's injury. On the other hand, in contract-law terms, when the subjective expectation of the policyholder claiming coverage is irrelevant, because the only requirement is that the objectively reasonable expectations of the majority of policyholders be honored, something like expectation damages are awarded. As in the typical case of contract breach, proof of reliance is not required, because the particular policyholder's lack of reliance — that is to say lack of expectation of coverage — is irrelevant.

The distinction between approaches that do and do not permit the dispelling of individual expectations also replicates the choice between negligence and strict liability under *contra proferentem*, which I suggested actually prompted development of the expectations principle in the first place.⁶³ Ordinarily an expectation of coverage either can be cost-effectively dispelled across the board, or it cannot. The problem is much like providing an effective warning to accompany a consumer product. A fine-print exclusion can be highlighted,⁶⁴ or selling agents can be directed to point it out,⁶⁵ or the marketing strategy that creates the expectation can be modified,⁶⁶ or else none of these expectation-

63. See *supra* text accompanying notes 58-59.

64. See, e.g., *Gerhardt*, 225 A.2d at 333; *Lehrhoff*, 638 A.2d at 892.

65. See, e.g., *Gordinier*, 742 P.2d at 285; *C & J Fertilizer*, 227 N.W.2d at 177 (rejecting defendant's assertion that *contra proferentem* does not apply because plaintiff knew the policy contained the provision, and observing that the "escape clause . . . was never read to or by plaintiff's personnel, nor was the substance explained by defendant's agent").

66. See, e.g., *Steven v. Fidelity & Casualty Co. of New York*, 377 P.2d 284, 288, 293-94 (Cal. 1962) (en banc) (holding that when airline trip insurance policy was marketed through a vending machine close to the time of departure, required the insured to

dispelling measures can be taken. When taking one of these or a similar measure is feasible and cost-effective, then a holding that a policyholder had an objectively reasonable expectation of coverage is, in effect, a holding that the insurer has been negligent in failing to dispel policyholder expectations generally.⁶⁷ In expectations principle cases an approach that makes any particular policyholder's expectations relevant therefore employs what amounts to a negligence standard governing the insurer's marketing behavior.⁶⁸

In contrast, an approach that makes any particular policyholder's expectations irrelevant and directs attention to the expectations of policyholders generally employs what amounts to strict liability. If the majority of policyholders reasonably expect the coverage in question, then regardless of whether the insurer has dispelled the expectations of the policyholder-plaintiff, apparently it is not cost-effective to dispel expectations generally. If the insurer is nonetheless liable for the consequence of its marketing behavior, logically this is strict liability for marketing behavior.

When this strict liability feature of the expectations principle is combined with the contract approach that makes any particular policyholder's expectation irrelevant, the result is strict liability for failure to provide coverage that the majority of policyholders reasonably expects. This strong version of the expectations principle in effect imposes liability on insurers for the breach of an implied promise to provide expected coverage. Ironically, then, the judicial reluctance to accept the strict liability feature of the traditional conception of *contra proferentem* has given way to a willingness to disregard unambiguous policy language in the service of majoritarian expectations. What began at least in part as a response to an interpretive bind has thus been transformed into judicial prescription of the contents of insurance policies.

mail the policy to the beneficiary prior to departure, and did not provide a duplicate copy, the insured had a reasonable expectation that substituted emergency transportation would be covered absent a clear manifestation of the limitation to the purchaser).

67. Occasional exceptions to this generalization include cases involving particular acts of negligence, such as an agent who fails to follow a directive that an unexpected exclusion be pointed out.

68. It is not necessarily inconsistent for a court that has implicitly held a policy provision to be sufficiently clear under all relevant circumstances — i.e., nonnegligently drafted — to also hold that the insurer's marketing behavior is nonetheless negligent. Under some circumstances the optimal approach to communicating the policy's meaning may well be to leave the policy language as it stands but to clarify its meaning by some extracontractual method of explanation.

