

REASSESSING THE "SOPHISTICATED" POLICYHOLDER DEFENSE IN INSURANCE COVERAGE LITIGATION

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I. INTRODUCTION

Insurance law often is ironically regarded as both consistent and confusing. However, the 1980s saw significant flowering in the development of an insurance coverage interpretation doctrine that, although seriously flawed in its present form, offers the as yet untapped potential of substantial improvement in judicial construction of commercial insurance policies through seemingly inconsistent treatment of insurance coverage disputes.

During the past two decades, in response to the prodding of lawyers representing insurers, courts have increasingly noted that not all insurance policyholders are equal. Some have more money and bargaining clout than others. Some have more sophistication and understanding about the nature, structure, custom, and practice of the insurance industry. Some employ professionals such as brokers and attorneys to represent their interests in procuring insurance. In general, some policyholders are less subservient to insurers. These "sophisticated" policyholders¹ are primarily large commercial enterprises. Other policyholders, such as individuals and small organizations, particularly voluntary associations or nonprofit enterprises, might be classified as "ordinary" or unsophisticated policyholders.

Recognizing the distinction between the average home or automobile owner and a major manufacturer, courts have diverged on whether the status of the policyholders should affect a court's approach to the interpretation of insurance contracts.² During the 1980s, courts increasingly appeared receptive to some revision of the usual approach to insurance contract construction. In particular, a number of courts declared that the contract axiom "contra proferentem," the rule that ambiguous contract terms should be construed against the drafter of the term, did not apply when the policyholder was sophisticated.³ This development seems to have subsided, but counsel for insurers continue to press the argument as a means of stripping policyholders of the ambiguity advantage often decisive in insurance coverage

1. The term "sophisticated" refers to policyholders who have substantial economic strength, desirability as customers, understanding of insurance, or readily available assistance in understanding and procuring insurance. For the most part, sophisticated policyholders are relatively large commercial enterprises. For some purposes, insurance departments in fact treat commercial policyholders differently than consumer policyholders. *See, e.g.*, N.J. ADMIN. CODE tit. 11, § 2-17.2 (1990) (noting state Unfair Claims Settlement Act does not apply to commercial insurance when annual premium exceeds \$10,000); *see also* IND. ADMIN. CODE tit. 28, r. 25(2) (1993); N.D. ADMIN. CODE § 45-05-07-01 (1992). Less frequently, however, a small organization or individual may be sophisticated as this Article defines the term. An individual who is not an expert on insurance (*e.g.*, an insurance agent, an actuary, or a law professor who teaches insurance law) would ordinarily need to be wealthy to be a sophisticated policyholder. Ordinary individual policyholders lack the financial clout to bargain with insurers and also lack the economic incentive and means to employ brokers and lawyers on their behalf.

2. *See infra* text accompanying notes 101-52.

3. *See infra* text accompanying notes 101-27.

litigation.⁴ Despite a seeming recent hiatus in the judicial adoption of the argument, courts probably have not seen the last of the sophisticated policyholder defense.

Although the sophistication of the policyholder should have a role to play in adjudicating insurance coverage disputes, that role should not eviscerate the *contra proferentem* doctrine. To date, courts have either erred in favor of insurers, by largely misinterpreting the significance of the policyholder's status, or in favor of policyholders, by incorrectly concluding the identity of the policyholder has no relevance to coverage questions.⁵ The notion that *contra proferentem* principles have no application to insurance contracts merely because the policyholder is sophisticated is misplaced and dangerous. By applying a more sensible version of the sophisticated policyholder approach to insurance policy interpretation, however, courts could render fairer, more predictable, and more economically sound decisions in insurance coverage disputes without unnecessarily undermining valid traditional contract law.

This Article briefly reviews general contract law principles applicable to insurance policies, with special focus on the role of ambiguity analysis and the reasonable expectations approach to insurance coverage litigation. The Article then examines judicial application of insurance contract doctrine in the context of coverage disputes between sophisticated policyholders and insurers. The Article reveals that the *contra proferentem* rule, properly constrained, still has an important role to play in resolving coverage disputes. The Article then suggests an alternative approach when the policyholder is sophisticated.

II. AN OVERVIEW OF INSURANCE POLICY INTERPRETATION

A. Basic Contract Ground Rules and Their Application to Insurance Coverage Disputes

Although insurance contract cases often differ from sale-of-goods or other typical contract cases, the conventional view categorizes insurance policy interpretation as an occasionally erratic subset of contract law. Regardless of practical differences between insurance disputes and commer-

4. Even standardized insurance policies, no matter how well-drafted, are likely to be ambiguous as applied to some fact situations in view of the widespread use of standard forms to cover a multitude of policyholders and risks. In addition, insurance policies are nearly always drafted by the insurance industry. Consequently, the *contra proferentem* rule often can be invoked by policyholders in a coverage dispute and provide the margin of victory. As discussed below, however, the *contra proferentem*, or ambiguity, approach is a creature of general contract law, not only of insurance contract law. *See infra* text accompanying notes 6-45.

5. This Article uses the term "erred" in the doctrinal sense. Many of the cases this Article construes as analytically in error appear to have reached the correct decision regarding the existence and extent of coverage.

cial contract cases, courts continue to use the contract law model, contract jargon, and basic contract interpretation methods in deciding insurance disputes. Cases routinely hold insurance policies are to be construed in the same manner as any other contract.⁶ Basic contract law forms the framework for addressing policy coverage disputes but the discussion frequently focuses on issues peculiar to insurance law.

As in other areas of contract law, the general rule is when a contract term has a plain meaning, courts will apply the plain meaning⁷ without consideration of other factors surrounding the transaction—for example, advertising, negotiations between the parties, oral statements, or conduct. Although cases are seldom explicit on this point, classical contract doctrine took the view that textual meaning was to be determined according to an objective standard, in which the meaning ascribed to text was that ascribed to the language by a hypothetical reasonable person.⁸ Under this approach, it was often necessary only to examine the policy itself.⁹

Commentators perceive a post-World War II replacement of classical objective contract doctrine with a neoclassical contract law more admitting of linguistic uncertainty and more sensitive of the position of the parties. The neoclassical view takes into account the sophistication and bargaining power of the parties, the subject matter of the contract, reliance, expectation, consequences, and public policy goals in addition to freedom of contract. Section 211 of the *Restatement (Second) of Contracts*¹⁰ actually rejects the "four-corners" approach of construing contracts based solely on their text, an approach dominating the first *Restatement*, by reasoning consumers should not be bound by unknown terms contained in standardized contracts.

The plain meaning approach is, however, far from extinct.¹¹ For example, it appears only one court has actually applied section 211 to an insurance policy dispute,¹² a surprising result in view of the mass standardization and complexity of insurance policies, most of which are never read by the average consumer. The potential implications of a large-scale refusal to enforce boilerplate insurance policy clauses are apparently too daunting for

6. See, e.g., *First Far West Transp., Inc. v. Carolina Casualty Ins. Co.*, 614 P.2d 1187, 1190 (Or. Ct. App. 1980); *Standard Venetian Blind Co. v. American Empire Ins. Co.*, 469 A.2d 563, 566 (Pa. 1983); *Bergera v. Ideal Nat'l Life Ins. Co.*, 524 P.2d 599, 600 (Utah 1974).

7. See *Halpern v. Lexington Ins. Co.*, 558 F. Supp. 1280, 1282 (E.D. La.), *aff'd*, 715 F.2d 191 (5th Cir. 1983); *Reserve Ins. Co. v. Pisciotta*, 640 P.2d 764, 767 (Cal. 1982).

8. See E. ALAN FARNSWORTH, *FARNSWORTH ON CONTRACTS* § 7.9, at 245 (2d ed. 1990).

9. See ROBERT H. JERRY II, *UNDERSTANDING INSURANCE LAW* § 25A (1987).

10. See *RESTATEMENT (SECOND) OF CONTRACTS* § 211 (1981).

11. See, e.g., *Eli Lilly & Co. v. Home Ins. Co.*, 482 N.E.2d 467, 470 (Ind. 1985), *cert. denied*, 479 U.S. 1060 (1987); *Insurance Co. of N. Am. v. Adkisson*, 459 N.E.2d 310, 313-14 (Ill. App. Ct. 1984).

12. See *Darner Motor Sales v. Universal Underwriters Ins. Co.*, 682 P.2d 388 (Ariz. 1984).

the judiciary.¹³ Instead, judges intervene on an ad hoc basis through other doctrines—for example, waiver, estoppel, contra proferentem, and reasonable expectations—to police insurance policies when perceived as necessary to avoid unfairness.

Although courts generally maintain that contract interpretation is designed to effect the intent of the parties,¹⁴ the standard for assessing meaning remains an objective one: the court asks what meaning reasonable persons would attach to a disputed term in the same position as the disputants. Essentially, the policyholder's lack of knowledge regarding many policy terms makes a reconstruction of the parties' intent fictitious, forcing courts to an objective view of terminology. In technical areas, the reference point is often the understanding of those with experience in the technical area. This slant on the plain meaning rule has almost no application to consumer insurance disputes because courts are reluctant to use technical or expert reference points to classify policy language as clear when this redounds to the detriment of the consumer.¹⁵ Courts occasionally are even more protective of the policyholder. For example, the Pennsylvania Supreme Court once held the insurer bears the burden of persuasion to show it provided an explanation of even unambiguous terms to the policyholder in order to rely on the policy provision in a coverage dispute.¹⁶ The court later retreated to a more traditional view and endorsed use of the plain meaning rule when the policy term at issue was unambiguous, irrespective of whether the provision was highlighted or explained to the policyholder.¹⁷ When courts depart from a plain meaning or objective text-centered approach to contract in insurance disputes, however, this tends almost invariably to benefit the policyholder.¹⁸

13. Insurance underwriting is commonly thought to require the use of standardized contracting so insurer actuaries can pool the policy risks and make aggregate decisions about pricing and availability of insurance. See ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW § 2.8 (1988); Curtis M. Caton et al., *The Rules of Insurance Policy Construction and the Myth of the "Sophisticated Insured,"* in INSURANCE, EXCESS, AND REINSURANCE COVERAGE DISPUTES 1990 (Barry Ostrager & Thomas Newman eds., 1989) (reproducing expert witness deposition testimony by former New York Insurance Commissioner Richard Stewart to support this proposition).

14. See, e.g., *Purcell v. Allstate Ins. Co.*, 310 S.E.2d 530, 531 (Ga. Ct. App. 1983); *T.E. Ibberson Co. v. American & Foreign Ins. Co.*, 346 N.W.2d 659, 661 (Minn. Ct. App. 1984); JOHN APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE § 7385 (1965).

15. See, e.g., *Ponder v. Blue Cross*, 193 Cal. Rptr. 632, 643 (Ct. App. 1983) (refusing to give a technical medical term objective enforcement when not drawn to policyholder's attention and explained).

16. See *Hionis v. Northern Mut. Ins. Co.*, 327 A.2d 363, 361-66 (Pa. Super. Ct. 1974).

17. See *Standard Venetian Blind Co. v. American Empire Ins. Co.*, 469 A.2d 563, 567 (Pa. 1983).

18. See, e.g., *Ponder v. Blue Cross*, 193 Cal. Rptr. at 643 (holding a health policy exclusion for "temporomandibular joint syndrome," although technically clear, becomes ambiguous to a layperson when not explained to the insured); see also *Holz Rubber Co. v. American Star Ins.*

Whether in technical or pedestrian matters, courts may find policy text clear because of a course of dealing between insurer and policyholder¹⁹ or because the esoteric term was explained or discussed. When courts do this, they have moved from an objective approach to a subjective approach and arguably have switched from plain meaning analysis to another approach. When there is a conflict between course of dealing and the contract text, express terms take precedence over any terms implied from usage in trade, course of dealing, or past behavior.²⁰ Various other contract rules also govern judicial interpretation of insurance policies. For example, the policy is to be interpreted as a whole.²¹ Various documents related to the transaction—for example, application, correspondence surrounding contract formation, and notes—are seen as the whole contract for purposes of interpretation.²²

Insurance policy construction is also governed by general contract rules concerning documentation. For example, the Statute of Frauds, which provides certain contracts²³ must be evidenced by a writing in order to be enforceable, applies to insurance.²⁴ The rule is almost never invoked in the insurance context, however, because of the heavy documentation attending most policies. When faced with oral contracts of insurance, courts have construed the contract as one of indemnity rather than surety and also have taken a liberal view of the one year performance limitation in order to avoid invalidating oral insurance contracts under the Statute of Frauds.²⁵ Courts usually reason that because loss can occur at any time, insurance contracts are capable of performance within one year. A few states have statutes enacting a statute of frauds specifically for insurance, requiring contracts be written to be enforceable.²⁶

A potential problem in life insurance may surface in states that have embellished the typical statute of frauds to require written contracts for

Co., 533 P.2d 1055, 1063 (Cal. 1975); *State Farm Mut. Auto. Ins. Co. v. Jacober*, 514 P.2d 953, 955 (Cal. 1973).

19. See JERRY, *supra* note 9, § 25A.

20. See *id.*

21. See *id.*

22. A key element of an insurance policy is the application completed by the applicant-policyholder. Most insurers routinely make the application part of the policy by physical attachment or incorporation by reference. In some states, the attached application for insurance automatically becomes part of the policy. See, e.g., N.Y. INS. LAW § 3204 (McKinney 1985). Individuals usually complete the questionnaire by response to questions posed by the insurer's agent, who completes the form. Commercial policyholders apply for insurance in more varied ways, often involving brokers who complete required forms as well as communication by letter, memorandum, telephone, and so on.

23. The most common examples are those involving real estate, marriage, those incapable of performance in one year, or those involving a debt payable to another. U.C.C. § 2-201 (1972).

24. See JERRY, *supra* note 9, § 31(d).

25. See *id.*

26. See, e.g., MASS. GEN. LAWS ANN. ch. 175, § 177C (West 1987); CONN. GEN. STAT. § 38a-1(15) (1992). Not surprisingly, these states have a substantial number of domiciled insurers.

transactions that cannot be performed during the lifetime of the parties. Fortunately, not much litigation seems to have arisen involving undocumented life insurance contracts. Judicial tolerance of oral insurance contracts does not necessarily mean, however, the party alleging an oral insurance contract has coverage. The alleged policyholder must show by a preponderance of the evidence that the parties agreed upon the subject matter of the policy, the risk, the duration of the risk, the amount of the policy, the premium rate or payment, and the identity of the insurer and the insured.²⁷

The parol evidence rule, which states extrinsic evidence may not be admitted to contradict the terms of a fully integrated written contract, also applies to insurance policies.²⁸ The rule has generally been relaxed or ignored far more frequently in the neoclassical contract era than in the classical era. Insurance law is no exception. Courts usually avoid parol evidence problems by concluding that the policy in question is not fully integrated²⁹ or by finding a term ambiguous, therefore requiring extrinsic evidence to resolve the ambiguity.³⁰ In addition, parol evidence can be received to show fraud, mistake, duress, or other factors that would evaluate the very making of the contract in dispute.³¹

In both regular and insurance contract interpretation, terms used in different sections of a policy are interpreted consistently and treated synonymously whenever possible.³² Contract terms should generally be interpreted to have some effect and not be reduced to surplusage.³³ The burden of proof generally falls on the party who wishes to argue the term means one thing in section A of the policy and another in section B.

Contract terms regarded as unconscionable will be invalidated, or modified to be made acceptable.³⁴ An unconscionable term is one that is unreasonably unfair to one of the parties.³⁵ Many jurisdictions are inclined to invoke unconscionability analysis only when dealing with a contract of adhesion.³⁶ Commentators tend to classify unconscionability as either procedural (bad contract formation, performance, or termination behavior) or substantive (contract provisions so unfair that, notwithstanding negotiated

27. See, e.g., *Gulf Ins. Co. v. Grisham*, 613 P.2d 283, 285 (Ariz. 1980); *Maryland Casualty Co. v. Foster*, 414 P.2d 672, 673 (N.M. 1966).

28. See JERRY, *supra* note 9, § 61(c).

29. *Id.* This is more difficult to accomplish, however, with insurance policies than with an invoice for the sale of widgets.

30. See *id.*

31. See RESTATEMENT (SECOND) OF CONTRACTS § 214(d) (1981).

32. See JERRY, *supra* note 9, § 25A.

33. See *id.*

34. See FARNSWORTH, *supra* note 8, §§ 4.27-28.

35. See *id.* § 4.28, at 332.

36. See, e.g., *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965) (applying District of Columbia law equal to the Uniform Commercial Code).

agreement, the court views the term as one no reasonable person should accept or gain advantage from).³⁷

Beyond unconscionability, outright fraud and misrepresentation will permit avoidance of both insurance and noninsurance contract provisions.³⁸ The penalties for misrepresentation may be slightly higher in insurance cases. For example, in most states, the filing of a false proof of claim by the policyholder permits the insurer to rescind the entire policy rather than merely to penalize the policyholder in proportion to the magnitude of its misrepresentation, usually the inflating of the amount of loss.³⁹

As in ordinary contract law, interpretations that would make a contract provision illegal or contrary to well-established public policy are disfavored.⁴⁰ Different states may, of course, have quite distinct views as to what constitutes a violation of public policy and what policy provisions consequently must be invalidated. In the insurance context, for example, some states prohibit indemnity for punitive damages or similar liability,⁴¹ although other states have no such restriction on insurability.⁴²

When faced with two equally plausible meanings of a contract term, and extrinsic evidence does not resolve the issue, courts adopt the interpretation more in accord with the public interest.⁴³ Specific terms control when in conflict with general terms.⁴⁴ Customized contract language usually takes on additional weight when added to a standardized contract.⁴⁵ In the insurance context, standardized endorsements separately negotiated or added prominently to a form policy are often accorded similar weight and are considered more probative of the parties' intent than the basic form contract.

