
Insurance, Ambiguity, and The Sophisticated Insured

MICHAEL SEAN QUINN AND H. MICHELLE CALDWELL

The general jurisprudence of insurance¹ and the law of almost every American jurisdiction contains the Contra-Insurer Ambiguity Norm (CIAN): Ambiguities in insurance policies are to be construed against the insurer.²

This principle is central to much insurance coverage litigation,³ and it is pivotal in environmental insurance coverage litigation.⁴ One court has held that an insurer's deliberate insertion of a known ambiguity in an insurance policy may constitute actionable insurer bad faith.⁵

While the CIAN is subject to criticism for being indeterminate and therefore inviting unprincipled applications,⁶ it is deeply embedded in the law. The relationship of CIAN to other interpretive principles is less clear, however. Some superficial cases, which have not considered the policy foundations of the norm, suggest that CIAN is a persuasive and strong interpretative principle that trumps virtually every other interpretive principle. This view of CIAN could be called the "Early and Firmly Theory," (EFT) since it supposes that CIAN is applied *early* in the interpretive process, before most other principles, and that every such application is firm. In contrast, there is the Last Resort Theory (LRT) which holds that CIAN is a weak interpretive principle, subordinate to virtually all others, applied only at the end of an interpretive sequence.

Our purpose in this article is to *sketch* the support that exists for LRT, to *explore* the newly emergent sophisticated insurance purchaser exception to CIAN, which complements LRT, and to *refute* a recent critique of the sophisticated insurance purchaser exception. We also demonstrate that the theory of adhesionary contracts is consistent with the sophisticated purchaser exception.

LAST RESORT THEORY OF THE CONTRA-INSURER AMBIGUITY NORM

CIAN applies only as a last resort. It is subordinate to all—or at least most—other rules of construction.⁷ Similarly, a disagreement about the

Michael Sean Quinn is a partner at Zelle & Larson in Dallas. He represents insurers in insurance-related pollution litigation. H. Michelle Caldwell is an associate at Cowles & Thompson in Dallas.

meaning of policy language does not imply the existence of ambiguity, before the disagreement must be reasonable.⁸ Because there are millions of insurance contracts in the United States at any given time, and because most of them do not involve negotiation in the underwriting process, judicial decisions commonly skip many other interpretive principles and rely on CIAN. The rhetoric of these decisions does not affect the subordinate position of CIAN.

Norms for Interpreting Contracts

The real strength of CIAN is demonstrated by the general theory of interpreting insurance contracts. As with any contract, the interpretation of an insurance policy requires discerning the intent of the parties.⁹ The key to determining the intent of the parties is the language of the contract. Where the language of the contract is clear, there is no further inquiry: "Insurance policies are to be construed and enforced in accordance with their plain meaning." If the language of an instrument bears to one reasonable reading—one construction, one understanding—then that is the meaning to be assigned to the instrument. Of course, unreasonable constructions are not permitted,¹⁰ so courts should not strain to find an ambiguity.¹¹ Obviously, CIAN is subject to the plain-meaning norm.¹²

In addition, parties are presumed never to intend absurd result.¹³ CIAN is subordinate to the anti-absurdity norm of construction.

Another norm of construing insurance policies is the prescription: "When construing the terms of the insurance policy, the contract must be read as a whole."¹⁴ An ambiguity exists only if it persists through a complete reading of the contract.¹⁵ CIAN is subject to the read-it-as-a-whole norm.

A third norm for interpreting insurance contracts might be called the anti-redundancy norm: "No insurance policy should be read in such a way that different terms are given the same meaning." No term should be treated as mere surplusage.¹⁶ Obviously, the ambiguity of an insurance policy cannot be evaluated until the anti-redundancy norms are prescribed.

Role of Extrinsic Evidence

Finally, if the foregoing rules of construction are insufficient, then courts may turn to extrinsic evidence to explicate the meaning of an uncertainty in an insurance contract.¹⁷ CIAN is subject to the receipt of extrinsic evidence. If extrinsic evidence disambiguates a contract, then it is never necessary to turn to CIAN.¹⁸

One important source of extrinsic evidence is custom. Industry custom trumps CIAN.¹⁹ Two industry customs may be considered: customs in the insureds industry²⁰ and customs of the insurance industry.²¹

Another extremely important source of extrinsic evidence is the price term of the contract. Most courts and commentators acknowledge that the

coverage provided to the insured is relevant to the amount of premium charged. A leading treatise states, for example, that "although the amount of premium cannot affect the plain terms of the contract, it is a fact to be taken into consideration in construing doubtful clauses in a policy. An insurer may fairly be assumed to intend to limit the risk to the price exacted."²² Thus, price limits other terms.

Many jurisdictions hold that the price term might trump others in construing an insurance contract. The Second Circuit, applying New York law, has expressly stated that the size of the premium is relevant to the construction of an insurance policy.²³ Furthermore, the New York Court of Appeals has also considered the price of the premium in determining the nature and extent of the coverage afforded to the insured. In *Harris v. Allstate Ins. Co.*, the court stated, "In view of the much lower premium payable because of such exclusion, the insured could not reasonably have expected the coverage of the policy to extend, nevertheless, to the [risk alleged]. . . ."²⁴

New York is not unique. Courts throughout the United States have relied on the rule that the premium charged evidences limits on coverage. A leading case is *McNeilab v. North River Ins. Co.*²⁵ In *McNeilab*, the District Court of New Jersey explicitly held the amount of the premium can be used in establishing the extent of coverage.²⁶ We discuss *McNeilab* presently.

Thus, generally accepted principles of insurance contract construction entail that CIAN is subordinate to many other significant rules of construction and—indeed—that it is a rule of last resort. Some cases have expressly affirmed this proposition. For example, in *Loblaw, Inc. v. Employers' Liability Assurance Corp.*, the court stated that "ambiguities will not be resolved in favor of the insured," until the search for intent is exhausted, and other interpretative devices are included.²⁷

Thus, EFT is refuted and LRT established on the basis of both the theory of legal interpretation and some case law.²⁸ In keeping with the best common law traditions, the law in this area is not frozen, but evolving. New judicial trends are further undermining EFT and tending to establish LRT.