V. THE PROBLEMS OF EVIDENTIARY MANAGEABILITY OUTSIDE THE TRADITIONAL CONCEPTION

It may have been possible until now for courts to camouflage, or even fail to recognize, their own departures from the traditional conception of *contra proferentem*. Once these departures are identified, however, the appropriate course of action is either to return to the traditional conception or openly to embrace a new approach. I think that the difficulties inherent in expressly departing from the traditional conception of *contra proferentem* are not worth the advantages of doing so. It is at least plausible to suppose that the traditional conception entails lower error and transaction costs than any of the alternatives. The traditional conception certainly affords greater predictability.

But if courts are going to depart from the traditional conception by engaging in the decisionmaking process I have described, then both justice and common sense demand that they be more candid about what they are doing. Greater candor will take some of the mystery out of the interpretive process and enable the parties to direct their arguments to the factors that actually influence the courts. However, the very considerations that have led the courts to be less than candid about these factors suggest that greater candor alone will not necessarily improve the process. Rather, modified rules that deal with the problems of evidentiary manageability and recognize the limits of judicial competence will be needed.

Two major uncertainties have probably contributed to the fiction that *contra proferentem* always involves strict liability and a penalty standard. First, while courts may feel some confidence in their ability to know a poorly drafted policy provision when they see it, they are also likely to recognize that they may be unaware of considerations relevant to the way in which the provision was drafted. For courts to acknowledge that they are employing a negligence standard therefore either would make them vulnerable to criticism for acting without sufficient evidence to support their decisions, or would subject them to mountains of evidence that would transform simple legal issues into complex questions of fact. Second, whereas a penalty standard asks nothing of the courts, an explicit majoritarian standard would pose evidentiary problems very similar to those that would be posed by employing a negligence standard. As citizens themselves, judges may think that they can reliably intuit the coverage expectations of the majority of policyholders, but they are also likely to recognize that intuition is no substitute for evidence regarding a question of fact, especially if the question is posed to a jury.

Departing from the traditional conception only when a policy provision self-evidently seems not to be perfectible or the coverage in question clearly would not be purchased by the majority of policyholders is a reaction to these uncertainties. But this *de facto* requirement that departures from the traditional conception take place only when it can be concluded virtually by "judicial notice" that the unstated standard has not been breached is only a partial solution. This approach avoids the need for factfinding by juries, but it does nothing to enable litigants themselves to address the relevant issues, even if the issues are to be decided by the court without traditional factfinding. If there are to be legitimate, limited departures from the traditional conception, then there will have to be at least some effort to allow litigants to address relevant issues.

A. *The Linguistic Standard of Care*

The key here would be to permit the parties to address the perfectibility of the policy language whose meaning is in question without opening the door to virtually unlimited amounts of evidence about that question. The best way to do this would be through a hindsight perfectibility standard, which would make the decisionmaking process more visible without radically changing its current character. Under a hindsight standard the policyholder could demonstrate the ambiguity of the policy provision in question not merely by showing that the provision is reasonably susceptible to more than one meaning, but also by identifying alternative language that would have been more suitable to achieve the insurer's aim, given the insurer's contention that the policyholder's claim is not covered. No other evidence directed at the question whether the relevant policy language is reasonably perfectible, however, would be admitted.

Under this approach the ambiguity decision would remain a question for the court, not a question of fact for the jury. By avoiding the foresight issue, the approach would not degenerate into an evidentiary inquiry into the considerations that might have been relevant to the acceptability of the alternative language prepared by the policyholder. The focus would still be on the language of the policy provision in question, not on the quality of the drafter's conduct or on the factors that affected the drafter's choice of language. As a consequence, the proposed change would only minimally disrupt trial-level litigation, if at all. The ambiguity inquiry would be pursued, much as it is now, on motion for partial summary judgment or motion *in limine*, and appellate courts therefore could continue to scrutinize the ambiguity decisions of lower courts.

Whether this approach would be both workable and superior to the de facto, unacknowledged departures from *contra proferentem* that now occur is uncertain. For example, insurers might argue that the approach unfairly favors policyholders, by permitting the policyholder to identify alternative, apparently more suitable policy language, without permitting the insurer to refute the contention that the policyholder's proposed alternative language would have been more suitable than the actual policy language.