Even when words used in text seem to have a clear meaning, sufficiently contrary conduct by a party may result in a finding that the term is ambiguous or the term in text actually does not mean what its dictionary definition would suggest.⁴⁶ Courts that are strictly orthodox about the plain

37. See, e.g., Arthur Allan Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485, 487 (1967); see also FARNSWORTH, *supra* note 8, § 4.28, at 332 n.44 (noting popularity of Leff's distinction).

38. See FARNSWORTH, *supra* note 8, §§ 4.9-20.

39. See JERRY, *supra* note 9, § 82(d).

40. See, e.g., Strickland v. Gulf Life Ins. Co., 242 S.E.2d 148, 151 (Ga. 1978).

41. See, e.g., St. Paul Ins. Cos. v. Talladega Nursing Home, 606 F.2d 631, 633 (5th Cir. 1979) (holding under Alabama law insuring against loss from intentional acts violates public policy).

42. See, e.g., Andover Newton Theological Sch. v. Continental Casualty Co., 964 F.2d 1237, 1241 (1st Cir. 1992) (holding Massachusetts public policy against insuring against loss from intentional wrongs does not bar coverage for federal Age Discrimination Act liability because this can result from recklessness or oversight rather than specific intent to discriminate); First Bank-Billings v. Transamerica Ins. Co., 679 P.2d 1217, 1223 (Mont. 1984) (holding insuring against punitive damages does not violate public policy).

43. See JERRY, *supra* note 9, § 25A.

44. See *id.*

45. See *id.*

46. See FARNSWORTH, *supra* note 8, §§ 7.5-6, 7.12-13.

meaning approach and the objective theory of contract do not permit inconsistent actions to overcome what they regard as contract text. A court in that situation may be more inclined, however, to characterize the contract language as ambiguous.⁴⁷

1. *Contract Formation in the Insurance Context*

Although it seems elementary, enforceable insurance contracts usually require the presence of offer, acceptance, and consideration, as in other contracts. The nature of contract formation for insurance policies, however, is quite distinct. Notwithstanding heavy expenditures for advertising and sales, the insurer does not make contract offers. Rather, the insurer solicits invitations to make an offer. The prospective policyholder makes the offer by completing an insurance application and submitting it to the insurer. Because the applicant is the offeror and the insurer the offeree, the company is ordinarily not bound until an authorized representative accepts the risk.

Acceptance is further complicated because most applications provide and many insurers take the position acceptance is incomplete until physical delivery of the policy to the insured. In cases when this additional requirement matters—for example, if the applicant-policyholder has died after the insurer has accepted coverage and issued a policy but before the agent delivered the policy to the decedent—courts have frequently found constructive delivery and coverage in order to avoid unfairness to the applicant-policyholder.⁴⁸ A significant number of cases have accepted, however, the insurer's view requiring physical delivery.⁴⁹

Even when the extreme and literal physical delivery requirement is rejected, insurers still have delivery defenses based on contract language requiring satisfaction of certain conditions, such as requiring the policyholder to be in "good health" at the time of delivery.⁵⁰ An unreasonable delay in decision or policy delivery by the insurer may result, however, in court-mandated acceptance and enforcement of the policy.⁵¹ Jurisdictions differ substantially in this area, with liberal jurisdictions more likely to find coverage due to delay whereas conservative courts find delay immaterial if the insurer would have declined coverage in any event.⁵²

47. See *id.* §§ 7.7-10.

48. See, e.g., *Kramer v. Metropolitan Life Ins. Co.*, 494 F. Supp. 1026, 1031 (D.N.J. 1980); *Wanshura v. State Farm Life Ins. Co.*, 275 N.W.2d 559, 562-63 (Minn. 1978).

49. See, e.g., *Reynolds v. Guarantee Reserve Life Ins. Co.*, 358 N.E.2d 940, 943-44 (Ill. App. Ct. 1976).

50. See KENNETH S. ABRAHAM, INSURANCE LAW AND REGULATION: CASES AND MATERIALS 26 (1991).

51. See, e.g., *Huberman v. John Hancock Mut. Life Ins. Co.*, 492 So. 2d 416, 417-18 (Fla. Dist. Ct. App. 1986); *Talbot v. Country Life Ins. Co.*, 291 N.E.2d 830, 832 (Ill. App. Ct. 1973).

52. See, e.g., *Life & Casualty Ins. Co. v. Central Steel Prods.*, 709 S.W.2d 830, 832 (Ky. Ct. App. 1985).

Whatever the jurisdiction, delay alone, absent other factors, is insufficient to create acceptance of the risk and constructive issuance of the policy by the insurer. Delay must be unreasonable to create a contract.⁵³ Courts and commentators differ both as to the rationale and the wisdom of these results. Although some courts construe unreasonably long delay by insurers as acceptance of the application offer,⁵⁴ this result is more commonly achieved through contract theories of promissory estoppel or detrimental reliance. Under these theories, the applicant has been promised reasonably swift action by the insurer and relied upon it by premium prepayment and conditional receipt or by ceasing to shop for insurance. Some courts seem to apply a version of equitable estoppel⁵⁵ or even waiver⁵⁶ to these situations.⁵⁷ Implicitly or explicitly, many courts treat the dispute as one of tort rather than contract, reasoning unjustified delay violates a duty to the applicant and the damages for this "contort" will be de facto issuance of the policy.⁵⁸ A court finding that insurer delay requires issuance of the policy does not, however, preclude the insurer from raising any defenses available under the policy.

For the applicant, the situation also differs from ordinary contract law acceptance. For example, upon issuance of a policy, the policyholder may cancel within a short time (usually ten days) under most state laws and regulations.⁵⁹ Even if the policyholder does not formally cancel the policy, he or she can achieve the same effect merely by failing to pay premiums.⁶⁰ Insurers generally have no recourse but to cancel and are unlikely to sue successfully the policyholder for damages based on the insurer's reliance, expectation, or out-of-pocket unwriting expense.

The consideration supporting the insurance contract usually consists of the mutual promises of applicant and insurer. The applicant promises to pay premiums, and often prepays the first premium at time of application. The insurer promises to issue a policy, which includes a host of other promises, if the applicant qualifies.

In general, insurers have succeeded in structuring the sale of insurance to achieve significant advantages as compared to vendors in other contract settings. Insurers avoid extended negotiation, discussion, or explanation over contract terms partly because they typically do not even provide policyholders with a copy of the policy, particularly in consumer lines, until after the

53. See *Megee v. United States Fidelity & Guar. Co.*, 391 A.2d 189, 192 (Del. 1978).

54. See, e.g., *Cartwright v. Maccabees Mut. Life Ins. Co.*, 247 N.W.2d 298, 301 (Mich. 1976).

55. These courts conclude it is wrongful conduct by the insurer to unreasonably delay, and the insurer should therefore not receive the benefits of a late denial of coverage.

56. That is, due to its unreasonable delay, the insurer has waived its right to reject the applicant according to its own underwriting standards.

57. JERRY, *supra* note 9, § 25A.

58. See generally *id.* § 32.

59. See *id.* § 31.

60. See *id.*

insurer has decided to accept the risk. Of course, the industry norm of standardized policies dampens negotiation even further. In a typical transaction, discussion centers only on a few basic terms such as premium price, policy limit, and a few broad coverage provisions or concepts.

2. *Intermediaries and Contract Formation*

Agents and brokers are often part of insurance contracting. Agents represent the insurer and generally are classified as general agents, who have express actual authority to enter binding insurance contracts on behalf of the insurer;⁶¹ special agents, who have actual authority only in certain limited areas such as sales, reports, investigations, and small claims settlement;⁶² or soliciting agents, which is primarily a synonym for special agents but implies the agent's authority may be limited to sales and closely related activities.⁶³ "Independent" agents are not employed by a particular company but are authorized to sell policies, and sometimes more, for a number of insurers.⁶⁴ The independent agent's authority and principal can often be ambiguous. For some purposes—for example, selecting coverage—the independent agent represents the policyholder. For other purposes—for example, collecting premiums—the agent represents the insurer. Some areas—for example, processing claims—are very situation-specific and may find different results. Brokers are intermediaries who represent the applicant or policyholder and are usually paid by commission rather than salary.⁶⁵ The broker's role, like that of the independent agent, can become ambiguous in certain areas, although the broker's link to the policyholder as principal is generally clearer than the status of an agent, especially in commercial lines.

Authority of agents generally is divided into express actual authority, in which the principal (the insurance company) has expressly authorized the agent to bind the principal contractually;⁶⁶ implied actual authority, in which conduct of the principal has strongly suggested authorization to act;⁶⁷ and apparent authority, which is created when the agent's actions are reasonably perceived by a third party to be authorized.⁶⁸ The hornbook legal rule of apparent authority requires some conduct by the principal to give rise to the agent's apparent authority.⁶⁹ Mere inaction can support, however, a finding

61. See *id.* § 13(c).

62. See *id.*

63. See *id.*

64. See *id.*

65. See *id.*

66. See *id.* § 35.

67. See *id.* § 35(b). An initially unauthorized agent may also acquire authority if the agent's act is later ratified by the principal. See *id.* § 35.

68. See *id.*

69. See, e.g., *Inland USA v. Reed Stenhouse, Inc.*, 660 S.W.2d 727, 733 (Mo. Ct. App. 1983).

of apparent authority under apt circumstances.⁷⁰ When the principal is an insurer, courts occasionally stretch hornbook law to bind insurers to unauthorized representations or outright misstatements by agents on apparent authority grounds.⁷¹ The insurer is not completely powerless in these situations. Unauthorized agent actions resulting in liability to the insurer can give rise to an indemnity claim against the agent.⁷² Similarly, negligence or misconduct by the agent may make the agent directly liable to the applicant.⁷³

B. *The Ambiguity Approach and its Rationale*

As noted above, the well-established contract principle of *contra proferentem* provides any ambiguities in a contract term shall, absent resolution of the ambiguity through extrinsic evidence or some other superior basis for decision, be resolved against the party who drafted the contract.⁷⁴ Because insurance policies are almost always drafted by the insurer, *contra proferentem* in this context means ambiguous terms are construed against the insurer, provided that all other indications of party intent are in equipoise. As a result, the ambiguity approach is often mischaracterized as a "contra insurer" doctrine.⁷⁵ The doctrine is therefore decried by those who see it as a great departure from general contract doctrine.⁷⁶ These critics often seem either to misunderstand the doctrine or to confuse judicial misapplication of the doctrine, however, with the doctrine itself. Critics of *contra proferentem* also imply, erroneously, that the doctrine is peculiar to insurance.⁷⁷ Although, as previously noted, the doctrine is more prevalent and presents special problems in insurance law, it is a basic contract law axiom.⁷⁸

Critics of *contra proferentem* regard it as too easy a default mechanism magically conveying victory to the insured.⁷⁹ These critics do not seem to understand that *contra proferentem*, when properly applied, is a judicial tie breaker of last resort.⁸⁰ Courts properly employing the ambiguity principle

70. See, e.g., *Travelers Ins. Co. v. Morrow*, 645 F.2d 41, 44-45 (10th Cir. 1981).

71. See, e.g., *Pearce v. American Defender Life Ins. Co.*, 343 S.E.2d 174, 177 (N.C. 1986).

72. See, e.g., *Elmer Tallant Agency v. Bailey Wood Prods.*, 374 So. 2d 1312, 1315 (Ala. 1979).

73. See, e.g., *Anderson v. Dudley L. Moore Ins. Co.*, 640 S.W.2d 556, 559 (Tenn. Ct. App. 1982) (addressing agent's liability when applicant's home damaged by fire after agent failed to mail in application for three weeks).

74. See *supra* text accompanying note 4.

75. See, e.g., *Goucher v. John Hancock Mut. Life Ins. Co.*, 324 A.2d 657, 662 (R.I. 1974) (holding policy ambiguities are to be construed against the insurer).

76. See, e.g., David S. Miller, Note, *Insurance as Contract: The Argument for Abandoning the Ambiguity Doctrine*, 88 COLUM. L. REV. 1849 (1988).

77. *Id.* at 1851-53.

78. See FARNSWORTH, *supra* note 8, § 7.11.

79. Miller, *supra* note 76, at 1852-53.

80. *Id.* at 1851.

invoke it only after having determined (1) the term in question is actually ambiguous, and (2) no extrinsic evidence—for example, testimony, documents, actions of the parties, prior dealings, and industry practices—serves to resolve the ambiguity.⁸¹ If, in fact, courts use the default mechanism of ambiguity only when more reliable indicia of intent have failed to resolve the matter, it is difficult to understand critics of *contra proferentem*. The critics' perspective is bolstered, however, by various generalities.

First, the nature of insurance (committing to indemnify for unknown risks well into the future) requires policy language to be broadly drafted. The effort to expand coverage can lead to ambiguous language, or language courts may perceive as ambiguous.

Second, this tendency toward ambiguity may be exacerbated by the use of an industry-wide organization—for example, the Insurance Services Office (ISO) for property and liability insurance—to write standardized policies, which drives policy language to a more comprehensive scope and greater level of generality, increasing the chances a particular term will be deemed ambiguous. Because insurance law is largely state law (much of it court-created common law) even diligent, state-specific efforts by ISO will not anticipate every contingency and potential ambiguity.

Third, insurers may have chosen to elect ambiguity rather than to write a detailed policy with such a long litany of excluded but unlikely events that scares off the majority of potential customers.

Fourth, courts, as a consequence of crowded dockets, laziness, or error, may fail adequately to explore nontextual evidence of meaning and too quickly resort to the *contra-proferentem* default for decision.

Finally, courts may fail to appreciate the remaining importance of an objective theory of meaning and the almost technical terms of art in policy provisions, thereby finding them ambiguous merely because they are not written specifically with the layperson in mind.

Although these factors are valid reasons for observers, particularly insurers, to express concern, these factors do not undermine the essential logic of *contra proferentem*: when all else fails, courts construe ambiguous language against the drafter to encourage clearer, more careful, and precise contract language and place the costs of uncertainty—that is, litigation losses—on the party better able to bear and spread the loss.⁸² Of course, the rise of carrier insolvency during the 1980s suggests this argument may be inapt for some lines of insurance or in situations when the policyholder has greater wealth than the insurer.

Contract ambiguity can result from imprecise language. In a celebrated contracts article, Professor E. Allan Farnsworth divided language imprecision

81. *Id.*

82. See generally GUIDO CALABRESI, THE COST OF ACCIDENTS 244-65 (1970) (arguing in close liability cases the better policy is to assign liability to the party who can most cheaply avoid the loss or minimize the cost of the loss).

into five categories: vagueness, ambiguity of term, ambiguity of syntax, ambiguous organization, and ambiguity created by extrinsic information.⁸³ Vagueness is terminology that, although conveying a general impression, becomes unclear in marginal situations—for example, claims arising due to new technologies, new commercial activity, or new developments in legal liability.⁸⁴ Ambiguity of term occurs when the potential for different readings results from ambiguous terms.⁸⁵ For example, does “disability” mean complete inability to work or merely inability to work in one’s prior chosen occupation? Does “damages” mean only a legal judgment or does it also encompass the amounts paid for regulatory compliance, informal settlement, fines, and so forth?⁸⁶ Ambiguity of syntax stems from imprecise grammatical structure.⁸⁷ For example, does the phrase excluding coverage for “disease of organs of the body not common to both sexes” mean gender-specific diseases are excluded or any problems affecting gender-specific body parts are excluded?⁸⁸ Because of standardization and scrutiny, this type of ambiguity is rarer in insurance contracts than in other contracts. Ambiguous organization occurs when the structure of the contract fails to inform the reader or perhaps even misleads the reader.⁸⁹ This problem is more frequently found in insurance policies as compared to other contracts because of the sea of standardized, often small print, terms in the policies. If sufficiently hidden and insufficiently reasonable, customary, or expected, courts may refuse to enforce such provisions or invoke *contra proferentem*.⁹⁰ Ambiguity created by extrinsic information is the ambiguity that occurs when the policy says one thing about coverage but the insurer’s agent or advertising literature says another.⁹¹ Although *contra proferentem* may be the next step, courts should, and ordinarily do, first attempt to resolve the issue by determining if the

83. See E. Allan Farnsworth, *Meaning in the Law of Contracts*, 76 YALE L.J. 939 (1967).

84. *Id.* at 952-53.

85. *Id.* at 954.

86. Many would characterize these examples as vague terms rather than ambiguous terms, suggesting that definition of ambiguity may itself have some ambiguity. Professor Jerry, for example, finds the term “occurrence” in automobile insurance to be a vague term. See JERRY, *supra* note 9, § 25A. A reader generally knows an “occurrence” is an accident, but when the policyholder’s car hits one car, bounces off and hits another, has there been one occurrence or two? Compare *Olsen v. Moore*, 202 N.W.2d 236, 241 (Wis. 1972) (one) with *Liberty Mut. Ins. Co. v. Rawls*, 404 F.2d 880, 880 (5th Cir. 1968) (two).

87. Farnsworth, *supra* note 83, at 954.

88. The former interpretation certainly seems to pass the test of common sense better. It is hard to understand why, for example, a health insurer would be entitled to, or would want to, refuse to provide a worker indemnity for contusions from a fall merely because some of the damaged portions of the body were female reproductive organs. See, e.g., *Business Men’s Assurance Ass’n v. Read*, 48 S.W.2d 678 (Tex. Civ. App. 1932) (finding coverage in favor of policyholder).

89. Farnsworth, *supra* note 83, at 956.

90. See, e.g., *State Farm Mut. Auto. Ins. Co. v. Bogart*, 717 P.2d 449, 456-57 (Ariz. 1986); *Commercial Union Assurance Cos. v. Gollan*, 394 A.2d 839, 841-42 (N.H. 1978).