SOPHISTICATED INSURANCE PURCHASERS

Sophisticated insurance purchasers present another problem for EFT. If EFT were true, the domain of CIAN includes all insureds, no matter who the insured is. But there is convergent authority rejecting precisely this view. Of course, the law does not speak with one voice on this matter,²⁹ either in the general jurisprudence of insurance or among the jurisdictions. In fact, the idea that sophisticated insureds should be treated differently from "innocent," naive insureds is an idea in its relative infancy. For this reason, no principle or rule pertaining to sophisticated insurance purchasers could yet be deeply embedded in the law of any jurisdiction.

Commentators and Critics

The reasoned views of objective, non-partisan scholars, text writers, and commentators are an extremely important source of authority in modern common law. This is inevitably so whenever common law is under pressure or in a state of transition.³⁰

As both a practical and as a historical matter, CIAN received wide application and became deeply embedded in insurance law because of disputes involving homeowner, auto, and other personal lines of insurance.³¹ Also, until the middle part of this century, businesses outside the maritime industry were not generally sophisticated in insurance matters. The unreflective expansion of CIAN to genuinely sophisticated commercial insurance buyers has been subjected to severe criticism by commentators³² and objective text writers.³³ According to the scholars, it makes no sense to subject negotiated commercial insurance contracts to CIAN, as understood by EFT, because this rule originates in contract rules applicable where contracts of adhesion are presented to parties of unequal bargaining power on a take-it-or-leave-it basis.

Recent Court Cases

In recent years, some courts have joined the scholars in concluding that anti-insurer norms of construction have no place in the realm of big-money commercial insurance. We recite these cases at some length, because their language is crucial.

The Second Circuit, for example, applying New York law, wrote in *Schering Corp. v. Home Insurance Co.*:

[T]here is an unresolved question whether the rule of *contra proferentem* is even applicable in a situation involving a large, sophisticated, counselled entity such as Schering, since a number of courts have recognized that in cases involving bargained-for contracts, negotiated by sophisticated parties, the underlying adhesion contract rationale for the doctrine is inapposite.³⁴

Thus, where the insurance contract is bargained for, and is not a contract of adhesion, the contra-insurer-interpretive norm should not apply. *Schering* is a very influential case.³⁵

Similarly, the Fifth Circuit in *Eagle Leasing Corp. v. Hartford Fire Insurance Co.*³⁶ found the contract was ambiguous, but elaborated as follows:

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. Significantly, the policy in question is not the usual printed form but is what is known as a "manuscript" policy, containing some standard printed clauses but confectioned especially for [the insured]. It is true, of course, as the trial judge observed, "scriveners of insurance policies are acutely aware of the meaning and effect of the language." We comment: So too, are counsel for large companies carrying fleet insurance with annual premiums in six figures. There is no purpose in following a legal platitude that has no realistic application to a contract confectioned by a large corporation and a large insurance company each advised by competent counsel and informed experts.

Thus, where the insurance purchaser is a sizable business, managed by sophisticates and advised by insurance and legal professionals, the contra-insurer-interpretive norm makes no sense. According to the court, one barometer of this kind of sophistication is the use of an actual negotiated policy. After all, these are not standard form contracts. The *Eagle Leasing* court was quite specific on this point.

In a footnote, the court went on to refute the justification of the contra-insurer-interpretive norm in the commercial context. The court stated, "An insurance [contract] is usually a 'contract of adhesion,' where the insured has no bargaining power. *Only* for this reason, is the policy construed against the insurer." Thus, if an insurance contract is not a contract of adhesion, then the contra-insurer-interpretive norm should not apply. We show that insurance for sophisticated insureds may not be adhesionary in Section IV below.

The law of Pennsylvania is similar to that expressed in *Eagle-Leasing*. In *Eastern Associated Coal Corp. v. Aetna Casualty & Surety Co.*,³⁷ the court wrote:

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.*

As pointed out . . . above, Eastern's insurance broker selected the policy forms, prepared the policies, and sent them to the insurance companies for execution (emphasis added and citations omitted).³⁸

Eastern Associated Coal recognizes that if a broker for a sophisticated corporation is involved in selecting the policy forms, then CIAN lacks justification.

The law of Massachusetts is similar. In *Falmouth National Bank v. Ticor Title Insurance Co.*,³⁹ the Circuit Court string cites a number of cases

affirming the existence of the sophisticated insurance purchaser exception and states as follows:

The rationale behind interpreting ambiguities against the insurer would not seem to apply as strongly when the transaction is between two parties of equal sophistication and equal bargaining power.

Falmouth National Bank is interesting because it does not wipe out CIAN for sophisticated insurance purchasers. Rather, it reduces the strength of the norm.

The California Supreme Court came to a very similar conclusion in *Garcia v. Truck Ins. Exch.*⁴⁰ In construing a medical malpractice policy purchased by a hospital trade association, the court stated as follows:

[T]he principle that ambiguities in insurance policies must be strictly construed against the insurer stems, primarily, from a recognition of the typical relationship between the parties. Ordinarily, we are faced with a conflict between the purchaser of an insurance contract and the insurance carrier. In such cases, it is typically the carrier who drafts the insurance contract, unilaterally, and for policy reasons is thus held responsible for any ambiguity in language. And, *in the typical situation, the policy represents a contract of adhesion "entered into between two parties of unequal bargaining strength, expressed in the language of a standardized contract, written by the more powerful bargainer to meet its own needs, and offered to the weaker party on a 'take it or leave it' basis. . . ." These factors are not present here. The terms of this policy were negotiated between the carrier and [the California Hospital Association], and the language in contention was the product of joint drafting. And it is apparent that CHA, acting as representative of hospitals throughout the state and in a favorable competitive position, enjoyed substantial bargaining power vis-à-vis the carrier.*

Thus, when the insured is advised by capable insurance counsel, *contra proferentem* has no place. One of the key points in *Garcia* concerns negotiation. If a policy is genuinely negotiated by parties who are not subject to distortive inequalities in bargaining power, then anti-insurer "construction" lacks justification.

The sophisticated insurance purchaser exception articulated in *Garcia* was reaffirmed in 1990. In *AIU Insurance Co. v. Superior Court*,⁴¹ the California Supreme Court wrote that the contra-insurer-ambiguity norm and the doctrine of reasonable expectations applied less stringently when the insured was sophisticated. The court wrote:

[w]here the policyholder does not suffer from lack of legal sophistication or a relative lack of bargaining power, and where it is clear that an insurance policy was actually negotiated and jointly drafted, we need not go so far in protecting the insured from ambiguous or highly technical drafting.