Although it is true that insurers would in a sense be placed at this disadvantage, they probably would be no more disadvantaged under this approach than they are when the traditional conception is in force. Insurers would not be precluded from criticizing the alternative policy language identified by the policyholder. The approach would make *evidentiary* criticism of the policyholder's proposed alternative language inadmissible, but would not rule out what might be termed *argumentative* criticism. Neither the policyholder nor the insurer would be permitted to offer evidence, based on fact or on expert opinion, going to the suitability of the policy language actually used by the insurer or offered as an alternative by the policyholder. But just as the policyholder could offer alternative language, so the insurer could criticize it, logically or linguistically, for unsuitability. Just as the parties now argue, often without resort to any evidence at all, about whether disputed policy language is ambiguous, under the new standard they would be permitted to argue about the strengths and weaknesses of the policyholder's proposed alternative language as compared to the actual policy language.

Thus, the insurer would be permitted to argue that the proposed alternative was even more ambiguous than the language actually contained in the policy, or that the language would not mesh with — or actually would contradict — other language in the policy. Arguments that stayed within the four corners of the insurance policy and the policyholder's proposed alternative would be permitted. From the insurer's standpoint this approach would at the least be no worse than the current state of affairs. Even at present presumably the policyholder should be permitted to offer alternative policy language in order to demonstrate, albeit indirectly, the linguistic ambiguity of a policy provision. The difference is that under the new standard such alternative language would help to demonstrate not simply that the actual policy language is susceptible to more than one meaning, but also that the alternative provision offered is more suitable. The operative standard of judgment therefore would be candidly acknowledged.

Although the hypothesized approach probably would be a second-best solution, it is impossible to know whether policyholders or insurers

as a group would gain greater benefit from the approach. On the one hand, insurers might gain if courts more consciously employed a negligence rather than a strict liability standard. On the other hand, certain policyholders who would fail today in their efforts to invoke *contra proferentem* might gain from the opportunity to address their arguments expressly to the negligence standard actually employed by the courts, and as a consequence might find themselves prevailing in cases that previously they would have lost.

B. *The Demand Dimension*

A penalty standard of course poses no evidentiary difficulties for the courts, because when such a standard is in force, a finding for the policyholder follows automatically from a finding of linguistic ambiguity, however defined. In contrast, a majoritarian standard requires information about the coverage preferences of policyholders before a result can be reached. Notwithstanding the greater normative appeal of a majoritarian standard, however, it would be extremely undesirable to require or even permit an ordinary interpretive dispute to be encumbered by evidence from experts, market surveys, and the like, regarding policyholder coverage preferences.

Moreover, the difficulty here is not simply the *amount* of evidence that would encumber interpretive disputes, but how factfinding could ever proceed effectively once that evidence were admitted. Other things being equal, all policyholders prefer broader to narrower coverage. The crux of a majoritarian standard cannot be simply to discern policyholders' coverage preferences without more. Rather, the elasticity of demand for the coverage in question — what policyholders would be willing to pay — is the core question. Assessing the degree of this demand for a particular form of coverage, however, is likely to be extremely difficult. More important, assessing demand and attempting to satisfy it is precisely what markets, including insurance markets, are adept at doing.

Consequently, courts inclined to apply a majoritarian standard would do this best not by seeking data about policyholder preferences, but by requiring evidence of a market failure that the judicial prescription of coverage could solve. Evidence of such market failure would consist, for example, of a misleading impression regarding the scope of coverage conveyed by the arguably ambiguous policy provision.⁶⁹ If

69. If the insurance market has declined (albeit ambiguously) to provide a particular form of coverage, then one of three possibilities obtains: the majority of policyholders would not in fact want the coverage at an accurate price; the market has failed to

policyholders believe they are already covered against the loss at issue, then they are likely already to be paying for such coverage. Not every ambiguous policy provision falls in this category, however. Only provisions with which the mass of policyholders is likely to have some general familiarity will qualify. Misleading impressions are not created by policy provisions that policyholders do not read or know anything about. Similarly, not all market failures are judicially correctable. Under a majoritarian standard, the insurer would have to be permitted to argue that the threat of adverse selection or moral hazard explains its putative coverage limitation, and that absent the limitation these phenomena would so raise the cost of coverage that the majority of policyholders would prefer a policy that includes the disputed coverage limitation, sold at the current, lower premium. Permitting the insurer such a defense, however, would exponentially raise the level of complexity of the typical dispute over policy interpretation.