91. See Farnsworth, *supra* note 83, at 957-65.

totality of extrinsic evidence resolves the issue without resort to the ambiguity doctrine. When there are no other grounds for resolution, the ambiguity principle is invoked.⁹²

1. *The Ambiguity Approach: Benefits and Drawbacks*

During prior eras of contract law, when a strict version of the parol evidence rule discouraged consideration of extrinsic evidence for fully integrated contracts, the ambiguity principle could be a particularly strong weapon for the nondrafter because courts were largely unwilling to consider whether extrinsic evidence surrounding the contract resolved the textual ambiguity.⁹³ Relaxation of the parol evidence rule during the twentieth century, however, allowed courts first to seek to resolve contract ambiguity by reference to the intent of the parties—for example, by examining what was said in negotiations and letters, the behavior of the parties, and so on. Consequently, the ambiguity approach slipped in importance and became more of a tie breaker for resolving contract disputes when other indicia of the parties' intent were absent.

This notion of invoking the *contra proferentem* principle as a tie breaker only after consideration of extrinsic evidence specific to the case is the better reasoned modern view of contract law. As one court stated:

Contracts are to be construed against the drafter only as a matter of last resort, when doubt persists 'after applying all of the ordinary processes of interpretation,' including all existing usages, general, local, technical, trade and custom and agreement of the two parties with each other, having admitted into evidence and duly weighed all of the relevant circumstances and communications between the parties . . .⁹⁴

The ambiguity principle has, however, retained central importance in insurance coverage litigation. Courts seem to exhibit less concern in such cases for issues raised by extrinsic evidence—for example, the understanding of the parties, special or technical meaning, prior course of dealing, and the purpose of the transaction—despite the exhortations of courts that an insurance policy is to be construed according to the "ordinary" rules of contract.⁹⁵

92. See, e.g., *Fritz v. Old Am. Ins. Co.*, 354 F. Supp. 514, 518 (S.D. Tex. 1973) (holding direct mail advertisement in conflict with policy language creates ambiguity); *Craver v. Union Fidelity Life Ins. Co.*, 307 N.E.2d 265 (Ohio Ct. App. 1973).

93. See *FARNSWORTH*, *supra* note 8, §§ 7.2, 7.3, 7.12(a).

94. *NLRB v. L.B. Priester & Son*, 669 F.2d 355, 364 (5th Cir. 1982) (quoting ARTHUR CORBIN, *CORBIN ON CONTRACTS* § 559 (1960) (applying federal common law of contract)); *accord FDIC v. Connecticut Nat'l Bank*, 916 F.2d 997, 1006 (5th Cir. 1990) (citing *CORBIN*, *supra*, § 559) (applying federal contract law).

95. See *Guant v. John Hancock Mut. Life Ins. Co.*, 160 F.2d 599, 602 (2d Cir.) (noting *contra proferentem* is "more rigorously applied in insurance than in other contracts" because of its complexity and technical jargon), *cert. denied*, 331 U.S. 849 (1947).

These cases and cases with opposite holdings tend to illustrate the judicial inconsistency that so often affects insurance coverage litigation. When the court has determined to find for the insurer, the catch phrase "insurance is just like any other contract" usually leads the charge toward a finding of no coverage.⁹⁶ When the court favors the policyholder and inclines toward finding coverage, it begins its discussion with a recitation of the *contra proferentem* principle.⁹⁷

Courts seem to invoke ambiguity analysis more often in insurance litigation than in other contract disputes. Several possibilities account for the prevalence of ambiguity analysis in insurance coverage litigation. One possibility is the "ultra-standardized" nature of insurance policies, which admits of little negotiation, situation-specific drafting, or party discretion to alter basic language. Another explanation is the integrated nature of most insurance policies, often with accompanying terminology, which may prompt courts toward a stringent view of the modern parol evidence doctrine. Conversely, of course, the nature of the policy drafting and sales process has prompted courts sympathetic to policyholders to disregard any limits on parol evidence stated in the policy text. Also contributing is the desire of courts to adjudicate coverage questions with a minimum of expenditure of judicial resources devoted to fact finding—for example, who said what to whom, what most doctors consider to be "ordinary and reasonable" expenses, and so forth. An additional possibility is the pervasiveness and importance of insurance to the ordinary functioning of much of America's commercial⁹⁸ and personal⁹⁹ activity. A final possibility is sympathy for policyholders, who often have markedly less economic power and contracting sophistication when compared to insurers.

Of course, not all policyholders lack economic strength and sophistication, which has prompted some courts to begin to move away from immediate and reflexive invocation of the *contra proferentem* principle.¹⁰⁰ In addition, crises of insurance availability in the mid-1970s (for medical malpractice) and mid-1980s (for commercial general liability, particularly for certain policyholders such as municipalities and child care providers) as well as increased judicial sensitivity to economic analysis have made insurers less disfavored litigants, opening the door to relaxation of use of the *contra proferentem* rule in favor of policyholders.

Jurisdictions tend to be divided, each applying strong, weak, or moderate versions of the ambiguity principle, regardless of the views of the bench concerning the sophistication of the policyholder. When policy language is

96. See, e.g., *Standard Venetian Blind Co. v. American Empire Ins. Co.*, 469 A.2d 563 (Pa. 1983).

97. See, e.g., *Eli Lilly & Co. v. Home Ins. Co.*, 794 F.2d 710, 716 (D.C. Cir. 1986) (applying Indiana law), *cert. denied*, 479 U.S. 1060 (1987).

98. For example, property and liability insurance.

99. For example, title insurance, homeowner's insurance, and automobile insurance.

100. See *infra* part III.

seen as ambiguous, "strong ambiguity courts" construe disputed terms against the insurer, seemingly without any effort to resolve the uncertainty by resort to extrinsic evidence.¹⁰¹ The strong *contra proferentem* courts are also more willing to characterize policy language as ambiguous.¹⁰² "Weak ambiguity courts" are usually less likely to find language ambiguous, and when they do, they will make substantial attempts to resolve the ambiguity through study of the whole policy and receipt of extrinsic evidence regarding the intent of the parties, using the ambiguity principle only as a last resort.¹⁰³ In between the poles of strong and weak ambiguity courts lie "moderate ambiguity courts,"¹⁰⁴ which attempt to employ an objective test of contract

101. See, e.g., *Chen v. Metropolitan Ins. & Annuity Co.*, 907 F.2d 566 (5th Cir. 1990) (applying Texas law).

Words and clauses of insurance contracts are strictly construed against the insurer, and if a word or clause is capable of more than one reasonable meaning, then the meaning favoring the insured must be adopted. If the term may be interpreted as a limiting term or the clause itself is an exclusionary clause, then the construction of the clause urged by the insured must be adopted as long as that construction is not unreasonable. Even if the insurer's construction is more reasonable than the insured's, the insured's must prevail.

Id. at 569 (citations omitted); accord *Eli Lilly & Co. v. Home Ins. Co.*, 794 F.2d 710, 716 (D.C. Cir. 1986) (applying Indiana law) (holding unnecessary to examine first other indicia of intent surrounding a disputed term because "the only factual predicate of the rule that insurance contracts should be construed against the insurer is the requirement that the contract be ambiguous"), cert. denied, 479 U.S. 1060 (1987).

A case such as *Eli Lilly* can be justly criticized for making *contra proferentem* a first resort rather than a last resort, but this does not make the *contra proferentem* doctrine entirely inapt for commercial insureds. Regarding *Chen*, recall the Fifth Circuit was cited in a footnote for the proposition that *contra proferentem* should only be used as a last resort. *NLRB v. L.B. Priester & Son*, 669 F.2d 355, 364 (5th Cir. 1982) (applying federal common law). There obviously may be inconsistency in the views of different appellate panels. In addition, federal courts must generally follow the applicable state law of contracts and insurance. Texas law may have left the *Chen* court with no alternative but strong use of the ambiguity doctrine.

102. See, e.g., *Read v. Western Farm Bureau Mut. Ins. Co.*, 563 P.2d 1162, 1167 (N.M. Ct. App. 1977) ("A word that an insured cannot understand is a word of doubtful meaning and ambiguous")

103. See, e.g., *FDIC v. Mmahat*, 907 F.2d 546 (5th Cir. 1990) (applying Louisiana law) (holding an exclusion in a law firm's malpractice policy for "dishonest acts" unambiguously includes intentional breach of fiduciary duty to a bank committed by the senior partner), cert. denied, 499 U.S. 936 (1991). In addition, a law firm would presumably qualify as a sophisticated policyholder, so the court could have invoked this as a basis for decision but did not.

One jurisdiction, Arizona, once purported to reject the ambiguity principle altogether. In *Darner Motor Sales v. Universal Underwriters Insurance Co.*, 682 P.2d 388 (Ariz. 1984), the court held it will replace the ambiguity rule with "established principles of contract law." *Id.* at 395. The "established" contract law used by the Arizona court was *Restatement (Second) of Contracts* § 211, a proconsumer provision virtually ignored by the judiciary. *Id.* at 396. Not surprisingly, perhaps, Arizona has in subsequent cases tended to look more like a weak ambiguity state (and occasionally a moderate ambiguity state) rather than a "no ambiguity" state. See, e.g., *Security Ins. Co. v. Andersen*, 763 P.2d 246 (Ariz. 1988); *Millar v. State Farm Fire & Casualty Co.*, 804 P.2d 822 (Ariz. Ct. App. 1990).

interpretation based on whether a reasonable third (nonexpert) person would find the language ambiguous.¹⁰⁵ These courts tend to resort to *contra proferentem* to resolve cases sooner than do weak ambiguity courts.¹⁰⁶

Although unspoken, the distinction between courts that invoke *contra proferentem* as a first, middle, or last resort may derive not only from judicial views of insurance law but also from the relative concern of courts for efficiency and conservation of judicial resources. By invoking ambiguity earlier, for example, a court retains contract interpretation as a question of law (decided by the judge) and eliminates the potentially time-consuming process of fact finding and jury trial. This may, of course, be a short-sighted view of efficiency if courts, in order to save their time, render decisions that increase insurance premiums and other costs for society as a whole.

2. *Criticisms and Reconsideration of Contra Proferentem*

Because of its frequent use, the ambiguity doctrine has been criticized in both insurance and noninsurance applications. In insurance applications, in which the doctrine is more easily and frequently invoked and is more akin to a substantive legal rule, criticism was always present in muted form, but has escalated significantly in recent years.¹⁰⁷ Historically, this criticism came primarily from insurers and was seen as partisan.¹⁰⁸ In recent years, however, substantial premium increases and unavailability of certain lines of insurance have prompted academics to reconsider *contra proferentem* and other legal rules tending to favor policyholders and tort claimants.¹⁰⁹

Scholars have found *contra proferentem* suspect because (1) the doctrine is only partially effective in protecting policyholders (a very clear but oppressive policy term will not run afoul of *contra proferentem*), (2) courts

104. *But see* Miller, *supra* note 76, at 1853-54 (dividing ambiguity states only according to strong and weak versions of the doctrine).

105. *See, e.g.*, *Cody v. Remington Elec. Shavers*, 427 A.2d 810 (Conn. 1980); *Northland Ins. Co. v. Crites*, 419 N.E.2d 164 (Ind. Ct. App. 1981).

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

107. *See, e.g.*, BARRY R. OSTRAGER & THOMAS R. NEWMAN, *HANDBOOK ON INSURANCE COVERAGE DISPUTES* § 103[e] (2d ed. 1989); Mark C. Rahdert, *Reasonable Expectations Reconsidered*, 18 CONN. L. REV. 323, 327-30 (1986).

108. *See* Rahdert, *supra* note 107, at 369-70.

109. *See, e.g.*, George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521 (1987).

are pressured by interests of fairness, and *contra proferentem*'s failure to easily achieve it, to stretch the concept of ambiguity out of shape, and (3) the doctrine relies on legal fictions about "freedom of contract, mutual assent, and the parties' mutual intent" that are hopelessly divorced from modern insurance contracting reality.¹¹⁰

The third criticism is most analytically serious. The first criticism—that *contra proferentem* fails to "do it all" in achieving just results—seems but a truism. Grander documents and doctrines such as the Constitution, the Equal Protection Clause, and equitable estoppel have similarly failed to save the world. When properly supplemented by the apt use of principles of fraud, misrepresentation, reasonable expectations, and estoppel, *contra proferentem* seems an effective arrow in the court's quiver of contract construction arrows. The second criticism—that courts abuse the ambiguity principle—begins to look more like a criticism of the bench than of the doctrine. The presence of a strong or hypertrophied version of the ambiguity doctrine, when words are stretched and insurers automatically lose, is a significant problem but perhaps not an inherent fault of the *contra proferentem* principle. The traditional (and wise) response to this problem is the improvement of judging rather than repeal of an otherwise valid rule or method. The third criticism—that *contra proferentem* is based on a contracting scenario that does not exist—is powerful, perhaps powerful enough to cast the wisdom and validity of the doctrine in doubt.

Despite increased criticism, there remain factors supporting continued use of the ambiguity principle. First, it can still be a helpful judicial tie breaker if properly used. Many things that lack intellectual rigor are quite effective for the task at hand. In addition, *contra proferentem* still has empirical support. Although parties do not often draw custom-made contracts as they once did, one of the parties can usually be identified as having primary control over contract form, language, and process. Finally, the original rationale of the ambiguity doctrine—that resolving close interpretative questions against the contract author will encourage careful drafting—still applies.

Even if the premises underlying a rule have changed, the rule may still be useful if it fits a different need. Although the classic bargaining model of contract no longer applies to most insurance sales (or to most consumer transactions for that matter) the ambiguity doctrine can still be defended because it places the burden upon the party with greater ability to avoid uncertainty, and usually upon parties with greater resources and ability to spread losses as well.

Mass standardization of contracts and the unusual dance of insurance contracting do not suggest a need for less protection to the nondrafting party. Instead, these modern developments suggest a need for more protection. Although protection of the nondrafter may not have been the primary purpose

110. See Rahdert, *supra* note 107, at 330.

of the ambiguity rule, it was a consideration.¹¹¹ *Contra proferentem* continues to have force when applied to many coverage questions because most policyholders are nondrafters who have nothing to say about the language of the contract. Consequently, if someone has to lose a contract dispute, one can make a good case it should not be the nondrafting policyholder.

If anything, drafters of standardized contracts have more time, resources, and expertise to devote to contract drafting than their customized contract predecessors. The judicial system wanted the drafters of customized contracts to draft with care when a mistake tended to affect only a small group. The judicial system presumably wants drafters of standardized contracts to act with at least equal care. The complex nature of insurance, the information disparity between insurer and policyholder, the virtual necessity for insurance, and the industry's ability to collaborate on contract terms without legal liability (because of the McCarran-Ferguson Act's antitrust exception for insurers¹¹²) all make modern consumer insurance a stronger case for calling close questions in favor of the nondrafter than were presented in the customized land lease, sale of goods, and shipping contracts from which the ambiguity doctrine sprang. Thus, the implicit rationale of *contra proferentem* continues with some vigor.

In addition, *contra proferentem* cases may not be any less predictable than any contract case, which often turns on a court's particular view of the allegedly plain meaning of text, or upon the judge or jury's reception of a particular piece of extrinsic evidence, or the assessed credibility of a given witness's testimony. Any of these approaches, all part of standard contract fare as is the ambiguity doctrine, can frustrate predictability as easily as *contra proferentem*.

Under these circumstances, perhaps both the criticism and defense of ambiguity adjudication sweep too broadly. Some criticism of the ambiguity approach is excessive flagellation of a straw man. Critics sketch the doctrine in not merely the strong form but paint it as an almost absurdly pro-policyholder vendetta by courts.¹¹³ Similar problems with other contract law doctrines are conveniently overlooked. For example, alternative approaches such as reasonable expectations analysis are usually minimized in cursory fashion. More often, no alternative to the ambiguity approach is proposed by its critics, who imply an almost religious belief that in the absence of *contra proferentem* the correct and unquestioned interpretation of the term will magically appear. The critics forget the absence of an easy resolution led to

111. See JEFFREY W. STEMPLE, *INTERPRETATION OF INSURANCE CONTRACTS: LAW AND STRATEGY FOR INSURERS AND POLICYHOLDERS* § 5.2 (1994).

112. See 15 U.S.C. § 1011 (1988).

113. See Miller, *supra* note 76, at 1850-52; E. Neil Young et al., *Insurance Law Interpretation: Issues and Trends*, 625 INS. L.J. 71, 73 (1975) (describing ambiguity approach as occasionally so strong that it protects even the "waysfaring fool" policyholder).

invocation of the ambiguity principle. They also seem to assume unrealistically that questions of party intent, credibility, inference, and certainty are crystal clear. Similarly, the critics seem to forget contract text often is not clear. Simultaneously, supporters of the doctrine tend to forget that courts have often turned *contra proferentem* into "contra insurer," a result not compelled by the mere existence of the ambiguity approach.

C. *The Reasonable Expectations Approach*

Although the underlying concept of contract construction to accord with the intent of the parties is of long standing, modern insurance law, particularly in the consumer context, is uncomfortable with the degree of interpretative divergence between the understandings of insurers and policyholders. Modern insurance law also recognizes the potential unfairness of adopting an objective theory of the meaning of contract terms in situations when the policyholder never read the contract in question or when the contracting involved an adhesion agreement with no real negotiation and bargaining.¹¹⁴ Consequently, one subcurrent of the *contra proferentem* line of cases had explicitly stated or implied that ambiguities should be resolved to accord with the reasonable interpretation given the challenged provision by the policyholder or even the reasonable expectations of the policyholder.¹¹⁵

In 1970, Robert E. Keeton, then a law professor and now a federal judge, synthesized and expanded upon these developments in his famous article *Insurance Law Rights at Variance with Policy Provisions*.¹¹⁶ Keeton's insight, in its most direct nutshell formulation, stated, "The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations."¹¹⁷ For courts that embraced this more express formulation of what, according to Judge Keeton, they had been doing tacitly, the duty to read contracts became largely irrelevant, at least for unsophisticated policyholders, in cases when the policyholder had a sufficiently reasonable understanding of the term in dispute and the insurer had done nothing to dispel that objectively reasonable understanding of the policyholder.