Criteria for Establishing Sophistication of the Insured

This version of the sophisticated insurance purchaser contains three elements. First, the policyholder must be either legally sophisticated or in possession of power commensurate with the insurer. Second, the insurance policy must actually be negotiated. And third, the policy must be jointly drafted.⁴² (Of course, many factual and conceptual questions arise. When is a contract negotiated? Can a contract involving forms ever be a negotiated one? When is a contract jointly drafted?)⁴³

Many reported cases of district courts come to similar conclusions. Applying Louisiana law, one court succinctly criticized CIAN as follows:

This 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 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.⁴⁴

Thus, if an insured is represented by a lawyer who is sophisticated in insurance matters, then CIAN should not apply. Although it is not discussed in the case, presumably this rule would apply if experienced counsel were in-house counsel. Then why shouldn't it apply if the insured has the assistance of someone as sophisticated in insurance and negotiation matters as the insurance counsel is likely to be? Might this not be a risk manager?⁴⁵

Parties of equal bargaining strength

Perhaps the most thoughtful district court decision on this issue is *McNeilab, Inc. v. North River Ins. Co.*,⁴⁶ which concerns the well-known Tylenol incident. In 1982, unknown terrorists poisoned Tylenol capsules in Chicago. McNeilab, a division of Johnson & Johnson, withdrew all of its Tylenol products from the market, destroyed them, and sought recovery from its liability insurers, even though it had considered—but refrained from purchasing—recall insurance. The court held that the policy unambiguously excluded coverage, but it went on to state:

But even were the policy ambiguous, defendants [the insurers] would prevail. Plaintiff argues that if an ambiguity be found, the rule of *contra proferentem* should be strictly applied and that extrinsic evidence, which here goes one way and one way only and which plaintiff seeks to avoid like the plague, should not be allowed to demonstrate the actual intent of the parties. Plaintiff reads New Jersey law to be that the strict rules of insurance construction should apply even when the insured is a large corporation which had the aid of counsel in choosing and bargaining over the policy. *Plaintiff is wrong.*

The facts of *McNeilab* were somewhat unusual. In this case, the insurer sold terrorist coverage, but *McNeilab* rejected it. There was extrinsic evidence proving this proposition. *McNeilab* opposed the admissibility of such evidence and argued for an absolutely automatic application of *contra proferentem*. The court rejected this gambit in the following language:

Although there are no New Jersey cases directly on point, it would seem that the New Jersey courts would decide that *insurance policies of large, skilled corporations*—and here, I venture to suggest, *Johnson & Johnson* is larger than its insurers—*would be treated as ordinary contracts*. Such a position would dovetail with the New Jersey policy that insurance policies are generally strictly construed because they are contracts of adhesion, i.e., they are products of unequal bargaining power.

In the present case, there is no question but that the parties were of *equal bargaining power* and that all that preceded and all that followed the execution of the policy at issue here is reminiscent of the entry into and the living under a treaty between two great nations. Plaintiff's protestations about the size and competitiveness of the liability insurance market and the "adhesion contract" prepared without its input, in a phrase, fall flat. This latter protest, I note, cannot have been other than tongue in cheek for the evidence belies any suggestion other than that the 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. . . .

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. . . . *Johnson & Johnson* was a "favored customer" [t]his 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 insured]. *Cessante ratione legis, cesset et ipsa lex*—"where the reason stops, there stops the rule."

Thus, where the insurance purchaser and the insurer are of equal bargaining strength, the contract should be construed in accordance with the usual rules of contract construction. In short, where the doctrine of adhesionary contract does not apply, a sophisticated insurance exception should.⁴⁷

Contract of adhesion

The New Jersey Supreme Court recently decided a case in accord with *McNeilab*—*Werner Industries v. First State Ins. Co.*⁴⁸—utilizing the doctrine of reasonable expectations and not the contra-insurer ambiguity rule. In this case, the court was called upon to determine whether an excess

liability carrier "drops down" upon the insolvency of the primary carrier. The general question in "drop down" cases is whether excess policies insure against not only bodily injury and physical damage, but also the specific economic risk of the insolvency of the primary carrier.

The *Werner Industries* court began from the doctrine of reasonable expectations, but it pointed out that courts did not have or at any rate had a lesser "special responsibility" insurance context where there was bargaining and where both sides were sophisticated in insurance matters. In such context, the court said the contract should be construed in accordance with the intent of the parties, not in accordance with some dispositive rule of construction.⁴⁹

In another recent case, *Northbrook Excess & Surplus Insurance Co. v. Procter & Gamble Co.*,⁵⁰ a case arising out of the toxic shock syndrome cases, the sophisticated insurance purchaser excepts less than the usual way. The case was tried under Ohio procedure, where the disambiguation of insurance contracts is a matter for the jury. Procter & Gamble contended for a jury instruction that would embody the EFT, whereas the insurer contended for a jury instruction presupposing the sophisticated insurance purchaser exception. The trial court gave the instruction sought by the insurer; Procter & Gamble lost the case and appealed.

The Seventh Circuit affirmed the court's finding that the insurance policy was not one of adhesion and, hence, affirmed the court's refusal to give an instruction embodying the EFT. The court of appeals recognized that the EFT "states correctly an abstract principle of law," but it held that the EFT did not govern. The court observed that *contra proferentem* is "grounded in the need to protect an insured from an insurer who has had exclusive control of the drafting process." The Court of Appeals found that concerns about an insurer seizing exclusive control of the drafting process were not implicated in the dispute it was adjudicating. The court stated as follows:

Ohio [construes insurance contracts against some insurers, but it also] follows the cardinal rule of contracts law that the document is to be enforced according to the intent of the parties. Therefore, we can assume that—like other jurisdictions—Ohio would not apply the *contra proferentem* principle to situations in which its underlying rationale is inapplicable.

The record clearly establishes that P & G was a co-drafter of the [insurance] policy and not simply a party given a take-it-or-leave-it option.

The Seventh Circuit held that the Procter & Gamble policy was virtually tailor-made and that it was "profoundly more than a standard insurance policy."