In short, the evidentiary problems of employing a majoritarian standard might be partially solved by looking first to the potentially misleading character of arguably ambiguous policy provisions, and by recognizing that in the absence of misleading provisions, the insurance market may well already be satisfying the coverage preferences of the majority of policyholders. But to perform even this seemingly contained task accurately could pose a very serious challenge for the courts.

CONCLUSION

My analysis has attempted to generate both descriptive and normative insights. As a descriptive matter, the recognition that *contra proferentem* is not one doctrine, but four different possibilities, should help to explain the outcome of disputes over the meaning of arguably ambiguous policy language that previously have been difficult to understand. Decisions that invoke *contra proferentem* even when the relevant policy language seems optimally clear and most policyholders would not expect the coverage at issue are applying the strict liability and penalty standards that characterize the traditional conception. On the other hand, decisions that hold policy language to be unambiguous even when that language appears to be susceptible to more than one reasonable interpretation, or that decline to adopt the policyholder's proposed interpretation of a policy provision that the court acknowledges to be ambiguous, constitute rejections of the traditional conception. These lat-

take advantage of an available gain from trading expanded coverage for higher premiums; or policyholders have inaccurately assumed that the ambiguous policy provision is already providing them with the coverage in question.

ter decisions employ a negligence standard to assess the linguistic quality of the disputed policy provision, or they apply the majoritarian demand standard to determine whether an admittedly ambiguous policy provision should be construed in favor of coverage, or they do both.

Litigants and insurance-law scholars alike would do well to recognize, therefore, that the version of *contra proferentem* that is in force in any particular dispute has a significant effect on the kinds of arguments that will appeal to the court and on the outcome of the dispute. Courts employing the traditional conception are unlikely to be influenced by insurers' efforts to demonstrate that a policy provision that is ambiguous is nonetheless optimally clear. Similarly, such courts are unlikely to be influenced by the argument that few policyholders would wish to purchase the coverage that would be afforded by construing an arguably ambiguous provision in the policyholder's favor. On the other hand, precisely these kinds of arguments are likely to influence courts that are inclined to depart from the traditional conception.

As a normative matter, the great advantage of the traditional conception of *contra proferentem* is that it does not ask more of the courts than they are able to deliver. Each of the three alternatives to the traditional conception of *contra proferentem* as strict liability with a penalty standard involves a more complex and more demanding process of judicial decision. Yet each of these alternatives also promises more precise achievement of the value at the core of *contra proferentem* — assuring that poorly drafted policy provisions do not deny policyholders the coverage they wish to purchase. The classic choice must therefore be made between a reasonably effective but overbroad rule (the traditional conception) and an approach (one of the three alternatives) that has the potential to achieve more perfect justice but only with higher transaction costs and potentially adverse side effects.

Moreover, one of the apparent side effects of the courts' reluctance to live with this choice has been the development of a strong version of the expectations principle that has led the courts to venture over the sometimes debatable line between interpretation of insurance policy language and regulation of the contents of insurance policies. A weak version of *contra proferentem* may thus lead to stronger versions of the expectations principle, whereas the traditional conception of *contra proferentem* may more typically be allied with a weaker version of the expectations principle that produces less judge-made insurance.

On balance I prefer the traditional conception of *contra proferentem* and a weaker version of the expectations principle. This combination leaves the courts to do more of what they are comparatively capable of doing — interpret — and less of what they tend to do poorly

— regulate. While candor about the developments that have resulted in departures from the traditional conception is desirable if such departures are to continue, a full airing of the complicated and difficult considerations that these departures generate suggests that adherence — or for some courts, return — to the traditional conception is likely to be the most advisable course of action.