Approximately fifteen states have adopted a strong or broad version of the reasonable expectations concept and have invoked the doctrine to find in favor of policyholders, despite clear policy language, when the language is insufficiently apparent and not drawn to the policyholder's attention.¹¹⁸ Some

114. See STEMPLE, *supra* note 111, § 5.2, at 183-84.

115. See, e.g., *Prudential Ins. Co. of Am. v. Lamme*, 425 P.2d 346 (Nev. 1967).

116. Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961 (1970).

117. *Id.* at 967.

118. See, e.g., *Baybutt Constr. Corp. v. Commercial Union Ins. Co.*, 455 A.2d 914 (Me. 1983); *Atwater Creamery Co. v. Western Nat'l Mut. Ins. Co.*, 366 N.W.2d 271 (Minn. 1985);

reasonable expectations states appear to have moved from the Keeton-stated formula to a more narrow view in which the degree of the policyholder's reasonableness, reliance, and damage is weighed against the clarity of the policy, insurer conduct, and disclosure in light of the overall equities of the situation.¹¹⁹ A similarly sized group of states has rejected the reasonable expectations doctrine in more or less explicit terms.¹²⁰

Another third of the states appear receptive to the underlying notion of vindicating the reasonable expectations of the policyholder but stop short of treating the notion as a distinct doctrine or principle for decision. Instead, these courts introduce reasonable expectations thinking into their opinions, often combining it with the ambiguity doctrine and relatively broad notions of promissory and equitable estoppel, waiver, unconscionability, and public policy review, but stop short of using the policyholders' expectations, however reasonable, to override policy language viewed as clear.¹²¹ Despite the general retreat from reasonable expectations shown by courts in the 1980s, some jurisdictions appear to have moved toward the Keeton concept.¹²² In general, however, the reasonable expectations approach, like strong forms of the ambiguity approach, appears to have receded in use during the past decade. This inconsistency and eclecticism of the states (including a good deal of intra-state divergence between the states) results from changing court composition,¹²³ different courts and majority opinion writers,¹²⁴ and different focuses and equities.¹²⁵

Estrin Constr. Co. v. Aetna Casualty & Sur. Co., 612 S.W.2d 413 (Mo. Ct. App. 1981). For an excellent summary of reasonable expectations case law and analysis of the doctrine's first 15 years of officially recognized existence, see Rahdert, *supra* note 107, at 335. See also Kenneth S. Abraham, *Judge-Made Law and Judge-Made Insurance: Honoring the Reasonable Expectations of the Insured*, 67 VA. L. REV. 1151 (1981). A state's exercise of a strong version of the reasonable expectations doctrine is subject to change. For example, in Peerless Insurance Co. v. Brennon, 564 A.2d 383 (Me. 1989), the Maine Supreme Court overruled *Baybutt* and moved toward a plain meaning, narrow version, of the reasonable expectations approach. *Id.* at 386-87.

119. See, e.g., Farm Bureau Mut. Ins. Co. v. Sandbulte, 302 N.W.2d 104 (Iowa 1981); Weedo v. Stone-E-Brick, 405 A.2d 788 (N.J. 1979).

120. See, e.g., Robbins Auto Parts v. Granite State Ins. Co., 435 A.2d 507 (N.H. 1981); Ryan v. Harrison, 699 P.2d 230 (Wash. Ct. App. 1985); Rahdert, *supra* note 107, at 345-47. Within this group are at least two states that adopted the doctrine in essentially Keeton-stated form but later backtracked to reject reasonable expectations and embrace "traditional principles of contract construction." See, e.g., Hallowell v. State Farm Mut. Auto. Ins. Co., 443 A.2d 925 (Del. 1982); Casey v. Highlands Ins. Co., 600 P.2d 1387 (Idaho 1979).

121. See, e.g., Allstate Ins. Co. v. Ellison, 757 F.2d 1042 (9th Cir. 1985) (applying Alaska law); Evenchik v. State Farm Ins. Co., 679 P.2d 99 (Ariz. Ct. App. 1984).

122. Compare Auto-Owners Ins. Co. v. Jensen, 667 F.2d 714 (8th Cir. 1981) (applying Minnesota law using hybrid of reasonable expectations and ambiguity doctrine) with Atwater Creamery Co. v. Western Nat'l Mut. Ins. Co., 366 N.W.2d 271 (Minn. 1985) (applying strong form of reasonable expectations doctrine).

123. For example, the post-1986 California Supreme Court is commonly viewed as more inclined to rule in favor of insurers because more conservative members were elected in the anti-Rose Bird campaign. See Moradi-Shalal v. Fireman's Fund Ins. Cos., 758 P.2d 58, 59-60 (Cal.

D. Contracts of Adhesion and the Insurance Policy

A contract of adhesion is one in which the drafter offers the terms on a "take it or leave it" basis, with no negotiation or revision of contract language.¹²⁶ Although the term is popularly associated with Professor Friedrich Kessler's famous article,¹²⁷ it was first seen in American legal literature in describing an insurance policy.¹²⁸ Insurance policies might even be termed "super-adhesive" contracts because their language is more rigid than many other standardized contracts. First, insurance policies are, as previously noted, not ordinarily read and discussed prior to their issuance (particularly in consumer lines). Second, the insurance sales force usually lacks any authority to alter terms or coverages. Third, insurance contract language is drafted either by ISO (in property/casualty lines) or adopted through industry-wide convention (in life/health lines), making individual insurers reluctant to alter policy text, even if inclined to at the request of highly sought clients. Fourth, the usefulness of replicable standard form policy language in assessing risk makes it unlikely insurers will want to customize contract language, even for the largest accounts. Even when a policy is tailored to a large commercial client, insurers generally accomplish this through mixing and matching various standardized language endorsements, working with the policyholder's broker, rather than through freshly drafted language.

In a typical adhesion contract, the parties do negotiate, or at least discuss, price, quantity, duration, and possibly factors such as warranty or delivery. Measured against this comparison, insurance contracts might also be termed super-adhesive because insurers typically will not alter premiums per \$1000 of coverage or alter their customary policies regarding the contracting process, even for the most valued customers. The essence of insurance—risk spreading—makes individualized pricing hazardous with

1988) (overruling the private bad faith cause of action under the Unfair Claims Practices Act recognized in *Royal Globe Ins. Co. v. Superior Court*, 592 P.2d 329 (Cal. 1979)).

124. Unless the state has definitely embraced a particular approach, the emphasis in any written opinion will differ according to the judge, staff having input, the manner in which counsel presented the case, and of course, the equities of the case. Some lower courts may even be "renegades" that knowingly run counter to the highest court's suggestions. Not every lower court decision will, however, be reviewed by higher courts.

125. Like it or not, all courts are at least somewhat result oriented. When faced with a case when application of one doctrine, even a doctrine generally embraced by the court, would yield a result perceived as unjust, the court will slide toward a doctrine that yields the fairer result (for either policyholder or insurer), usually without expressly telling the litigants or readers.

126. See *FARNSWORTH*, *supra* note 8, § 4.26, at 480.

127. See Friedrich H. Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943).

128. See Edwin W. Patterson, *The Delivery of a Life Insurance Policy*, 33 HARV. L. REV. 198 (1919).

even the most seemingly secure risks. Insurance policies are also super-adhesive in terms of length and complexity. The ticket stubs one receives at a parking lot or sporting event contain adhesion disclaimers of liability or limits of liability. They cannot be changed by the customer¹²⁹ but at least can be read quickly and roughly understood. The same usually cannot be said of consumer insurance policies.

Of course, the super-adhesive nature of insurance policies does not make them "bad" or legally suspect. Standardized adhesion contracts are probably the majority of contracts in use today and are widely enforced. Courts view standardization as an inevitable consequence of a mass contracting, consumer-driven, market-oriented economy.¹³⁰ Standardization reduces the time and money spent on contracting and courts generally are receptive to enforcing them so these savings can be realized, so long as the adhesive terms are not unfair.¹³¹ When dealing with insurance policies, courts and commentators are even more solicitous of the benefits derived from standardized terms and adhesion marketing, because they not only lower transaction costs but facilitate risk spreading through developing a risk pool of policy-holders all subject to the same contract language. When focused on these aspects of adhesion, courts construing insurance policies are generally solicitous of insurers.

The flip side of the inquiry often leads courts to focus on the policyholder's dependence on coverage that hinges on an adhesion contract term the policyholder never read, probably could not understand or did not expect, and contained in a document he or she received long after making the insurance commitment.¹³² When focused on these traits, courts are more likely to make liberal use of doctrines such as *contra proferentem* and reasonable expectations and find for policyholders. This tendency is, as expected, more pronounced in close cases and those involving consumer insureds.

In contract law, generally, the rules of construction are often said to be the same for adhesion contracts as for any other contract. In practical application, however, court construction of adhesion agreements tends to differ in a few distinct respects.

First, courts are quicker to deem a term ambiguous if it is contained in an adhesion contract, including, for example, apartment leases, credit card agreements, and insurance policies.¹³³

129. Many courts treat ticket stubs more as receipts than as contracts. See *Kushner v. McGinnis*, 194 N.E. 106 (Mass. 1935); *Jones v. Great N. Ry.*, 217 P. 673 (Mont. 1923); *FARNSWORTH*, *supra* note 8, § 4.26, at 482-84.

130. See *FARNSWORTH*, *supra* note 8, § 4.26.

131. See *id.*

132. See, e.g., *Gaunt v. John Hancock Mut. Life Ins. Co.*, 160 F.2d 599 (2d Cir.), cert. denied, 331 U.S. 849 (1947).

133. See, e.g., *Ohio Casualty Group of Ins. Cos. v. Gray*, 346 F.2d 381 (7th Cir. 1984) (applying Indiana law).

Second, correspondingly, courts appear more willing to characterize a nondrafter's alternative interpretation of an adhesive term as "reasonable" for purposes of resolving a dispute on ambiguity grounds.¹³⁴

Third, many courts treat adhesion as a near prerequisite for deeming a contract term "unconscionable." That is, many courts state, at least in dicta, a term is unconscionable if the disadvantaged party had no real choice of terminology and the term is unreasonably beneficial to the drafter.¹³⁵

In actual application, most courts are not so doctrinaire. Instead, adhesion and unconscionability are part of a two-axis chart on which the court locates the disputed term before rendering construction. If the term is very high on the adhesion axis, it need not be as high on the unconscionability-unfairness axis to prompt a court to set it aside or interpret it favorably to the nondrafter. Conversely, a nonadhesive term generally needs to be more unfair to the complaining party before a court will consider invoking unconscionability analysis.

This *de facto* approach occurs throughout contract law. Because insurance policies are so super-adhesive, however, the practical effect for insurers is to lower the threshold for court invocation of unconscionability, *contra proferentem*, and public policy grounds in favor of the policyholder. As in other areas, the tendency in insurance is most pronounced in cases involving a consumer.

Notwithstanding the separate treatment often accorded insurance policies because of their adhesive nature, adhesion—both in theory and in practice—is not a sufficient basis to reject clear contract language that is not woefully unfair to the policyholder. Courts all accept this view but differ considerably in their analyses of when ambiguity, reasonable expectations, unfairness, public policy, or breach of warranty require a pro-policyholder construction. Cases in which the policyholder purchased flight insurance from a vending machine provide a stark example.¹³⁶

III. THE SOPHISTICATED POLICYHOLDER AND THE AMBIGUITY APPROACH

A. *The Attack on *Contra Proferentem* When the Policyholder is Sophisticated*

The ground rules of contract interpretation are generally written as though applied in a vacuum separated from the facts of any particular case.

134. See, e.g., *Crane v. State Farm Fire & Casualty Co.*, 485 P.2d 1129 (Cal. 1971).

135. See, e.g., *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965).

136. See, e.g., *Steven v. Fidelity & Casualty Co.*, 377 P.2d 284, 288-89 (Cal. 1962) (applying California law) (refusing to enforce policy term putting policy in force only for travel on scheduled airlines). *But see Mutual of Omaha Ins. Co. v. Russell*, 402 F.2d 339, 340 (10th Cir. 1968) (applying Texas law) (enforcing time limit to preclude coverage when policyholder's return flight was delayed), *cert. denied*, 394 U.S. 973 (1969).

Contract doctrine is supposed to be objective, neutral, and portable from one fact situation to another without regard to the identity of the parties. Although courts have historically departed from this notion of contract formalism in many cases, often for the benefit of policyholders, their discussion has typically not been open and candid.¹³⁷

Relatively recently, however, some courts have expressly suggested the applicability of some rules of contract interpretation, particularly the doctrine that ambiguous language should be construed against the contract drafter (*contra proferentem*), should turn on the identity of the parties to the dispute. In particular, courts in the 1980s acted with increasing frequency in rejecting or modifying the ambiguity principle when the nondrafter was a sophisticated party or was sufficiently involved in the contract drafting process. In insurance cases, in which the insurer nearly always is the drafter of the policy, a distinct line of cases has emerged in this trend.

In a sense, this development reverses to some degree the historic tendency of courts to bend regular contract doctrine in favor of the policyholder. By limiting or rejecting ambiguity analysis, courts in a sense bend regular contract doctrine in favor of the insurer. In addition, the emergence of a sophisticated policyholder defense by insurers to coverage claims can be seen as the flip side of the reasonable expectations approach, which is usually invoked by policyholders as a ground for coverage. The sophisticated policyholder defense tends to narrow the range of basic liability insurance coverage for commercial entities although the reasonable expectations doctrine tends to expand coverage for individual policyholders.

Although focusing on the ambiguity principle, judicial acceptance of the notion that contract doctrine varies somewhat according to the nature of the parties and the facts of the transaction logically should affect other contract rules in addition to *contra proferentem*—for example, waiver, estoppel, and reasonable expectations. To date, however, most judicial assessment of the policyholder's sophistication has focused on whether the sophisticated policyholder may obtain the benefit of the *contra proferentem* principle in coverage disputes. Many, especially insurers and their counsel, have cheered these developments. Others, particularly policyholders and their counsel, have questioned both the legitimacy of differential application of the rule and the particular cases finding ambiguity unavailable to aid commercial insureds.

The pros and cons of the ambiguity approach noted above have led many judges and commentators to suggest it should not be applied when the policyholder is an economically powerful commercial entity sophisticated in insurance matters.¹³⁸ Although discussion of the matter to date has focused on commercial liability policies procured by corporate policyholders, there is

137. See, e.g., *Diamond Shamrock Chemicals Co. v. Aetna Casualty & Sur. Co.*, 554 A.2d 1342 (N.J. Super. Ct. App. Div. 1989), *rev'd in part*, *State v. Signs Trading Int'l, Inc.*, 612 A.2d 932 (N.J. 1992); *Graham v. Public Employees Mut. Ins. Co.*, 656 P.2d 1077 (Wash. 1983).

138. See, e.g., *OSTRAGER & NEWMAN*, *supra* note 107, § 1.03(c).

no logical reason why the sophisticated policyholder exception, if it is persuasive, should be completely restricted to commercial lines or to business policyholders. For example, very wealthy people pay sufficient premiums for insurance (usually non-CGL¹³⁹ insurance such as life, health, homeowners, and disability) that they could easily hire counsel and employees to do their insurance research and negotiating. In effect, they become sophisticated.

Although open discussion of a sophisticated policyholder exception has occurred primarily during the past fifteen years, the notion of differential application of the ambiguity doctrine is not completely new.¹⁴⁰ Commercial insurers suggest larger and richer commercial policyholders are not like helpless consumers; they know a good deal about how the insurance world works and may even have in-house risk management staff; they pay enough in premiums it is to their financial benefit to retain counsel and consultants as necessary; the desirability of their business allows them to play off one insurer against another to get better rate-coverage packages; they can often turn to sources of protection other than regular insurance by self-insuring, forming a captive company, participating in a risk retention group, or going bare. On occasion, insurers or brokers acting as their agents may draft certain policy provisions. Frequently, commercial policyholders select the actual mix of optional coverage endorsements added to the basic CGL policy.¹⁴¹

The counter argument made against the sophisticated policyholder exception tends to reflect the general defense of the ambiguity principle and, its supporters argue: (1) there should be no broad based exception to the ambiguity approach simply because a nondrafting policyholder is sophisticated; (2) even well-heeled policyholders may have had nothing to do with the particular policy language in dispute¹⁴² (why should they bear any legal or financial burden from the uncertainty?); and (3) continued use of the ambiguity doctrine encourages clearer, more careful drafting, greater disclosure and explanation, and perhaps even frank discussion of potentially confusing points.

139. "CGL" stands for "commercial general liability," the basic type of third-party liability insurance sold to commercial policyholders. It is designed to cover the ordinary claims expected against a business, such as when a patron sues for negligence if injured by slipping on a restaurant's wet floor.

140. See, e.g., *United States Shipping Bd. Merchant Fleet Corp. v. Aetna Casualty & Sur. Co.*, 98 F.2d 238, 241-42 (D.C. Cir. 1998) (criticizing the ambiguity doctrine in a business context although the term was unambiguous).

141. See, e.g., OSTRAGER & NEWMAN, *supra* note 107, § 1.03[c]; Michael Knox, *Insurance Contract: Rules of Construction, Judicial Consumerism, and Coverage*, 135 N EW L.J. 684, 687 (1985).