Clearly, the sophisticated insurance purchaser exception is a matter being taken seriously by the courts. The paradigm where it unquestionably applies

is the specially prepared, co-drafted insurance contract, where both parties have equal bargaining power. In addition, the exception should apply in other situations as well, which, in some contemplation, approximate the paradigm. Nearly twenty-five years ago, a Pennsylvania court philosophized on the sophisticated insurance purchaser exception as follows:

Words can be baffling, but that does not preclude them from considered judgment and an intelligent interpretation of the English language. Nor does it mean that precise legal analysis should give way to an amorphous cloak, conceptually less taxing, called "ambiguity." Were this case between an individual who purchased the policy through a subway advertisement, e.g., and a giant insurance company, there might be good reason to construe the clauses very strictly, and in case of the slightest doubt, against the insurer. [This should be done on the grounds other contractors wanted adhesion.] The policy behind this rule is sound: the insurer wrote the policy and the individual purchaser is concerned primarily with monetary benefits. Concern with definitional clauses and exclusions is minimal; therefore, if they do become material, they should be strictly construed against the insurer. (¶) There would be little purpose in hewing to legal platitudes with no application where one large corporation and one large insurance company, both advised by competent legal counsel, do business with each other.⁵¹

To use the more contemporary parlance of economic jurisprudence, this case asks whether it makes sense to allocate the risk created by using language entirely to the insurer, where two substantial corporations are involved in the insurance transaction. Does that really make sense, the court impliedly asks, for the policy requires that insurance contracts be relatively brief, as contract documents go, formulated in plain language, as legal language goes, and set forth in general and abstract terms.

ONE RECENT ATTACK CONCERNING THE SOPHISTICATED INSURANCE PURCHASER

Although a number of courts, the principal textbook writers, and several commentators have converged to formulate a "sophisticated insurance purchaser" (SIP) exception to CIAN, the idea remains controversial, and some commentators recently rejected this exception.⁵²

The Case against the Sophisticated Insurance Purchaser Exception

Russell and her colleagues (Russell) argue against the sophisticated insurance purchaser exception on the grounds of the EFT.⁵³ In Russell's view, CIAN is a powerful, universal rule covering the domain of all insureds, save only those represented by attorneys sophisticated in insurance matters, and it is overridden, if at all, only by extrinsic evidence.⁵⁴ Russell excludes the possibility of sophisticated insurance purchaser excep-

tion, and contends that no such exception exists *both* as a matter of law *and* as a matter of fact. We examine both lemmas of this argument.

No Insurance Purchaser Exception Exists as a Matter of Fact

The Russell paper suggests that the sophisticated insurance purchaser exception is a "myth" because of the widespread standardization of insurance contracts. The authors begin from the proposition that the nature of insurance markets requires substantial standardization, that the information gathering and interpretation necessary for success of insurance markets would be impossible without widespread standardization, that both excess and reinsurance markets depend on standardization (for example, for "follow form" policies and for reinsurance treaties), and that state regulation presupposes standardized policies.

The authors infer from this observation that there are no sophisticated insurance purchasers. What else could it mean to suggest the sophisticated insurance purchaser was a "myth"? Of course, policy standardization does not entail that everyone who buys policies is unsophisticated and naive any more than the existence of standardization implies everyone who sells such policies is sophisticated or knavish. This argument simply rests on a fallacy.

Perhaps the Russell paper suggests that the existence of standardization precludes negotiation, so that even if there are sophisticated insurance purchasers, their sophistication has no bearing on policy interpretation since it can have no effect on policy terms. Of course, it is true that insurers are substantially disinclined to modify some terminology in their policies. This fact, however, does not entail there is *no* negotiation, any more than the fact that insurers insist on being paid some price entails there is no haggling over premium levels. In fact, there is a good deal of negotiation in many business insurance contexts. An insurance broker once explained his business to us as essentially "more coverage, less premium." Many insurance brokers spend a great deal of time on the telephone negotiating many features of insurance contracts.

Negotiating Terms of Insurance Contract

Two of the most important negotiations are the price to be paid and the level of the deductible. Since the price term has some bearing on the interpretation of other terms, it follows that one of the key terms in the policy is subject to negotiation. Common sense must govern the relationship between price and coverage when one thinks about insurance policies, at least in general: the higher the price, the more coverage there is likely to be; conversely, the lower the price, the less coverage there is likely to be. The same is true for deductibles and price: the higher the deductible, the higher the price, the more coverage there is likely to be over the deductible; conversely, where the deductible is higher and the price is lower, the existing

insurance coverage is likely to be less.

Obviously, the larger and more sophisticated the insurance purchaser, the more haggling there is likely to be over price and deductibles. If the price term bears on the interpretation of other terms, then the negotiation of the price has at least an indirect bearing on the interpretation of other terms. This observation corresponds to common knowledge about negotiation tactics. If one party is loathe to give up or even alter some provisions of the contract, the other party will harp on that fact in order to obtain concessions, where concessions may be had. These kinds of negotiation tactics are common not only in insurance markets but also in other industrial markets. For example, many manufacturers of large equipment (turbines, generators, boilers, and the like) absolutely will not alter any clauses in their contracts negating implied warranties or limiting their liability. Purchasers of such equipment frequently return to this matter again and again in order to extract other concessions. Thus, intransigence on some clause may have implications for the totality of the negotiation. The Russell paper seems unaware of these matters.

Negotiating Coverages and Endorsements

The Russell authors also seem to think there is no negotiation over matters pertaining to Commercial (or Comprehensive) General Liability insurance other than price and deductibles. This is not true. There are coverages that may or may not be purchased in a CGL policy. Advertising liability is one example. Additionally, there are many endorsements that may be purchased, thereby generating large numbers of extended or unusual coverages. For a number of these extended coverages, there are several alternative endorsements available. In other words, there are several different forms with different wording that address the same problem area. Thus, an insured may or may not purchase host liquor liability insurance, and if desired, the coverage may be procured by means of several different endorsements. Similarly, if an insurer is a manufacturer, it may or may not wish to purchase a vendor's endorsement. If the insured wants one, it may select from several different formulations, which arguably contain somewhat different coverages and exclusions.²⁵

Russell contends that standardization is necessary to ensure the efficiency of markets for excess insurance. This contention is doubly false. First, excess policies themselves are far from standardized. Many excess policies do not follow form. For example, it is not uncommon for CGL policies to include endorsements designating other insureds by classes, but not naming them. Vendor's endorsements frequently designate all of the vendors of a manufacturer's product without listing them. Policies of excess insurance above such a primary policy need not "follow form"; in other words, they need not incorporate the vendor's endorsement. On the con-

trary, they might restrict its coverage to the named insured or to the named insured plus others listed in the excess policy. Second, an efficient market for excess insurance does not require perfect uniformity in the underlying primary market. The existence of "follow form" policies excess of primary policies with many different combinations of endorsements details this proposition.