142. See Caton et al., *supra* note 13, at 6-12.

B. *The Sophisticated Policyholder Defense in the Courts*

1. *Cases Suggesting Ambiguity Analysis is Inapt for Sophisticated Policyholders*

During the past twenty years, a number of cases have endorsed or applied a sophisticated policyholder exception to the *contra proferentem* principle.¹⁴³ An influential modern case suggesting a different approach for sophisticated policyholders and transactions is *Eagle Leasing Corp. v. Hartford Fire Insurance Co.*¹⁴⁴ The court, in an opinion by well-respected Judge John Minor Wisdom, found no coverage in construing policy language it deemed ambiguous in isolation but not ambiguous in the context of the whole policy, the intent of the parties, and the economic realities of marine insurance.¹⁴⁵ In some ways, this holding is not exceptional: the court could simply have held the policy provision in dispute was not ambiguous when viewed in context. *Eagle Leasing* bypassed, however, such a relatively tame approach to become a rhetorical gold mine for lawyers representing insurers. The court held:

We do not feel compelled to apply, or indeed, justified in applying the general rule that an insurance policy is construed against the insurer in the commercial insurance field when the insured is not an innocent but a corporation of immense size, carrying insurance with annual premiums in six figures, managed by sophisticated business men, and represented by counsel on the same professional level as the counsel for insurers. In substance the authorship of the policy is attributable to both parties alike. . . . There is no purpose in following a legal platitude that has no realistic application to a contract concocted by a large corporation and a large insurance company each advised by competent counsel and informed experts.¹⁴⁶

143. These decisions can look, however, to *United States Shipping Bd. Merchant Fleet Corp. v. Aetna Casualty & Sur. Co.*, 98 F.2d at 241-42, as their intellectual ancestor. There, the court, apparently applying federal common law, found the notice provision of a surety bond not to be ambiguous and held the government had failed to satisfy a condition precedent to coverage. *Id.* at 243. In passing, the court noted "both the contract and the bond were prepared by the Board. In these circumstances, the rule that where an insurance contract is so drawn as to be susceptible of two different constructions that most favorable to the insured will be adopted, loses much of its force." *Id.* at 241. The court did not, however, actually apply the ambiguity principle against the policyholder. *Id.* at 242.

144. *Eagle Leasing Corp. v. Hartford Fire Ins. Co.*, 540 F.2d 1257 (5th Cir. 1976), *cert. denied*, 431 U.S. 967 (1977) (applying Missouri law).

145. *Id.* at 1262-63.

146. *Id.* at 1261 (citations omitted).

An insurance [policy] is usually a "contract of adhesion," where the insured has no bargaining power. Only for this reason, is the policy construed against the insurer.¹⁴⁷

Another federal appellate case found for the insurer against a title company's assertion of coverage under an errors and omissions policy.¹⁴⁸ The real estate broker in question had liability that arose from remitting funds to satisfy tax liens to the wrong taxing authority, resulting in forfeiture.¹⁴⁹ Although the policy generally covered negligence, an exclusion existed for "claims based upon or arising out of handling or disbursement of funds."¹⁵⁰ The court quickly concluded the exclusion was unambiguous.¹⁵¹

In response to the title company's claim that the exclusion was nonetheless unenforceable under Pennsylvania law because the exclusion was not highlighted and explained to the insured,¹⁵² the court restricted the explanation requirement to lay insureds and found it inapplicable for those experienced in insurance matters.¹⁵³ Like others of its genre, however, this case of an apparent "sophisticated policyholder" exception can also be interpreted as a case rejecting a policyholder's claim of a reasonable expectation of coverage because the expectation was subjective (unknown to the insurer) and objectively unreasonable. The exclusion, although not explained, had been read out loud to the policyholder prior to purchase of the policy.¹⁵⁴

147. *Id.* at 1261-62 n.4. Judge Wisdom, like another respected judge to whom he cited, see *Siegelman v. Cunard White Star Ltd.*, 221 F.2d 189, 204 (2d Cir. 1955) (Frank, J., dissenting), was wrong on the adhesion point. Adhesion contracts, because they involve very little discussion or bargaining from which a court can divine the parties' intent, are more frequent candidates for *contra proferentem*. As noted above, however, the ambiguity principle has historically been applicable to customized contracts in order to encourage more careful drafting and discourage the drafter's attempts to wreak unfair surprise upon the nondrafter. See 17A AM. JUR. 2D *Contracts* § 346 (1991) (stating general rules of contract law hold doubtful language is to be interpreted against the drafter). In addition, as previously noted, see *supra* text accompanying note 145, bargaining power is not the only rationale for the ambiguity doctrine.

148. *Brokers Title Co. v. St. Paul Fire & Marine Ins. Co.*, 610 F.2d 1174 (3d Cir. 1979).

149. *Id.* at 1176.

150. *Id.*

151. *Id.* at 1181 (applying Pennsylvania law).

152. *Id.* at 1179 n.3. At the time, Pennsylvania courts applied the rule of *Hionis v. Northern Mut. Ins. Co.*, 327 A.2d 363 (Pa. 1974), which held exclusions must be pointed out and explained to insureds who are unaware of the exclusion. *Id.* at 366. In *Standard Venetian Blind Co. v. American Empire Ins. Co.*, 469 A.2d 563 (Pa. 1983), the Pennsylvania Supreme Court subsequently repudiated the *Hionis* rule. *Id.* at 566-67.

153. *Brokers Title Co. v. St. Paul Fire & Marine Ins. Co.*, 610 F.2d, 1174, 1180 (3d Cir. 1979).

154. *Id.* at 1177. A First Circuit case, *Utica Mutual Insurance Co. v. Impallaria*, 892 F.2d 1107 (1st Cir. 1989) (applying Massachusetts law), took a different view of the exclusion in a professional liability policy "for premiums, return premiums, commissions or claim or tax monies," requiring the malpractice carrier to provide coverage for liability arising from a underquoted bid on a large policy, finding this to result in "damages" rather than losses from premium handling. *Id.* at 1109. Because the policyholder was an insurance broker, a sophisticated insured defense

In another case the same circuit court found a coal company's business interruption insurance, which was triggered by a mine fire that shut down the mine for a year, did not provide indemnity for the funds spent purchasing coal on the open market in order to cover its contract obligations.¹⁵⁵ In reaching this result, the court recognized the general validity of the *contra proferentem* principle but found the policy formula for calculating covered business interruption losses was unambiguous.¹⁵⁶ Thus, it did not need to invoke *contra proferentem* against either party. As in *Eagle Leasing*, however, the language of the opinion is very helpful to insurer counsel and suggests if pushed, the court would have held the ambiguity approach inapplicable irrespective of the policy's text. The court stated:

If an ambiguity does exist and if the insurer wrote the policy or is in a stronger bargaining position than the insured, the ambiguity is generally resolved in favor of the insured and against the insurer. However, the principle that ambiguities in policies should be strictly construed against the insurer does not control the situation where large corporations, advised by counsel and having equal bargaining power, are the parties to a negotiated policy.

[The policyholder's] insurance broker selected the policy forms, prepared the policies, and sent them to the insurance companies for execution. Under these circumstances, the Pennsylvania cases indicate that conflicts over the interpretation of an insurance contract should be resolved against the party preparing the contract. At a minimum, [this] require[s] that we not construe the language against the defendants' [insurers].¹⁵⁷

The court seemed to suggest the activity of the broker, who was clearly the policyholder's agent, in mixing and matching policy forms, made the policyholder the drafter of the policy. If widely adopted, this view would strip many commercial policyholders of the benefit of the ambiguity doctrine because they frequently employ brokers and "mix-and-match" policy endorsements.¹⁵⁸ One can question, however, whether assembling contract segments is the same thing as drafting them and whether essentially normal broker activity should in and of itself negate the ambiguity doctrine. One can also question whether a policyholder's supposed bargaining power (the court

may have been applicable, but the First Circuit showed no interest in it, perhaps because it regarded the language of the policy as clearly in favor of the policyholder. *Id.* at 1108.

155. *Eastern Associated Coal Corp. v. Aetna Casualty & Sur. Co.*, 632 F.2d 1068, 1080-81 (3d Cir. 1980) (applying Pennsylvania law), *cert. denied*, 451 U.S. 986 (1981).

156. *Id.* at 1079.

157. *Id.* at 1075 (citations omitted).

158. *See, e.g., Puerto Rico Elec. Power Auth. v. Philipps*, 645 F. Supp. 770, 773 (D.P.R. 1986) (holding ambiguity analysis not applicable when policyholder's broker selected coverage endorsements).

says nothing about the other coverage options available from its insurers or other insurers) can alone negate the ambiguity approach.

In spite of the logical inconsistencies bedeviling attempts to renounce the ambiguity approach for sophisticated policyholders, a number of court decisions during the 1980s appeared receptive to this approach.¹⁵⁹ One well-

159. See, e.g., *Insurance Co. of N. Am. v. John J. Bordlee Contractors*, 543 F. Supp. 597 (E.D. La. 1982) (applying Louisiana law). *John J. Bordlee Contractors* held a policy endorsement for "excess collision" liability could not provide coverage, and stated:

[The ambiguity] rule is apt when the insured is an innocent and naive party unfamiliar with the insurance field. But where the insured is a corporation, as here, represented by counsel on the same professional level as the counsel for insurers, then ambiguous provisions should not be construed strictly *against* the insurer, but should be construed *in favor of* what reason and probability dictate was intended by the parties with respect to coverage.

Id. at 602 (citing *Eagle Leasing Corp. v. Hartford Fire Ins. Co.*, 540 F.2d 1257 (5th Cir. 1976)). In *Chicago Insurance Co. v. Pacific Indemnity Co.*, 566 F. Supp. 954 (E.D. Pa. 1982) (applying Pennsylvania law), *aff'd*, 737 F.2d 657 (7th Cir. 1984), the court rejected the contention of a medical malpractice excess carrier that claimed the primary carrier had not paid its applicable limits based on whether ongoing medical malpractice resulted in one claim or multiple claims for purposes of determining the primary carrier's limits with court finding one claim. *Id.* at 957-58. In a controversial conclusion, the court held that the spouse's derivative consortium claim in the lawsuit was not a distinct claim for purposes of the primary insurance policy. *Id.* at 958. Although not central to its decision, the court added a rejection of *contra proferentem*:

[The ambiguity] principle applies, however, only as between the insured and the company. It does not apply in a dispute between two insurance companies. Moreover, the alleged ambiguity in defendant's policy produces a corresponding ambiguity in plaintiff's policy which, if the principle of construing ambiguities against the insurance company were applicable, would merely produce a presumption against plaintiff which would cancel out the presumption against the defendant. If there is ambiguity in either policy, trade custom and usage may properly be looked to for aid in construing the policies. The defendants' [sic] uncontradicted affidavits establish that medical malpractice policies have universally been interpreted and applied in conformity with defendant's arguments in the present case.

Id. at 960. Although the court is probably correct, it is correct not because of the sophistication of the disputants *per se*, but because the dispute involves two contract drafters who are not in strict privity with one another. There was no contract author and contract taker as is the case in standard insurance transactions with consumers and most business insureds.

Additionally, in *Halpern v. Lexington Insurance Co.*, 715 F.2d 191 (5th Cir. 1983) (applying Louisiana law), the court found the policyholder "drafted" the portion of the policy in dispute and the insurer had no reason to know of the error. *Id.* at 193. The court noted, "[W]hen it is the insured or his broker who supplies the language in question, here the description [of the property], the reasons behind the [ambiguity] rule of construction favoring the insured completely disappear." *Id.* (quoting *Halpern v. Lexington Ins. Co.*, 558 F. Supp. 1280, 1283-84 (E.D. La. 1983)). Similarly, in *Bradley Bank v. Hartford Accidental & Indemnity Co.*, 562 F. Supp. 241 (W.D. Wis. 1983) (applying Wisconsin law), *aff'd*, 737 F.2d 657 (7th Cir. 1989), the court held that a bankers fidelity bond did not cover losses from a check kiting scheme perpetrated by a depositor rather than bank employees, suggesting *contra proferentem* might not be available to business insureds under controlling Wisconsin law. *Id.* at 242-43 (citing *State Bank v. Capitol Indem. Corp.*, 214 N.W.2d 42 (Wis. 1974)). The court took a broader version of the sophisticated policyholder defense that, if taken literally, might remove ambiguity analysis from

known case, *McNeilab, Inc. v. North River Insurance Co.*,¹⁶⁰ not only resolved a huge coverage question in favor of the insurer, but also gave considerable rhetorical support to the sophisticated policyholder defense. The case began with the Chicago area Tylenol poisoning that occurred in 1982.¹⁶¹ In response to product tampering, Tylenol-maker McNeilab and its parent (Johnson & Johnson) began (without consulting insurers) a massive recall campaign at an estimated cost of \$100 million, which involved recall and destruction of existing product, a six-week hiatus from the market, and introduction of new, tamper-resistant packaging, as well as attendant advertising and public relations.¹⁶² Thereafter, McNeilab sought reimbursement for the recall campaign expenses pursuant to its liability insurance, mainly arguing that its shrewd recall actions had mitigated potential exposure to litigation and damages.¹⁶³

The court rejected the claim, finding the mitigation argument too strained in light of policy language and precedent.¹⁶⁴ In an opinion highly linked to the uncontested facts of the case, the court emphasized McNeilab was well aware of the availability of separate policies for product recall insurance and this implied, of course, the standard CGL policy did not provide such coverage.¹⁶⁵ Johnson & Johnson had stated in corporate reports it maintained no recall insurance.¹⁶⁶ The testimony of its risk manager confirmed this position.¹⁶⁷ In addition, an ISO explanatory statement accompanying the 1966 CGL, which the court found within McNeilab's constructive knowledge, specifically stated recall insurance required a separate endorsement.¹⁶⁸

entire classes of cases. The court stated, "The contract here, the Bankers Blanket Bond, is the product of negotiation between the banking and surety industries, thus making the rule of *contra proferentem* unavailable." *Id.* at 243. In *Keystone Insurance Co. v. Allstate Insurance Co.*, 633 F. Supp. 1358 (W.D. Pa. 1986) (applying Pennsylvania law), the court refused to consider ambiguity analysis because the disputants were both insurance companies. *Id.* at 1360 (citing *Chicago Ins. Co. v. Pacific Indem. Co.*, 566 F. Supp. 954 (E.D. Pa. 1982)).

160. *McNeilab, Inc. v. North River Ins. Co.*, 645 F. Supp. 525 (D.N.J. 1986) (applying New Jersey law), *aff'd*, 831 F.2d 287 (3d Cir. 1987).

161. *Id.* at 527.

162. *Id.* at 527-28.

163. *Id.* at 528.

164. *Id.* The court showed palpable disdain toward McNeilab and Johnson & Johnson, which it saw as talking out of both sides of its mouth by claiming its actions mitigated damages while simultaneously denying any possible liability to Tylenol users because the product tampering occurred after the Tylenol had left its hands. *Id.* at 528. The McNeilab position is not, however, necessarily so inconsistent. Presumably, even unsuccessful lawsuits against McNeilab would have triggered the CGL's duty to defend, creating significant legal expenses, which could grow large if there were a flood of suits. By the date of the court's decision in 1986, however, it was clear McNeilab had dodged the bullet and no such litigation flood was unleashed.

165. *Id.* at 537.

166. *Id.* at 537, 542.

167. *Id.* at 542-43.

168. *Id.* at 541.

In effect, *McNeilab* presents a sophisticated policyholder defense but not one focusing so much on *contra proferentem* as upon the actual understanding and intent of the parties, industry custom, prior course of dealing, and perhaps even estoppel. One can also regard *McNeilab* as a reasonable expectations case in which the court found the policyholder, both because of the specific facts of the case and because of its sophistication, could not have had an objectively reasonable expectation of coverage. Notwithstanding these other bases of decision, the court could not resist using strong language to reject *McNeilab*'s argument that as a policyholder it should benefit from ambiguity analysis, stating:

[T]he policy itself was negotiated, as were almost all of the fifteen addenda to the policy, most of which added or subtracted specific form coverages over the years. If the policy reflected few if any changes from the "London form", none were requested, not because Johnson & Johnson lacked the opportunity or the capacity to make such requests, but because the language accomplished what was intended. . . .

Johnson & Johnson, which ranks fifty-ninth in the Fortune 500, generates annual insurance premiums of approximately \$20,000,000 and maintains a Corporate Insurance Department consisting of an expert insurance staff with a legal staff at its disposal. . . . [It] was a "favored customer[.]" . . . "[T]he significance of plaintiff's having its own expert insurance staff to represent it in determining its insurance program, in implementing that program, and thereafter in its negotiations with [the insurer] cannot be overstressed. This was not the usual insured-insurer relationship."

Concededly a sophisticated insured, Johnson & Johnson cannot seek refuge in the doctrine of *contra proferentem* by pretending it is the corporate equivalent of [an individual consumer].¹⁶⁹

As in other cases promoting the sophisticated policyholder defense, the anti-ambiguity rhetoric of *McNeilab* rests on some shaky logical precepts. Although *McNeilab*'s sophistication undoubtedly affected its understanding, intent, and expectations, the fact remains, as the court noted, the policy terms in question arose from standardized forms.¹⁷⁰ *McNeilab* may have been sophisticated, but it did not draft those standardized contracts, the insurers did.¹⁷¹ *McNeilab* has not been widely criticized, probably because its ultimate holding appears to be correct based on the policyholder's understanding and the overall clarity of the coverage issue. Other cases expressing support for the sophisticated policyholder defense seem to make the same analytic

169. *Id.* at 547.