What is true for excess markets is also true for reinsurance markets. Reinsurance policies are not uniformly standardized and they reinsure many primary and excess policies with diverse combinations of coverages, exclusions, and conditions.

Three Important Conclusions

These commercial matters imply several important conclusions. First, a notion of a single, unitary standard form policy is misleading. There are literally dozens and dozens of forms available for use. When used properly, coverages can expand and contract, within limits, to the extent the deal is dickered. It is misleading to suggest insurance policies are *absolutely standardized*. The use of printed forms, where there are several different printed forms, contradicts the notion of *absolute standardization*. Of course, the body of the CGL policy is a unitary standardized form, but it can be varied by endorsement. Effectively, each CGL policy can (within limits) be tailored to fit specific needs of the insured. This can be done by means of endorsements that add or delete coverage. Given the number of endorsements available—and we have seen CGL policies with over a hundred endorsements—it is just misleading to speak of *standardization simpliciter*. Of course, the use of standard forms means there is some degree of standardization—or *relative standardization*—but the notion of simple, per se, invariant, across-the-board standardization is wrongheaded.

Second, insurers will not issue liability policies without a pollution exclusion. They want an exclusion as rigorous as possible precisely because they do not wish to issue coverage for pollution-related events. Nevertheless, the determination and tenacity of the insurers on this point does not imply that the policy, *taken as a whole*, is not subject to negotiation.

Third, the Russell paper assumes that the relative standardization of insurance policies benefits only insurers. This assumption is false. Insureds frequently benefit from relative standardization, which is a mixed blessing for insurers. With respect to insureds, standardization facilitates information exchanges, dialogue, and education, in addition to simplifying risk management. Outside the commercial area, we suggest that homeowners know far more about the contents of their insurance policies as a result of standardization, and the conversational sharing of information it makes possible, than they would know in the absence of standardization. Relative standardization in the commercial area creates similar (although vastly more

sophisticated) benefits.⁵⁶

Hence, as a matter of fact, it is simply not true that the sophistication of an insurance purchaser is completely irrelevant to what terms the policy will contain. As a result, the first lemma of the Russell argument fails.

No Sophisticated Insurance Purchaser Exception as a Matter of Law?

Russell argues on a number of grounds that, as a matter of law, there should be no sophisticated insurance purchaser exception to the EFT. None of the arguments is successful.

Seven Unsuccessful Russell Arguments

First, Russell points out that if there were a sophisticated insurance purchaser exception, then the same term—the same word—would mean one thing for one insurance purchaser and something else for another. Russell regards this as an unacceptable anomaly, which she thinks refutes the exception. It does not. In fact, it is fairly common in contract law for a term to be understood as an ordinary layperson would understand it, unless there is reason to believe the term was meant in a special sense. The sophisticated insurance purchaser exception simply establishes a framework for arguing that some insurance purchasers understand the language of insurance policies in a way different from the general public. Where this is true, a word would be construed in one way where a purchaser was a member of the general public and another way when it was a sophisticated business entity. This is not an uncommon situation in contract law. The sophisticated insured is held to a higher standard, but reaps the benefits of its higher level of expertise during policy negotiations.

Second, Russell contends that if terms meant one thing for sophisticated insurance purchasers and another for the general public, then the requirement of relative standardization, thought to be fundamental to insurance markets, would be violated and insurance markets would collapse. Russell appears to suggest the sophisticated insurance purchaser exception is contrary to the interests of the insurance industry so that insurers are mad to argue for it. In fact, this view is fallacious. The sophisticated insurance purchaser exception to the EFT invariably *narrows* the scope and domain of terms. The requirement of relative standardization would be undercut only if it systematically expanded the domain of the terms, or was unpredictably related to terms as understood by the common layman.

Third, the Russell paper suggests the insurance industry knew all along the EFT applied and has charged a “fudge factor” premium for it. As a result, Russell suggests that permitting the insurance industry to use a sophisticated insurance purchaser exception at this point would result in unjust enrichment. This argument is unproven, unlikely, and turns on matters of fact. Of course, sound underwriting practice requires some “fudge factor” in pre-

mium calculation, which is designed to cover "secondary risks," such as risks created by anomalous judicial decisions. However, the criteria for calculating that premium is what is important. The Russell authors do not discuss this matter, and we know of no evidence to suggest insurance underwriters presuppose the applicability of the EFT in calculating the premium for secondary risks. Indeed, the position of the authors would require underwriters to include a "fudge factor" premium for an antecedently unknowable, but anomalously large and systematically-related group of repetitious losses (e.g., cleaning up dump sites).⁵⁷ As a conceptual matter, this is extremely difficult to imagine; as a competitive matter, it seems highly unlikely; as a practical matter, we know of no facts to suggest underwriting practices include such large and unpredictable "fudge factors."⁵⁸

Fourth, Russell rejects the view that the sophistication of an insurance purchaser should be predicated "solely" on its size. This point is no doubt true, but it demonstrates nothing. Nobody has suggested that sizable companies should be—for that reason alone—conclusively presumed to be sophisticated. Sophistication is the key—not size. Nevertheless, size and business sophistication often go together. Sophistication would have to be proved in each case. If a large corporation could not bargain at all with respect to the contract taken as a whole, then the sophisticated insurance purchaser exception should not apply.⁵⁹ Of course, no insurance purchaser can bargain with respect to every clause. Some clauses are so important to insurers, they insist on them. If there is bargaining with respect to the entirety of the contract, then the exception should apply.

The authors of the Russell paper also suggest that large companies, in fact, have less bargaining power than smaller ones. This proposition is false. A strategically imaginative approach to risk management invariably cracks open all sorts of insurance markets. If nothing else, large sophisticated companies can create their own insurers. Generally, the larger the entity, the greater the resources it has to think through an innovative insurance scheme. Of course, if the world's largest company tried to place all of its losses under a single policy, it might find placement unwieldy. But this does not entail that marketing power is inversely proportionate to size among very large companies.