170. *Id.*

171. *Id.*

error—equating a policyholder's choice of coverage options with actual authorship of the language of the endorsement.¹⁷²

A variant of the sophistication rationale for rejecting *contra proferentem* holds ambiguity analysis inapt if the parties in dispute are both insurance companies.¹⁷³ Two leading commentators characterize refusal to use ambiguity analysis “particularly apt in cases where the insured will be covered in any other event.”¹⁷⁴ This view at first may seem essentially correct in cases when both insurers are using standard industry language, which was arguably drafted by the insurance industry rather than any one insurer. Rejection of *contra proferentem* also seems to make sense when the competing insurers have not directly contracted with one another but are merely two different insurers tied by accident to the same policyholder. It then becomes hard to say one insurer “relied” upon the other's contract language. Complete rejection of *contra proferentem* between insurers may, however, be a mistake. Even when two primary carriers, joined only by their separate policies issued to a single policyholder, are fighting over which is the primary carrier and which has secondary status, the dispute may still center upon a particular clause in one of the policies. In these instances, one insurer remains the author of the central contract language in dispute, even if it has plagiarized the language from a standard industry policy or ISO form. When more preferred means of resolving the dispute are unavailing, *contra proferentem* remains a logical and fair tie breaker, especially when the disputants are

172. See, e.g., *First State Underwriters Agency v. Travelers Ins. Co.*, 803 F.2d 1308 (3d Cir. 1986) (applying Pennsylvania law). In *Travelers*, the court found the excess coverage began only after the primary carrier limits had been exhausted from occurrences happening within the term of the primary policy. *Id.* at 1313. The court saw the particular term at issue as ambiguous but resolved the ambiguity as a matter of law by reference to the entirety of both policies and industry practice, finding the ambiguity rule inapplicable because “the principle that ambiguities in policies should be strictly construed against the insurer does not control the situation where large corporations, advised by counsel and having equal bargaining power, are parties to a negotiated policy.” *Id.* at 1311-12 (quoting *Eastern Associated Coal Corp. v. Aetna Casualty & Sur. Co.*, 632 F.2d 1068, 1075 (3d Cir. 1980)); see also *Industrial Risk Insurers v. New Orleans Pub. Serv.*, 666 F. Supp. 874, 881 (E.D. La. 1987) (applying Pennsylvania law) (holding *contra proferentem* was not available to a large commercial insured with professional assistance in procuring policy); *Farm Air Flying Serv. v. Southeastern Aviation Ins. Serv.*, 254 Cal. Rptr. 1, 3 (Ct. App. 1988) (holding ambiguity analysis inapplicable when insured's broker negotiated, but did not draft, policy); *Fireman's Fund Ins. Co. v. Fibreboard Corp.*, 227 Cal. Rptr. 203, 206 (Ct. App. 1986) (holding *contra proferentem* inapplicable where both parties were “large corporate entities, each represented by specialized insurance brokers or risk managers, [who] negotiated the terms of the insurance contracts”).

173. See, e.g., *Keystone Ins. Co. v. Allstate Ins. Co.*, 633 F. Supp. 1358, 1360 (W.D. Pa. 1986); *Chicago Ins. Co. v. Pacific Indem. Co.*, 566 F. Supp. 954, 960 (E.D. Pa. 1982); *Auto-Owners Ins. Co. v. Blue Cross & Blue Shield*, 349 N.W.2d 238, 246 (Mich. Ct. App. 1984); *Atlantic Mut. Ins. Co. v. Travelers Ins. Co.*, 195 Cal. Rptr. 476, 478 (Ct. App. 1983); *Loblaw, Inc. v. Employers' Liab. Assurance Corp.*, 446 N.Y.S.2d 743, 745 (App. Div. 1981), *aff'd*, 442 N.E.2d 438 (N.Y. 1982).

174. See *OSTRAGER & NEWMAN, supra* note 107, § 1.03[c][6] (citing *Union Carbide Corp. v. Travelers Indem. Co.*, 399 F. Supp. 12 (W.D. Pa. 1975); *Maurice Pincoffs Co. v. St. Paul Fire & Marine Ins. Co.*, 447 F.2d 204 (5th Cir. 1971)).

insurers, who by definition can spread losses resulting from such impasses throughout their books of business.

In many of these cases, of course, the insurer adversely affected is hardly an innocent victim of contracting happenstance. For example, insurers typically include "other insurance" (in property insurance) and "coordination-of-benefits" clauses (in health insurance) to attempt to assign liability coverage to another carrier notwithstanding the insurer has collected premiums to insure the risk that gave rise to the dispute.¹⁷⁶ Although the insurers are not contracting with each other, the policy language used by one of the carriers may well be the source of coverage difficulty.

For example, an insurance policy *X* may provide it gives the policyholder coverage in excess of the limits of any other applicable policy¹⁷⁶ although insurance policy *Y* states it provides the same type of coverage unless another policy is in force, in which case policy *Y* provides no coverage.¹⁷⁷ Assuming policies *X* and *Y* each have a limit of \$100,000 and the policyholder has a loss of \$150,000, the court is presented with a number of possible holdings: it may view policy *Y* as primary and policy *X* as excess, it may view policy *Y* as inapplicable because of the existence of policy *X*, or it may find policies *X* and *Y* to be mutually repugnant and enforce proration of benefits by operation of law. A particularly harsh court (to policyholders) might even hold both policies inapplicable (because policy *Y* does not apply when there is another policy but policy *X* does not apply without the presence of a primary policy).¹⁷⁸ Whatever path the court takes,¹⁷⁹ a prudent decision by the court may well involve scrutiny of policy language. When that

175. These clauses do serve a legitimate purpose in lowering the overall social cost of insurance in a market served by several sources of insurance (e.g., personal, business, group, employment-related) and thousands of carriers and are consequently enforced by the courts. See JERRY, *supra* note 9, § 97.

176. This is known as an "excess" clause. *See id.*

177. This is known as an "escape" clause. *See id.*

178. In these instances, presumably opponents of the ambiguity approach such as counselors Ostrager and Newman, see *supra* text accompanying note 174, would, absent countervailing factors, endorse use of *contra proferentem* because refusal to invoke the doctrine would result in the policyholder going uncompensated for loss despite paying premiums on two policies that seemingly covered such loss. Of course, under the skeletal facts of this example, courts and commentators may find the policy provisions grudging but clearly in favor of the insurers, although this Article disagrees.

179. The preferred resolution of the problem is proration of benefits: \$75,000 paid by each insurer in this example. *See, e.g.*, Royal-Globe Ins. Cos. v. Safeco Ins. Co. of Am., 560 S.W.2d 22 (Ky. Ct. App. 1977); Union Ins. Co. v. Iowa Hardward Mut. Ins. Co., 175 N.W.2d 413 (Iowa 1970). This approach is generally nontextual and based more on public policy and a functional analysis of the role of insurance rather than formal contract analysis. Thus, the ambiguity approach is largely inapt except the court may wish to review the language of the policies as a whole to satisfy itself neither policy is intended as primary or secondary in light of the overall insurance contract. For a discussion of the distinctions between the formal and the functional approach to insurance contract interpretation, see Peter Nash Swisher, *Judicial Rationales in Insurance Law: Dusting Off the Formal for the Function*, 52 OHIO ST. L.J. 1037 (1991).

language was the product of one insurer's efforts and more precise indicia of meaning are absent, invocation of *contra proferentem* may be quite apt.

The ambiguity doctrine logically also has a role in other facets of insurer versus insurer disputes. For example, if one insurer (such as a primary carrier) uses a policy it knows will be the basis for another insurer's (such as an excess carrier or reinsurer) contractual rights, courts would act reasonably in construing the primary carrier as the "drafter" of language in dispute. When that language is unclear and not illuminated by extrinsic evidence or the reasonable professional expectations of the insurers involved in the dispute, ambiguity analysis again provides a prudent tie breaker.¹⁸⁰

Another version of anti-ambiguity analysis finds *contra proferentem* inapplicable when standardized language was negotiated between the insurance industry and a specific class of sophisticated policyholders.¹⁸¹ For example, when policy language resulted from negotiations between insurers and bankers, courts have seen the language as co-drafted by these powerful commercial interests.¹⁸² Although this reasoning may be correct, case law enunciating this exception to *contra proferentem* has been rather breezy in its characterization of the insurer-banker interactions. If representatives of banks and representatives of insurers truly co-wrote a policy, rejection of ambiguity analysis is apt. If bankers merely jawboned insurers about their needs and preferences, however, with insurers writing the policy in response, the insurers remain the drafters of the contract language subject to any ensuing disputes. Cases rejecting *contra proferentem* construe insurer-banker activity on the standard banker's bond as co-drafting but provide only sketchy facts in support of that assessment.¹⁸³ In view of the historical antipathy of the industries,¹⁸⁴ a true contract writing partnership between the two is

180. See Caton et al., *supra* note 13, at 10.

181. See, e.g., *Shearson/American Express v. First Continental Bank & Trust Co.*, 579 F. Supp. 1305, 1311 (W.D. Mo. 1984) (noting language in question in surety bond resulted from joint efforts of insurance and commercial banking representatives); *Bradley Bank v. Hartford Accident & Indem. Co.*, 562 F. Supp. 241, 243 (W.D. Wis. 1983), *aff'd*, 737 F.2d 657 (7th Cir. 1984) (same); *Garcia v. Truck Ins. Exch.*, 682 P.2d 1100, 1106 (Cal. 1984) (holding policy resulting from joint negotiation and discussion between malpractice carrier and hospital associations not subject to ambiguity analysis).

182. See, e.g., *Bradley Bank v. Hartford Accident & Indem. Co.*, 562 F. Supp. 241, 243 (W.D. Wis. 1983), *aff'd*, 737 F.2d 657 (7th Cir. 1984).

183. See, e.g., *id.* at 243.

184. Banks and insurers have always competed to some degree. For example, if a policyholder decides to "self-insure" by saving money in its own account rather than continuing a policy, banks have gained business at the expense of insurers. Conversely, a policyholder's decision to purchase whole or universal life insurance and to build large cash value in the policy rather than purchasing cheaper term insurance and saving the difference in premiums brings business to insurers at the expense of bankers. More recently, banks have sought to alter laws restricting their ability to offer insurance coverage or market insurance, moves vigorously opposed by the insurance industry.

Partners may co-draft a contract, but do adversaries? So long as the insurer-policyholder relationship is not considered a fiduciary one, it seems more likely policyholders voice their views

sufficiently counter-intuitive that courts should perhaps take a harder look at the issue. They may be correct but some continue to be less than firmly convinced.

In addition to these variants of the anti-ambiguity approach, there are some additional, relatively unusual situations in which the derivation of the policy affects the availability of ambiguity analysis. For example, courts have held policy language resulting from statutory requirements does not subject the insurer to *contra proferentem*.¹⁸⁵ Ambiguity analysis has also been deemed inapplicable when the insurer is in receivership and the policyholder was apprised of changes in policy language, given the opportunity to comment, and did not object, implying the policyholder understood the policy language and accepted it.¹⁸⁶ Ambiguity analysis has been deemed irrelevant when the litigant claiming its benefit is not actually a party to the contract.¹⁸⁷

2. *Cases Rejecting the Sophisticated Policyholder Defense or Upholding the Ambiguity Approach*

Although many courts have rendered results at odds with the sophisticated policyholder defense,¹⁸⁸ relatively few have specifically spoken to the issue. A number of opinions directly reject, however, the notion the policyholder's individual traits make certain contract construction rules inapplicable *per se*.¹⁸⁹ For example, in *General Insurance Co. v. City of*

but insurers retain final drafting authority. When the insurer completely accommodates a policyholder by using exactly the contract language desired by the policyholder, the policyholder should then be considered the drafter of the contract provision, in which case *contra proferentem* applies against the policyholder. In either event, completely disavowing the ambiguity approach seems imprudent.

185. See, e.g., *Herbert L. Farkas Co. v. New York Fire Ins. Co.*, 76 A.2d 895, 898 (N.J. 1950); *Nabor v. Occidental Life Ins. Co.*, 396 N.E.2d 1267, 1270 (Ill. App. Ct. 1979); *University of Judaism v. Transamerica Ins. Co.*, 132 Cal. Rptr. 907, 909 (Ct. App. 1976); see also *State Farm Mut. Auto. Ins. Co. v. McCauley*, 921 F.2d 673, 676 (6th Cir. 1990) (holding auto insurer's policy definition of "uninsured" motorist does not violate statutory scheme or public policy notions flowing from scheme).

186. See *O'Brien v. General Am. Life Ins. Co.*, 103 N.E.2d 193 (Ill. App. Ct. 1951).

187. See *Allstate Ins. Co. v. Roelfs*, 698 F. Supp. 815 (D. Alaska 1987).

188. See, e.g., *Ingersoll Milling Mach. Co. v. M/V Bodena*, 829 F.2d 293 (2d Cir. 1987) (applying Illinois law), cert. denied, 484 U.S. 1042 (1988); *Westchester Resco Co. v. New England Reinsurance Corp.*, 818 F.2d 2 (2d Cir. 1987) (applying New York law); *Eli Lilly & Co. v. Home Ins. Co.*, 794 F.2d 710 (D.C. Cir. 1986), cert. denied, 479 U.S. 1060 (1987); *Pan Am. World Airways v. Aetna Casualty & Sur. Co.*, 505 F.2d 989 (2d Cir. 1974) (applying New York law); *Commercial Union Ins. Co. v. Pittsburgh Corning Corp.*, 553 F. Supp. 425 (E.D. Pa. 1981).

189. See, e.g., *St. Paul Mercury Ins. Co. v. Grand Chapter of Phi Sigma Kappa, Inc.*, 651 F. Supp. 1042, 1045 (E.D. Pa. 1987) (holding *contra proferentem* principle applies to commercial policyholders as well as consumers unless the parties possess equal bargaining power); *Lazovick v. Sun Life Ins. Co. of Am.*, 586 F. Supp. 918, 925 (E.D. Pa. 1984) (holding the sophistication of the insured is not relevant if the policy provision is unambiguous); *Minier v. Travelers Indem. Co.*, 159 F. Supp. 230, 232 (N.D. Ill. 1958) (holding ambiguity analysis is based not on sophistication or bargaining power but on notion that insurer drafted policy).

Belvedere,¹⁹⁰ the city was sued, apparently with considerable success, for damages arising out of an inverse condemnation proceeding.¹⁹¹ The insurer sued seeking a declaratory judgment of no coverage based on an exclusion exempting coverage for liability arising under "Article I, Section 14" of the California state constitution.¹⁹² The Court found the exclusion ambiguous and ruled in favor of the policyholder, specifically rejecting the insurer's invitation to apply a variant of the sophisticated policyholder defense.¹⁹³ The court stated:

Language in the policy is to be construed as a layman would read it, not as an attorney or insurance agent might read it. [The insurer's] claim that a subjective test is to be employed is therefore inaccurate. [The insurer's] further contention that, as a public entity, the City of Belvedere should be held to a higher standard of knowledge or sophistication concerning interpretation of terms in insurance policies is unsupported by California case law. . . .

While inarguably conspicuous and plain, it is doubtful that [the insurer's] purported exclusion, even as reformed, is sufficiently clear to meet the text required under California law. Employing the required objective standard, it is questionable whether the reasonable person of ordinary education and intelligence, upon being referred by his policy to [the exclusion] would emerge with any conviction that what was meant was inverse condemnation.¹⁹⁴

What the *Belvedere* court failed to explain, however, is why an objective standard necessarily compels the judiciary to adopt the layperson as a reference point of reasonable behavior. As will be discussed,¹⁹⁵ a court could conceivably (and, quite easily) adopt a "reasonable corporate policyholder" objective standard of measurement in cases involving sophisticated policyholders. Nonetheless, the "layperson" standard of objective reference continues to enjoy substantial support in the courts, even when the policyholder is a commercial entity.¹⁹⁶ Consumer policyholders continue to receive the broad

190. General Ins. Co. of Am. v. City of Belvedere, 582 F. Supp. 88 (N.D. Cal. 1984) (applying California law).

191. *Id.* at 89-90.

192. *Id.* at 89. The insurer apparently had failed to update its policies in response to legislative change. *Id.* Before 1974, art. I, § 14 was the eminent domain provision of the California constitution. *Id.* Thereafter, eminent domain was located in art. I, § 19, whereas § 14 dealt with felony prosecutions. *Id.* The Belvedere policy issued in 1978. *Id.* The insurer began its argument in favor of exclusion in a weakened position by asking the court to disregard the text and assume it had meant to exclude § 19 liability from coverage. *Id.*

193. *Id.* at 90.

194. General Ins. Co. of Am. v. City of Belvedere, 582 F. Supp. at 89-90.

195. See *infra* part IV.

196. See, e.g., *Album Realty Corp. v. American Home Assurance Co.*, 607 N.E.2d 804, 805 (N.Y. 1992) (reaffirming commitment to layperson standard of measuring insurance policy meaning and ambiguity).

benefits of *contra proferentem* and also often benefit from additional requirements that exclusionary language be particularly clear, well-known, or highlighted to the policyholder.¹⁹⁷

Another example of judicial resistance to a sophisticated policyholder defense is *ACANDS, Inc. v. Aetna Casualty & Surety Co.*,¹⁹⁸ a major asbestos coverage case in which the Court of Appeals for the Third Circuit that has supported the sophisticated policyholder defense in other cases professed allegiance to *contra proferentem*. The court in *ACANDS* specifically rejected the insurer's argument that *contra proferentem* should be abandoned for sophisticated contracting parties, finding Pennsylvania law supported ambiguity analysis "in cases in which the insured was a commercial entity."¹⁹⁹ The court seemed also to apply a strong version of *contra proferentem* because it rejected the insurer's request that extrinsic evidence be considered to resolve the ambiguity prior to the court's invocation of *contra proferentem*.²⁰⁰

One important and prominent case, *Keene Corp. v. Insurance Co.*,²⁰¹ which is better known for its adoption of the so-called "triple trigger" of coverage in asbestos liability coverage cases,²⁰² implicitly rejected any approach that differentiated among policyholders. On the ambiguity issue, the court noted "the well-accepted rule that ambiguity in an insurance contract must be construed in favor of the insured" and did not deny Keene, a commercial insured, the benefit of the rule.²⁰³ The court also extended to Keene a doctrine often restricted to consumers when it declared that in construing the policies, "our guide is—as it must be—the reasonable expectations of Keene when it purchased the policies."²⁰⁴ Other cases have strongly implied the

197. See, e.g., *20th Century Ins. Co. v. Liberty Mut. Ins. Co.*, 965 F.2d 747 (9th Cir. 1992) (applying California law).

198. *ACANDS, Inc. v. Aetna Casualty & Sur. Co.*, 764 F.2d 968 (3d Cir. 1985) (applying Pennsylvania law).

199. *Id.* at 973 (citations omitted).

200. *See id.*

201. *Keene Corp. v. Insurance Co. of N. Am.*, 667 F.2d 1034, 1041 n.10 (D.C. Cir. 1981) (apparently applying universal law), *cert. denied*, 455 U.S. 1007 (1982).

202. *Keene* held that either inhalation of asbestos, exposure in residence, or manifestation of injury would act to trigger coverage of the policies in question but only a single policy's limits would apply to any single injury claim, with the policyholder allowed to select which policy would apply to specific claims in order to maximize coverage. *Id.* at 1047, 1049.

203. *Keene Corp. v. Insurance Co. of N. Am.*, 667 F.2d at 1041-42. Is it not self-evident of course, that a commercial manufacturer like Keene is truly sophisticated about insurance, especially when the claims prompting the declaratory judgment were essentially unknown at the time the policies were placed? Contrast this to the district court's findings of fact in *McNeilab, Inc. v. North River Ins. Co.*, 645 F. Supp. 525 (D.N.J. 1986), *aff'd*, 831 F.2d 287 (3d Cir. 1987), that Johnson & Johnson had established substantial internal expertise in insurance. *Id.* at 547.

204. *See Keene Corp. v. Insurance Co. of N. Am.*, 667 F.2d at 1041-42; *Steven v. Fidelity & Casualty Co.*, 377 P.2d 284, 288-89 (Cal. 1962); *Allen v. Metropolitan Life Ins. Co.*, 208 A.2d 638, 644 (N.J. 1965); *Collister v. Nationwide Life Ins. Co.*, 388 A.2d 1346, 1353-54 (Pa. 1978), *cert. denied*, 439 U.S. 1089 (1979); *Owens-Illinois, Inc. v. Aetna Casualty & Sur. Co.*, 597 F.

contra proferentem principle applies to commercial or sophisticated policyholders but the policyholder's knowledge may be relevant to its expectations of coverage or determining whether the policy's text is ambiguous.²⁰⁵

In *Ogden Corp. v. Travelers Indemnity Co.*,²⁰⁶ the court found the insurer had a duty to defend the policyholder in actions arising out of the sinking of a ship built by the policyholder's subsidiary.²⁰⁷ The court summarily rejected the insurer's argument for a sophisticated policyholder defense abrogating the ambiguity doctrine due to Ogden's use of a large insurance broker in procuring the policy and in assembling coverage provisions. The court wrote:

In the field of insurance contract provisions, the general rule is to construe ambiguities in favor of the insured and against the insurer. This rule applies particularly to exclusionary clauses. Defendant Travelers argues, however, that the traditional rule should not apply in this case, since it alleges that Ogden, through its insurance broker, Frank B. Hall, was primarily responsible for drafting the insurance pro-

Supp. 1515 (D.D.C. 1984) (predicting Ohio law). *Owens-Illinois* followed the *Keene* approach in an asbestos trigger of coverage dispute and rejected the sophisticated policyholder defense as a basis for avoiding either contra proferentem or the reasonable expectations doctrine, both of which it found applicable for commercial policyholders. *Id.* at 1523-24. See also *Lac D'Amiante Du Quebec, Ltee. v. American Home Assurance Co.*, 613 F. Supp. 1549 (D.N.J. 1985) (applying New Jersey law). In *Lac d'Amiante du Quebec*, Judge Maryanne Trump Barry, who embraced the sophisticated insured defense a year later in *McNeilab, Inc. v. North River Ins. Co.*, 645 F. Supp. 525 (D.N.J. 1986), *aff'd*, 831 F.2d 287 (3d Cir. 1987), appeared receptive to, or at least acceptant of, ambiguity analysis, stating an insurance "policy was to be construed against the insurer, [with] ambiguities . . . resolved in favor of the insured" and "ambiguities, such as the failure to define the method by which coverage is triggered, are, in accordance with applicable law, construed in favor of the insured." *Lac D'Amiante Du Quebec, Ltee. v. American Home Assurance Co.*, 613 F. Supp. at 1557. *Lac d'Amiante du Quebec, Ltee.* and *McNeilab* are not necessarily inconsistent. Commercial insureds may vary in sophistication. Furthermore, courts may not make findings regarding knowledge, bargaining power, and sophistication unless presented with appropriate facts by counsel. Perhaps the differences in these outcomes involve only specific facts and presentation by counsel. Nonetheless, one is left with the nagging sense that judicial enthusiasm for the sophisticated policyholder defense may be as result-oriented as other varying applications of contra proferentem and the reasonable expectations doctrine.

205. See, e.g., *Shearson/American Express v. First Continental Bank*, 579 F. Supp. 1305 (W.D. Mo. 1984) (applying Kansas law). In *Shearson/American*, the court found no coverage under a bank's surety bond due to an exclusion of "trading" activities because the term is not ambiguous in the context of the policy and the parties. *Id.* at 1311. The court noted with approval the ambiguity principle and appeared willing to invoke it for the policyholder if the term in dispute had been ambiguous, notwithstanding the insured's status. *Id.* at 1309-11. In determining ambiguity, however, the court applied the perspective of "a reasonable person in the banking industry." *Id.* at 1310. The court also suggested some de facto consideration of the policyholder's reasonable expectations, but found the bank's argument for coverage subjective and implicitly unreasonable because it did not "coincide with the objective understanding" of other bankers. *Id.* at 1311. The court also rejected any duty of the surety to highlight and explain the exclusion to policyholders. *Id.*

206. *Ogden Corp. v. Travelers Indem. Co.*, 681 F. Supp. 169 (S.D.N.Y. 1988).

207. *Id.* at 170.

visions at issue. The Court is not persuaded by this argument. Although Ogden did in fact negotiate with Travelers, it cannot be said that Ogden completely drafted the provisions in question so as to cause the Court to apply a limited exception to the general rule by construing ambiguities in favor of the insurer.²⁰⁸

An important state court decision rejecting the defense ushered in the 1990s. In *Boeing Co. v. Aetna Casualty & Surety Co.*,²⁰⁹ Boeing sought coverage for hazardous waste cleanup costs imposed upon it pursuant to the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA, perhaps better known as "Superfund").²¹⁰ Boeing viewed these as damages within the meaning of its CGL although Aetna took the view damages meant only traditional judgments assessed (or settlements in compromise of such claims) by courts of law.²¹¹ The Court adopted Boeing's view, notwithstanding an express sophisticated insured defense raised by Aetna. The court wrote:

[O]n the facts of this case, it is questionable whether these standard rules of construction are no [sic] less applicable merely because the insured is itself a corporate giant. The critical fact remains that the policy in question is a standard form policy prepared by the company's experts, with language selected by the insurer. The specific language in question was not negotiated, therefore, it is irrelevant that some corporations have company counsel. Additionally, this standard form policy has been issued to big and small businesses throughout the state. Therefore it would be incongruous for the court to apply different rules of construction based on the policyholder because once the court construes the standard form coverage clause as a matter of law, the court's construction will bind policyholders throughout the state regardless of the size of their business.²¹²

Even in jurisdictions regarded as relatively conservative and pro business, consumer policyholders still receive the benefit of the doubt.²¹³ In addition, a number of cases appear to be willing to abrogate the ambiguity rule but only on the basis of evidence more compelling than the general sophistication of the policyholder. For example, in *J. Ray McDermott & Co. v.*

208. *Id.* at 173-74.

209. *Boeing Co. v. Aetna Casualty & Sur. Co.*, 784 P.2d 507 (Wash. 1990).

210. *Id.* at 509. CERCLA is codified at 42 U.S.C. §§ 9601-9675 and provides that generators or transporters of hazardous waste or owners of hazardous waste sites are jointly and severally strictly liable for cleaning up sites where there is a substantial threat of a release of the waste. See ABRAHAM, *supra* note 50, at 473.

211. *Id.* at 510.

212. *Boeing Co. v. Aetna Casualty & Sur. Co.*, 784 P.2d at 514.

213. See, e.g., *Rivera v. Benefit Trust Life Ins. Co.*, 921 F.2d 692 (7th Cir. 1991) (applying Illinois law).

Fidelity & Casualty Co.,²¹⁴ the court recognized the general validity of ambiguity analysis but found it inapplicable because the salvage expense reimbursement provision at issue had in fact been written by the policyholder's broker and accepted verbatim by the insurer.²¹⁵ The court might then have been prepared to invoke ambiguity analysis against the policyholder due to the drafting of its agent, but this was unnecessary because the court found the broker-drafted clause unambiguously required a ruling in favor of the insurer.²¹⁶

In *Metpath, Inc. v. Birmingham Fire Insurance Co.*,²¹⁷ the court adopted a sophisticated policyholder approach but reaffirmed the applicability of *contra proferentem*.²¹⁸ The policyholder had, through its broker, actively worked with the insurer to tailor the policy in question.²¹⁹ The court stated that "[c]ontracts of insurance are to be construed in the same way as any other contract,"²²⁰ which included the ambiguity principle, but found no ambiguity of text in the instant case.²²¹ The *Metpath* court did not precisely describe the contract formation process but it appears the policyholder's broker actually wrote the policy language rather than merely assembling standardized provisions as part of a relatively unusual policy.²²² Several other courts have sided with insurers in coverage disputes based not on any abrogation of the ambiguity doctrine but because of the policyholder's role in drafting the text or otherwise shaping the contract.²²³

Overall, many cases purporting to jettison the ambiguity approach can be explained by other, more persuasive grounds for decision. Nonetheless, the sophisticated policyholder defense is now a factor to be considered whenever courts decide commercial insurance disputes. Furthermore, the sophisticated policyholder defense seemed to be doing quite well, at least

214. *J. Ray McDermott & Co. v. Fidelity & Casualty Co.*, 466 F. Supp. 353 (E.D. La. 1979).

215. *Id.* at 361-62.

216. *Id.*

217. *Metpath, Inc. v. Birmingham Fire Ins. Co.*, 449 N.Y.S.2d 986 (App. Div. 1982).

218. *Id.*

219. *Id.* at 989.

220. *Id.*; *accord Harbor Ins. Co. v. Continental Bank Corp.*, 922 F.2d 357 (7th Cir. 1990) (applying Illinois law).

221. *Metpath, Inc. v. Birmingham Fire Ins. Co.*, 449 N.Y.S.2d at 989.

222. *See id.* at 987.

223. *See, e.g., Western World Ins. Co. v. Stack Oil, Inc.*, 922 F.2d 118, 122 (2d Cir. 1990) (applying Connecticut law) (holding policyholder bound by knowledge of its agent regarding existence of absolute pollution exclusion); *Travelers Indem. Co. v. United States*, 543 F.2d 71, 74 (9th Cir. 1976) (holding *contra proferentem* inapplicable when policyholder or its agents has supplied policy language); *Standard & Poor's Corp. v. Continental Casualty Co.*, 718 F. Supp. 1219, 1221 (S.D.N.Y. 1989) (stating courts do not apply *contra proferentem* when a policyholder "had at least equal input [as the insurer] into drafting the policy generally, and the specific clause at issue"); *Puerto Rico Elec. Power Auth. v. Phillips*, 645 F. Supp. 770, 773 (D.P.R. 1986) (holding *contra proferentem* inapplicable when policyholder drafted policy and submitted it to insurer for approval).

rhetorically, during the early and mid-1980s. More recently, courts seem to be less willing to forgo *contra proferentem* altogether, although acknowledging the ambiguity doctrine should not become a rule dictating insurers lose whenever the language is even remotely unclear. For example, some cases suggest the knowledge and experience of the policyholder may set firm limits on its reasonable expectations, although these cases usually do not specifically invoke the reasonable expectations doctrine and are often rendered in jurisdictions that do not expressly embrace the doctrine. Rather, these courts use the range of the policyholders' expectations to determine whether there are ambiguities in the policies.²²⁴ In another group of cases, the sophistication or economic power of the policyholder seems to make the courts less sympathetic to losses suffered by the policyholder.²²⁵

IV. TOWARD USEFUL AND FAIR CONSIDERATION OF THE POLICYHOLDER'S SOPHISTICATION

In determining the applicable variant of contract law that should control an insurance coverage dispute, courts would do well to avoid any myopic focus on the sophistication, wealth, or other attributes of the policyholder. Even powerful and prominent policyholders are essentially "trapped" into accepting standardized contract provisions in insurance as in other fields.²²⁶ Better results and more enlightening analysis come from examining the specific aspects of a case from a functional perspective. Courts should ask what was actually done to or for whom and do those activities bear on the questions of contract meaning, tie breaker rules, and public policy. Several issues are worth considering.

First, courts should consider the actual identity of the drafter. At the outset, commentators and courts should distinguish more carefully between situations in which the policyholder is merely a sophisticated party adhering to a standardized contract of adhesion, and those cases in which the policyholder is more than the consumer of a prefabricated insurance product.

224. See, e.g., *Western World Ins. Co. v. Stack Oil, Inc.*, 922 F.2d at 122 (holding an absolute pollution exclusion enforceable against a commercial insured both because of clarity of exclusion and knowledge of insured's agent); *Falmouth Nat'l Bank v. Ticor Title Ins. Co.*, 920 F.2d 1058, 1062-65 (1st Cir. 1990) (applying Massachusetts law) (holding bank could not reasonably make claim against policy until loss became fixed); *Ryan v. Royal Ins. Co. of Am.*, 916 F.2d 731, 742-43 (1st Cir. 1990) (applying New York law) (holding an informational letter from New York Department of Environmental Conservation not sufficiently adversarial to give rise to damages claim when contaminated property subsequently sold at a discount).

225. See, e.g., *Borman's, Inc. v. Michigan Property & Casualty Guar. Ass'n*, 925 F.2d 160, 163 (6th Cir. 1991) (holding a statutory limitation of ability to collect claims against state guaranty funds based on net worth of insured does not violate constitution), cert. denied, 112 S. Ct. 85 (1991).

226. See, e.g., *Graham v. Scissor-Tail*, 623 P.2d 165, 171-72 (Cal. 1990) (noting even famous rock concert promoter, the late Bill Graham, had no choice but to accept standard American Federation of Musicians contract in order to book acts for concert).

Regarding litigation outcomes, the policyholder is in the weakest position when it in fact drafted the language. Almost everyone would agree that when a policyholder or its bona fide agent drafts a contract term, the rule of *contra proferentem* should not operate in its favor. On the contrary, in these instances, the ambiguity principle should operate in favor of the insurer and against the insured. Although this might shock consumer advocates, it is a sensible approach. *Contra proferentem* becomes an untenable, unprincipled doctrine if it comes to mean the insurer always loses.

Second, courts should consider broker presence and activity. Care must be taken in determining the drafting party when a broker is involved. The general rule of law deems the broker is the agent of the policyholder; independent agents may similarly be characterized as agents of the policyholder, at least for certain purposes. In consumer insurance, of course, this is often a fiction; the typical independent agent is more interested in remaining in the good graces of the insurers whose products he sells. In commercial insurance, when policyholders pay big premium dollars, expect broker performance, and have enough information and experience to fire brokers who fail to perform, the presumption of broker as agent for the policyholder usually is realistic. Nevertheless, courts err in automatically assuming a broker acts as a fiduciary for every commercial policyholder. Many times a commercial policyholder's naiveté and other factors make the broker a closer ally of the insurer. This, and any relaxation or truncation of *contra proferentem* for business policyholders, should depend on the facts of each case.

Similarly, even the most zealous research and advocacy by a broker does not make the broker or the policyholder the drafter of the contract when the broker and policyholder merely select coverage options authored by the insurer in standardized language. Product selection is not the same as product manufacture. Customers may choose a Ford over a Chevrolet or purchase optional equipment on their car of choice, but in neither case has the customer designed or manufactured the car. The sounder historical view does not require adhesion or disparate bargaining power to justify the ambiguity doctrine in such cases.