Fifth, Russell suggests there is precedent rejecting the existence of a sophisticated insurance purchaser exception. While this is true, its import is far from clear. Many of the cases the authors cite do not reject the exception *per se*, but reject its applicability to a set of facts.⁶⁰ Nevertheless, some cases clearly reject the sophisticated insurance purchaser exception. As the law changes, however, it is not at all unusual for courts to diverge on an issue. Arguments from precedent are not terribly persuasive—or even instructive—when the law is in flux, as insurance law clearly is now. What is important when the law is in transition is not precedent by way of holdings,

but authority by way of reasoned argument. Few, if any, recent judicial decisions have developed a reasoned case against the sophisticated insurance purchaser exception.

Sixth, although the Russell authors concede that the sophisticated insurance purchaser applies to an insured who is advised in the negotiation process by sophisticated counsel, they deny that the assistance of a broker or a risk manager triggers the exception. The logic of this argument is difficult to discern. For one thing, insurance brokers and risk managers are sometimes themselves lawyers. For another, insurance brokers and risk managers specialize in understanding insurance policies—and their nuances—as well as in negotiating them. There is a fair chance that the sophisticated insurance broker is more knowledgeable about some insurance matters than even sophisticated insurance coverage counsel. For example, it is likely the broker will know more about negotiation, reciprocal expectations, and market possibilities than a lawyer could hope to know. Thus, the Russell position on the role of brokers and risk managers in enhancing sophistication seems unjustifiable.

Finally, Russell rejects the view that “manuscripted” policies should be treated differently from standard form policies. Manuscripted policies, of course, are policies that are prepared individually, though the authors contend manuscripted policies are sometimes simply typed versions of standard form policies. In experience this is seldom true. Close examination of a typewritten policy almost invariably reveals an important difference between the manuscripted policy and the standard form policy. Of course, it is also true that manuscripted policies use certain commonly utilized insurance nomenclature. The Russell authors appear to understand this as they point out that key coverage and exclusionary terms are rarely changed even when manuscripted policies vary from standard forms. While this is so, an important rule of construction is that an insurance contract must be read as a whole. Therefore, the negotiated wording in one part of the contract may very well have an impact on the interpretation of another part of the contract. For example, if the parties went over the contract in detail, negotiated it as a whole, and varied some of the terms but not others, it would not be unreasonable to infer that the parties thought about even the standard terms carefully.

The Russell authors try to demonstrate that the sophisticated purchaser exception should be restricted to a very narrow set of facts and should not be expanded. They argue this on the basis of the nature of insurance markets, their conception of sound public policy, and precedent. None of their arguments is successful.

INSURANCE POLICIES AND CONTRACTS OF ADHESION

Much of the argument against the sophisticated insurance purchaser

exception is based on the notion that insurance policies are contracts of adhesion, and many of them are.⁶¹ Similarly, the doctrine of adhesion is one of the most frequently given justifications for asserting EFT. Does all this really make sense in complex insurance markets where insureds are knowledgeable?

Adhesion

Several factors are present when insurance policies are said to be contracts of adhesion. First, an adhesion contract generally arises when the "stronger party drafts the contract." Second, a contract of adhesion exists when "the weaker party has [had] no opportunity to negotiate" the terms of the contract (i.e., the contract is presented on a take-it-or-leave-it basis). Third, "in many adhesion contract cases[,] the weaker party must either adhere to the contract or forgo the needed service [insurance]".⁶² Thus, where bargaining is possible or where the insurance is available by other means, the adhesional dimensions of the contract are reduced.⁶³ Fourth, contracts of adhesion are usually standardized form contracts.⁶⁴ The terms of the form contract are frequently confusing and mainly designed to protect the interests of the party in the superior bargaining position.⁶⁵ Some courts have approached the doctrine of adhesion microscopically. This means that whatever the implications of the doctrine of adhesionary contracts are, they will apply only to those provisions of a contract that are "weighted in favor of the stronger party."⁶⁶

Although many courts have held, under particular circumstances, that insurance policies are contracts of adhesion,⁶⁷ there appears to be little authority for the proposition that insurance policies are under all circumstances contracts of adhesion. In fact, adhesionary status requires unequal bargaining power, and there appears to be "no authority prohibiting an insurer from attempting to rebut a presumption of adhesion in an insurance contract."⁶⁸

The Theory of Adhesion

Whether the doctrine of adhesion applies to commercial insurance policies negotiated between large businesses and insurers depends on the purposes of the doctrine of adhesion. From its inception, it was mainly a consumer protection doctrine. The underlying justification of the doctrine, however, is not a matter about which there is a consensus. The history of various justifications has been summarized in an article by David Slawson.⁶⁹ In that article, Professor Slawson develops a widely cited theory of adhesion. An alternative theory has recently been developed by Todd Rakoff.⁷⁰ On either of these theories, a sophisticated insurance purchaser exception is justified. Both of these theories are more compatible with LRT than with EFT.

Slawson's Theory

According to Slawson, contracts were originally interpreted to fulfill the reasonable expectations of the parties to the contract. These reasonable expectations were to be found in their intentions, which was to be found in the language of the contract. With the advent of standard forms, the theory changed; the reasonable expectations of the party became the contract. This change in the nature of contract law derives from the use of standard forms, the existence of many products, "the number and complexity of legal implications to which even one transaction can now give rise," and "the increased presence of mass commercial communications," which creates stable and reasonable expectations. In the new world of contract,

[c]onsumers typically come to transactions with their expectations about the product [including intangible "products" like insurance] already largely formed. If businesses are able to create whatever legal implications they like, they not only can create implications that the consumer does not expect, but they can destroy or reverse the expectations that the consumer has already formed. The new meaning of contract, however, enables fairness to be restored by making the contract include the reasonable expectations that the consumer has already formed.

The manifestations of agreement at the time of [contract formation] are also counted as part of the contract, but only to the extent they would reasonably be expected to *change* the consumer's precontracting expectations; and under the conditions of modern transacting, it is a rare case in which the standard forms can reasonably be expected to have this effect. It is usually not a question of how clearly the forms are drafted or how conspicuous are their salient terms, because under the conditions of modern contracting buyers are usually not reasonably expected even to read the forms before they become bound. It is the normal practice in the insurance industry, for example, to mail a buyer's policy to him a few weeks *after* he has purchased the insurance which the policy describes.

In the general case, therefore, the forms are considered as part of the performance of the contract, not as part of the contract itself. They are given effect only to the extent they conform to the reasonable expectations that the consumer had about transactions of the kind before he engaged in the particular transaction.

Slawson believes that insurance contracts conform to this paradigm, and he suggests the doctrine of reasonable expectation in insurance law, as well as the duty of good faith and fair dealing, are derived from his theory of the new meaning of contract.⁷¹

Rakoff's Theory

Rakoff does not share Slawson's precise view, although they both try to

justify the doctrine of adhesion. According to Professor Rakoff, classical contract theory does not apply to contracts of adhesion, because the classical theory presupposes a showing consent by the contracting parties. It is all very well to impose a duty to read on a few sloppy promissors, but it makes no sense to found an entire theory of contract on a duty to read that is seldom honored. Thus, according to Rakoff, the doctrine of adhesion contracts was developed. Sometimes it was justified on the grounds of public policy, sometimes on the grounds of unconscionability, and sometimes strictly on the basis of superior bargaining power.

According to Rakoff, more recent scholars have thought about adhesion contracts on the model of statutes. This might be called the "Public Law Analogy." The plausibility of this view derives from the fact that adhesion contracts are not founded on knowing consent, are usually used in a massive number of transactions (and are hence quite generally applicable), and involve "imposition" by a superior power on an inferior one. (What is implausible about this analogy is that the superior power is in no sense sovereign.)

Rakoff, in contrast, begins with the observation that standardized contracts increase the efficiency of large, organized business structures and thereby reduce transaction costs. In his view, customers accept take-it-or-leave-it adhesion contracts because they intuitively understand such contracts are necessary for modern institutional arrangements. On this basis Rakoff concludes that the fundamental issue in contracts of adhesion is the eternal conflict between power and freedom. He suggests that "enforcing boiler plate terms trenches on the freedom of the adhering party," so that adhesionary contracts should be regarded as presumptively unenforceable. At the same time, Rakoff recognizes that "there is at least some liberty interest in the enforcement of contracts of adhesion,"⁷² namely, the maintenance of private power to resist the dangers of large government. Nevertheless, such countervailing institutions must be regulated. Importantly, the theme of regulating private power as if it were public power runs like a red thread through virtually all sophisticated discussions of adhesion contracts.

Rakoff recognizes some contracts are more adhesionary than others, and he seems to suggest the more "visible" terms a contract has—as opposed to "invisible terms"—the less adhesionary it is. According to Rakoff, bargained-for terms are visible, as are those terms "for which a large proportion of adherents (although not necessarily all) may be expected to have shopped." Thus,

[t]he visible terms of a contract of adhesion are most often those that would constitute the entire explicit contents of a very simple ordinary contract, with a price term (dickered or not) being the paradigmatic example. The invisible terms are, quite simply, all the rest.

Rakoff recognizes that how many and which terms will be visible in a contract depends—to a considerable degree—on the sophistication of the consumer. He summarizes his view this way:

Commercial parties with greater expertise, and with more at stake in individual deals, may reasonably be expected to shop or bargain for a greater number of terms. When this rationale is not applicable, deals between businesses ought not to be treated differently. Thus, sophisticated purchasers are not to be treated in the same way as unsophisticated purchasers.

Application to Commercial Insurance

Once these rationales for the doctrine of adhesion are understood, they do not apply to complex commercial insurance markets. This is true of both Slawson's and Rakoff's theories.

Slawson's account of the new meaning of contract by its very terms was restricted to consumers. The rhetoric of Slawson's writings makes it clear he is talking about individual consumers and small businesses. In addition, the notion of an antecedently formed and firmly fixed reasonable expectation makes a good deal less sense for a large business, for example, employing risk managers who are thinking hard about insurance matters, than it does for individuals in small businesses.⁷³

The same is true of Rakoff's view. To use his terminology, all or most of the terms of a CGL policy are "visible" to the sophisticated insurance purchaser. He actually studies the proposed contract, he shops the deal, he dickers with his insured over price, he negotiates additional endorsements, and so forth.

To be sure, many of the key terms are standardized, and this reduces transaction costs. Therefore, for the sophisticated general business purchaser, the reduction of costs is a blessing for it, as well as for the insurer. Moreover, it is not illusory to suppose the sophisticated insurance purchaser could behave otherwise in a world of higher transaction costs. (This observation plainly does not apply to individuals who are unsophisticated in insurance matters.) Interestingly, few of the cases Rakoff cites are insurance cases, and he does not treat commercial insurance markets as paradigms of adhesionary contracts.

There is much more to be said about contracts of adhesion and about the various justifications for the principles that limit their enforcement and structure their interpretation. Enough has been said for the time being, however, to indicate that the adhesionary appearance which insurance contracts have does not defeat the proposition that there should be a sophisticated insurance and purchaser exception to the CIAN.

CONCLUSION

The Contra-Insurer Ambiguity Norm is much weaker and more limited

than is generally realized. It is not a preeminent rule of interpretation, even though it stands alone in many simple cases. Rather, it is a legal norm to be applied only after all other interpretative strategies have failed. It should, furthermore, be restricted to situations in which the insured is relatively unsophisticated. It is especially true in light of the fact that CIAN has been developed, in part, on the basis of the claim that insurance policies are contracts of adhesion. Obviously, that notion has no place in the contract law regulating sophisticated insurance transactions.

NOTES

1. This happy phrase comes from *Owens-Illinois, Inc. v. Aetna Casualty & Surety Co.*, 597 F. Supp. 1515, 1521 (D.C. 1984).

2. CIAN is also called "Contra Proferentem." That rubric derives from the longer phrase "*verba fortius accipiuntur contra proferentem*," which literally means "words are to be taken most strongly against him who uses them." *Black's Law Dictionary* 1728 (4th ed. 1968). However, the two-word phrase has taken on a life of its own and may be considered a legal term of art. B. Garner, *A Dictionary of Modern Legal Usage* 151 (1987). "[T]he name of the doctrine that, in interpreting documents, ambiguities are to be construed against (unfavorably to) the drafter." *Id.* See D. Walker, *The Oxford Companion To Law* 283 (1980). See also *Black's Law Dictionary* 393 (5th ed. 1988).

New Hampshire first adopted the *contra proferentem* rule for insurance policies in 1980. *Trombly v. Blue Cross/Blue Shield*, 423 A.2d 980, 984 (N.H. 1980). See Comment, *Insureds Versus Insurers Litigating Comprehensive General Liability Policy Coverage in the CERCLA Arena*, 43 Sw. L.J. 969 (1990). "Maryland is the only state that does not follow the ambiguity rule because Maryland courts do not consider insurance policies to be contracts of adhesion." *Id.* at 975 n.45.