Third, courts must consider attorney presence and activity. Like broker involvement, attorney involvement on behalf of the policyholder can be important. It can also be meaningless. What matters is what the attorney did. The mere involvement of a lawyer or broker does not automatically mean the policyholder drafted the contract language in dispute. If a policyholder's lawyer drafted policy language, however, *contra proferentem* should inure to the detriment of the policyholder. If the lawyer only advised a policyholder client, *contra proferentem* should still ordinarily be available to the policyholder. When legal advice has affected the policyholder's understanding of or expectations about policy coverage, however, this may abrogate use of ambiguity analysis. Similarly, the legal advice to an insurer may be relevant

and determinative of questions regarding expectations, the meaning of terms, or even the applicability of potential defenses such as waiver and estoppel.²²⁷

Fourth, courts should consider the degree of negotiation surrounding the policy and whether it is fairly characterizable as "customized" rather than standardized. Even a manuscript policy, despite involving considerably more negotiation and discussion than consumer policies, will vary on a continuum from being essentially drafted by the insurer to essentially drafted by the policyholder, with different policies falling on different points of the continuum. If the policy provision in question is essentially drafted by the insurer, a restrained version of the ambiguity principle should hold, with courts taking a reasonable, objective view of linguistic meaning and exploring other avenues to determine party intent before invoking *contra proferentem*. If the term is essentially drafted by the policyholder, a similar version of *contra proferentem* should apply in reverse (against the policyholder as a last resort). When the evidence is mixed, the ambiguity doctrine should perhaps be inapplicable.²²⁸

Tough questions may be presented by the use of manuscript policies in business insurance. A manuscript policy is one composed of segments of standardized language but the configuration of which is "confected especially" for the insured.²²⁹ One leading commentator has stated that the ambiguity doctrine is inapt for "individually negotiated manuscript policies [which] by their nature reflect the negotiation and bargaining power of the insured."²³⁰ This view, standing alone, however, says nothing about authorship, which should still be treated as a question of fact in each instance. In many cases, of course, the negotiation and hybridization of component parts into a quasi-

227. For example, a lawyer or broker may not have merely consulted the policyholder but may have co-authored the contract (making *contra proferentem* inapplicable) or authored it (making the policyholder the target of the doctrine). *See, e.g.*, *Travelers Indem. Co. v. United States*, 543 F.2d 71 (9th Cir. 1976) (interpreting policyholder's broker-drafted policy); *Fireman's Fund Ins. Co. v. Fibreboard Corp.*, 227 Cal. Rptr. 203 (Ct. App. 1986) (finding policy language cocreated by the parties). Unfortunately, some cases find mere proximity to the transaction the equivalent of drafting the contract or confuse policyholder involvement in selecting coverage provisions with actual drafting of the contract. *See, e.g.*, *Eastern Associated Coal Corp. v. Aetna Casualty & Sur. Co.*, 632 F.2d 1068, 1075 (3d Cir. 1980) (holding the policyholder's broker had created a contract through a mixture of policy forms tendered to insurer for execution), *cert. denied*, 451 U.S. 986 (1981).

228. *See, e.g.*, *Kinney v. Capitol-Strauss, Inc.*, 207 N.W.2d 574, 577 (Iowa 1973) (holding *contra proferentem* "inapplicable where the instrument is prepared with the aid and approval, and under scrutiny of legal counsel for both of the contracting parties"). Some opponents of the ambiguity doctrine cite cases like *Kinney* for the proposition *contra proferentem* is inapplicable whenever the parties have counsel. In *Kinney*, however, the parties in fact co-drafted the contract (a lease) and there was no single drafter. *Id.* at 576. The *Kinney* situation differs markedly from an insurance sale in which the policyholder has counsel but has no hand in writing the policy language.

229. *See Eagle Leasing Corp. v. Hartford Fire Ins. Co.*, 540 F.2d 1257, 1261 (5th Cir. 1976), *cert. denied*, 431 U.S. 967 (1977).

230. *See OSTRAGER & NEWMAN, supra* note 107, at §1.03(c).

customized manuscript policy becomes the practical equivalent of a co-authored policy. In those situations, rejection of *contra proferentem* seems apt.²³¹

The facts of many cases will, however, undoubtedly show that even large businesses in intensive discussions with insurers remain in essentially the same position as a consumer reviewing auto insurance options with an agent—there is some measure of choice but the policyholder can hardly be said to be writing the contract. Even a sophisticated process of cutting and pasting insurer-provided standardized terms into a policy does not alter authorship. When the insurer wrote the language likely to be at issue, *contra proferentem* should be available to resolve close cases.

Some courts appear to have taken roughly this middle position and required the insurer raising a sophisticated policyholder defense to show more than mere negotiation but to proffer sufficient evidence to suggest the policyholder “completely drafted the provisions in question” in order to avoid *contra proferentem*.²³² In effect, this preserves the ambiguity rule in cases when the policyholder is merely mixing and matching standardized terms or chipping away at policy language authored by the insurer. Other cases have been less protective of ambiguity analysis but have taken the view that something more than mere negotiation is required before the policyholder is deemed a policy co-drafter or loses the benefit of the *contra proferentem* rule.²³³

Fifth, courts must consider whether, regardless of the drafter's identity, the term in dispute is really ambiguous if examined in light of the parties and the facts. In this regard, sophisticated policyholders should often stand on a different footing than consumer policyholders because business representatives and brokers will often understand exactly what the policy means when speaking of an “increase in the hazard,” “conduct expected or intended from the standpoint of the insured,” and the like. If insurer and policyholder have an ongoing business relationship, they may well have an understanding of terminology developed through years of claims processing. Similar experience is unlikely in consumer lines unless dealing with a policyholder who is extremely accident prone (or engaging in fraud).

Sixth, courts should consider the understandings conveyed by the oral and written conduct of the parties surrounding the negotiation, finalization,

231. See, e.g., *Shearson/American Express v. First Continental Bank & Trust Co.*, 579 F. Supp. 1305, 1311 (W.D. Mo. 1984) (interpreting a policy drafted by joint efforts involving recommended changes); *Bradley Bank v. Hartford Accident & Indem. Co.*, 562 F. Supp. 241 (W.D. Wis. 1983), *aff'd*, 737 F.2d 657 (7th Cir. 1984) (same, but joint drafting was not by individual policyholder but through interest group representing hospital insureds).

232. See *Ogden Corp. v. Travelers Indem. Corp.*, 681 F. Supp. 169, 173-74 (S.D.N.Y. 1988).

233. See, e.g., *Lac D'Amante Du Quebec, Ltée. v. American Home Assurance Co.*, 613 F. Supp. 1549 (D.N.J. 1985); *General Ins. Co. of Am. v. City of Belvedere*, 582 F. Supp. 88 (N.D. Cal. 1984); *Owens-Illinois, Inc. v. Aetna Casualty & Sur. Co.*, 597 F. Supp. 1515 (D.D.C. 1984).

and implementation of the policy. If, for example, the policyholder requested an endorsement to cover business interruption losses, and received it with the disclaimer that interruptions from military activity of any type were excluded, the policyholder would be hard-pressed to sustain a business interruption claim for problems related to Iraq's August 1990 invasion of Kuwait. Conversely, representations by the insurer or its agents might result in a more narrow construction of a military operations exclusion found in the text—for example, "we would only exclude coverage if there was a real war."

Seventh, courts should consider the presence of an objectively reasonable expectation of or reasonable reliance upon coverage due to no fault of the policyholder and when the insurer, if it took a different view of the term in dispute, could have corrected the policyholder's view. If the *contra proferentem maxim* is to be relaxed, a similarly venerable maxim—"no estoppel into coverage"—might also need clarification or relaxation. Although courts have not been particularly precise when using this maxim, it appears they usually mean equitable estoppel alone can not form a contract—it can only preclude rescission of a contract when an insurer has acted inequitably. Promissory estoppel—the actual creation of a contractual obligation due to promises, reasonable reliance, and detriment—is common in noninsurance matters and probably in insurance as well when one decodes cases or reads between their lines. A movement to place insurance closer to the realm of "regular" contract law should accept this and focus upon setting strict limits and tests for determining when coverage by promissory estoppel is apt—for example, whether the insurer induced reliance, whether the reliance was reasonable, whether it should have been disclosed to the insurer, and whether the insurer took reasonable steps to discover the reliance or expectation or had reason to know of the reliance.

Although this approach has traditionally been an anathema to insurers, it could promote fairer case results. For example, a policy provision may be ambiguous (due to semantics, syntax, or context) and have been primarily or even exclusively drafted by the insurer. A sophisticated policyholder reading the provision may have no reasonable expectation of coverage (although a less experienced consumer policyholder might), however, in view of the purposes and cost of the policy purchased. This type of sophisticated policyholder cannot be said to have reasonably relied on any representations by the insurer. When a large commercial policyholder legitimately relies upon the insurer's representations and expects coverage, however, it should have coverage, regardless of its size, wealth, or retinue of advisors.

Eighth, courts should consider the presence of a genuine contractual relationship between the disputants. A number of cases have held the ambiguity principle inapt in disputes between insurers. As previously discussed,²³⁴ this abrogation of ambiguity analysis is often apt (and certainly less troublesome when the policyholder receives coverage from at least one

234. See *supra* text accompanying notes 143-87.

insurer) but should not become a universal exception. Even when rejection of the ambiguity approach is a correct conclusion, this does not usually stem from the sophistication of the policyholder or policyholders involved. In many cases, disagreements over "other insurance" clauses, exhaustion of primary limits, and so forth, do not involve insurers who have actually contracted with one another. Rather, each insurer contracted with the policyholder but was thrown into collaboration and opposition by the dispute over apportionment of the loss. At best, these are semivoluntary transactions: voluntary in the sense the insurers willingly sold the insurance and expect disputes of this type; involuntary in that the insurers can not pick the other carriers with whom a policyholder will deal. In many instances, two different clauses authored by two different insurers will be in conflict. Thus, *contra proferentem* is not strictly applicable. In other cases, the interpretative culprit will be one particular policy authored by one of the insurers. Ambiguity analysis would presumably be appropriate in those cases, although a nontextual rule of law such as proration of benefits would presumably make more sense in light of the pseudo-contractual relationship of the insurers in dispute.

Ninth, courts must consider the presence of extrinsic evidence. Sometimes the inter-insurer contract is surrounded by extrinsic evidence courts may use to derive policy meaning. In other cases—for example, certain reinsurance treaties—inter-insurer contract behavior may provide even fewer nontextual clues to meaning than found in consumer policies (except reinsurance typically will involve a longstanding course of dealing between the parties). As with contract disputes generally, courts are on sounder ground in resolving the matter based on specific evidence of meaning rather than resorting to a broad legal rule or presumption that exists to make decisions in the face of uncertainty.

Tenth, courts should consider whether, in the absence of more probative evidence of contract meaning, it is fundamentally fair to invoke *contra proferentem* against the insurer. Under certain circumstances, *contra proferentem* seems to have a legitimate role to play in the future as a judicial tie breaker. Although a dispute between two insurers or an insurer and a large commercial policyholder cosmetically suggests a situation in which two 500-pound gorillas can fight it out without benefit of the ambiguity tie breaker, cases grabbing too quickly at exempting these transactions from the *contra proferentem* approach forget many contract terms really are ambiguous when applied to a particular dispute and there may exist no fairer way to resolve the conflict other than invocation of the ambiguity doctrine. In fact, large commercial policyholders may on occasion have greater need for insurance and more difficulty obtaining it than other policyholders.²³⁵

One alternative is decision based on judicial notions of public policy, a consideration perhaps even more likely to produce outcomes favoring the pol-

235. See Caton et al., *supra* note 13, at 13 (reviewing deposition testimony of insurance expert Richard Stewart).

icyholder. After all, the policyholder paid premiums and wanted protection, the insurer is in the business of providing protection, risks should be spread throughout society, and so forth. Of course, in some cases, a pro-policyholder result could raise premiums and aggregate social costs or perhaps even bankrupt a carrier or prompt widespread coverage unavailability. Courts and legislatures tend to see these policy considerations as more speculative and less weighty, however, than any perceived immediate (and legitimate) desire for compensation or risk spreading. Despite the power and expertise of the participants, usually an individual drafted the contract term at issue and is "responsible" for the existence of a nonfrivolous controversy as to contract meaning.²³⁶ When other accepted construction tools fail, courts may be able to do no better than to vindicate the policies traditionally at work in the ambiguity doctrine regardless of the identity of the parties. When the ambiguity doctrine is used in business cases, however, it should be in the weak form, when findings of ambiguity and recognition of the reasonableness of the policyholder's suggested interpretation do not come too easily.

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

Unfortunately, cases invoking the sophisticated policyholder exception, although they often appear to have reached the correct result, have employed rhetoric that seems to breeze over these considerations in order to focus upon economic strength rather than contracting activity. Further, many cases expressing support for the sophisticated policyholder defense²³⁷ took these views in dicta that was not essential to the coverage decision.²³⁸ Other courts appear to have refused to apply *contra proferentem* to reach holdings in favor

236. See, e.g., *Keystone Ins. Co. v. Allstate Ins. Co.*, 633 F. Supp. 1358, 1359 (W.D. Pa. 1986); *Chicago Ins. Co. v. Pacific Indem. Co.*, 566 F. Supp. 954, 959 (E.D. Pa. 1982).

237. See, e.g., *Halpern v. Lexington Ins. Co.*, 715 F.2d 191 (5th Cir. 1983) (applying Louisiana law); *Brokers Title Co. v. St. Paul Fire & Marine Ins. Co.*, 610 F.2d 1174 (3d Cir. 1979) (applying Pennsylvania law); *Fireman's Fund Ins. Co. v. Fibreboard Corp.*, 227 Cal. Rptr. 203 (Ct. App. 1986).

238. See, e.g., *Eastern Associated Coal Corp. v. Aetna Casualty & Sur. Co.*, 632 F.2d 1068 (3d Cir. 1980) (applying Pennsylvania law), *cert. denied*, 451 U.S. 986 (1981); *Garcia v. Truck Ins. Exch.*, 682 P.2d 1100 (Cal. 1984); *Metpath, Inc. v. Birmingham Fire Ins. Co.*, 449 N.Y.S.2d 986 (App. Div. 1982).

of the insurer.²³⁹ A fair reading of these cases tends to suggest, however, the courts did not strictly need to attack the ambiguity approach because in many cases the courts were able to resolve the ambiguity by means other than *contra proferentem*.

Another common problem is judicial confusion of contract ambiguity with the "contract of adhesion" doctrine. As contracts expert Professor E. Allan Farnsworth has noted, ambiguity considerations often are completely independent of whether the contract (however drafted) is one of adhesion.²⁴⁰ He gives the example of a large corporation that, "in order to park its truck, adheres to the terms of a small operator of a parking lot."²⁴¹ Of course, the corporate trucker can elect to spend the day circling the block in search of a parking space but this "free choice" does not change the substance of the transaction: either the trucker "takes" the terms of the parking stub "contract" or he leaves for the not-so-open road.

Similarly, an insurance policy should not meaningfully be regarded as adhesive when the policyholder had some choice in determining whether to accept the policy or to shop around for different coverages.²⁴² When the policyholder has such choices, it is hard to view the process or the policy as unconscionable or to suggest the policyholder reasonably relied on a construction of the policy at variance with the language. Fraud, misrepresentation, and coercion are harder still to foresee. In short, on a number of fronts, the evidentiary factors in a large commercial insurance case all tend more toward interpretation more favorable to the insurer than one finds in typical consumer and small business insurance contracts.²⁴³

239. See, e.g., *First State Underwriters Agency v. Travelers Ins. Co.*, 803 F.2d 1308 (3d Cir. 1986) (applying Pennsylvania law); *Eagle Leasing Corp. v. Hartford Fire Ins. Co.*, 540 F.2d 1257 (5th Cir. 1976) (applying Louisiana law), *cert. denied*, 431 U.S. 967 (1977); *Industrial Risk Insurers v. New Orleans Pub. Serv., Inc.*, 666 F. Supp. 874 (E.D. La. 1987).

240. See FARNSWORTH, *supra* note 8, § 4.26, at 480.

241. See *id.* § 4.2, at 480 n.5.

242. Commercial policyholders, as long as they are occasionally going to lose doctrinal advantages because of their brokers, lawyers, and staff, can counterattack by putting this staff to work in obtaining explanations of coverage, writing and demanding explanatory letters, taking good notes, as well as maintaining a file on policy history, all of which may prompt a court to some day resolve a textually ambiguous policy in favor of the business policyholder even without benefit of *contra proferentem*.

243. Notwithstanding the undue preoccupation with bargaining power found in cases like *Schering Corp. v. Home Ins. Co.*, 712 F.2d 4, 10 n.2 (2d Cir. 1983), the Second Circuit seems particularly resistant to efforts to limit the doctrine. See, e.g., *Ingersoll Milling Mach. Co. v. M/V Bodena*, 829 F.2d 293 (2d Cir. 1987), *cert. denied*, 484 U.S. 1042 (1988); *Pan Am. World Airways v. Aetna Casualty & Sur. Co.*, 505 F.2d 989 (2d Cir. 1974) (applying New York law). Perhaps this results from the relatively restrained versions of *contra proferentem* prevailing in the states (New York, Connecticut, Vermont) comprising this circuit.

V. CONCLUSION

Although the courts have shown a disturbing tendency to confuse inappropriately a policyholder's sophistication with contract drafting and the applicability of the ambiguity approach, a policyholder's sophistication in many cases is germane to issues affecting the interpretation of insurance contracts. Thus, courts also err when they foreclose any consideration of the policyholder's sophistication in deciding insurance coverage disputes. Sophisticated policyholder considerations have a role to play in a more subtle insurance coverage jurisprudence of the future. That role is, however, considerably more sophisticated than courts have acknowledged to date. Treating Fortune 500 companies like impoverished and credulous individuals makes no sense. A blanket or reflexive rejection of the time-honored ambiguity approach for commercial policyholders, however, makes even less sense. Assessing future coverage questions involving sophisticated policyholders by reference to this Article's list of considerations can form an initial basis for a sounder insurance coverage doctrine.²⁴⁴

244. Presumably, courts will decide coverage questions based on a more functional and less formal approach. See generally James M. Fischer, *Why are Insurance Contracts Subject to Special Rules of Interpretation?: Text Versus Context* , 24 ARIZ. ST. L.J. 995 (1992); Swisher, *supra* note 179. Courts seeking to vindicate the effective functioning of modern insurance should also, however, retain sight of fairness concerns affecting the policyholder. To the extent the typical operation of the ambiguity doctrine is a bit of contract formalism designed to give the policyholder an edge in close cases, it has substantial continued vitality.