3. *Claussen v. Aetna Casualty & Sur. Co.*, 676 F. Supp. 1571 (S.D. Ga. 1987), *rev'd on other grounds*, 888 F.2d 747 (11th Cir. 1989). See *Gaunt v. John Hancock Mut. Life Ins. Co.*, 160 F.2d 599, 602 (2d Cir. 1947), *cert. denied*, 331 U.S. 849 (1947). "[T]he canon *contra proferentem* is more rigorously applied in insurance than in other contracts, in recognition of the difference between the parties in their acquaintance with the subject matter. A man must indeed read what he signs, and he is charged, if he does not; but insurers who seek to impose upon words of common speech an esoteric significance intelligible only to their craft, must bear the burden of any resulting confusion." *Id.* at 602 (a Learned Hand opinion). See also *Frazier v. Frazier*, No. 1588 (Ohio App. 1990) (1990 Westlaw 34261).

4. See, e.g., Comment, *Pollution Exclusion Clauses: The Agony, the Ecstasy, and the Irony for Insurance Companies*, 17 N. Ky. L. Rev. 443 (1990). This law review article summarizes all previous cases and commentary. Comment suggests that the trend of judicial decisions favored insureds in 1986: "Out of 35 pollution exclusion cases from 1981 through 1986, 27 were decided in favor of the insured business." *Id.* at 455. However, according to Comment, the trend of decisions favored the insurers thereafter until 1989: "Of the 51 pollution exclusion cases reported for 1987 through October 1989, 28 have been decided in favor of the insurance company." *Id.* at 460. See also Jurczyk & Ream, "The Pollution Exclusion: 'Sudden and Accidental' Decisions from the Courts," *For The Defense* 2 (Feb. 1991).

5. *Alexander & Alexander, Inc. v. Rose*, 671 F.2d 771, 777 (3d Cir. 1982).

6. R. Keeton & A. Widiss, *Insurance Law* 629 (1988). Arizona has adopted the Keeton critique, and it has adopted §211 of the *Restatement (Second) Of Contracts* (1981). *Darner*

emphasizes the continuity between general contract law and insurance law. The *Darner* court was attempting to strike a balance between intricate faith and fairness in a commercial system where standardized contracts reign in the legal regime where there is a "temptation to create ambiguity or invent intent in order to reach a result." *Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co.*, 140 Ariz. 383, 682 P.2d 388, 399 (1984).

7. The necessity for analysis interpretation does not apply the existence of an ambiguity. *State Farm Fire & Casualty Co. v. Oliveras*, 441 So. 2d 175, 178 (Fla. Dist. Ct. App. 1983). See *Hess v. Liberty Mut. Ins. Co.*, 458 So. 2d 71 (Fla. Dist. Ct. App. 1984).

8. *Robbins Auto Parts, Inc. v. Granite State Ins. Co.*, 435 A.2d 507, 509 (N.H. 1981); *American Medical Int'l, Inc. v. Scheller*, 462 So. 2d 1, 7 (Fla. Dist. Ct. App. 1984). See *Laconia Rod & Gun Club v. Hartford Accident & Indem. Co.*, 459 A.2d 249, 251 (N.H. 1983). But see *Northwest Airlines v. Globe Indem. Co.*, 303 Minn. 16, 225 N.W.2d 831 (1975). "[T]he very fact that their respective positions as to what this policy says are so contrary compels one to conclude that the agreement is indeed ambiguous." *Id.* at 837.

9. *Rigel v. National Casualty Co.*, 76 So. 2d 285, 286 (Fla. 1954). "The Court should construe the contract of insurance to give effect to the intent of the parties." *Id.* at 286.

10. *Washington Pub. Util. Dists. Util. Sys. v. Public Utility District No. 1*, 112 Wash. 2d 1, 771 P.2d 701, 706-07 (1989). See *Preferred Risk Mutual Ins. Co. v. Lewallen*, 146 Ariz. 83, 703 P.2d 1232 (Ariz. App. 1985). Courts will not "torture the English language" to find an ambiguity and courts "may not create an ambiguity where none exists even though the insured may suffer harsh results." *Id.* at 1234.

11. *Calcasieu-Marine Nat'l Bank v. American Employers' Ins.*, 533 F.2d 290, 296 (5th Cir. 1976).

12. *City of Milwaukee v. Allied Smelting Corp.*, 117 Wis. 2d 377, 344 N.W.2d 523 (1983). "[I]t is fundamental that no insurance contract should be rewritten so as to bind any insurer to a risk which it did not contemplate and for which it was not paid, unless the terms are ambiguous or obscure." *Id.* at 526.

13. In New York, for example, courts hold that contracts of insurance may not be construed to reach an absurdly harsh result. *Silverstein v. Metropolitan Life Ins. Co.*, 254 N.Y. 81, 171 N.E. 914 (1930); *Cross Armored Carrier Corp. v. Valentine*, 49 Misc. 2d 917, 268 N.Y.S.2d 792, 798 (1966); *McGrail v. Equitable Life Assurance Soc'y*, 292 N.Y. 419, 425, 55 N.E.2d 483 (1944).

14. *Falmouth Nat'l Bank v. Ticor Title Ins. Co.*, 920 F.2d 1058, 1061 (1st Cir. 1990); *Zurich Ins. Co. v. Raymark Indus., Inc.*, 118 Ill. 2d 23, 112 Ill. Dec. 684, 514 N.E.2d 150 (1987); *Leatherman v. American Family Mut. Ins. Co.*, 52 Wis. 2d 644, 190 N.W.2d 904 (1971).

15. Of course, some parts of insurance policies trump other parts, as a matter of law. *Morbark Indus. Inc. v. Western Employers Ins. Co.*, 170 Mich. App. 603, 429 N.W.2d 213 (1988). "The general rule, in Michigan as elsewhere, is that if there is an ambiguity such that all parts of the contract cannot be harmonized, the language of the policy endorsement or rider controls." *Id.* at 218. The EFT seldom acknowledges this terribly important norm.

16. *Allstate Ins. Co. v. Freeman*, 432 Mich. 656, 443 N.W.2d 734, 742 (1989), and cases there cited. See *Falmouth Nat'l Bank v. Ticor Title Ins. Co.*, 920 F.2d 1058, 1061 (1st Cir. 1990); *Ross v. Western Fidelity Ins. Co.*, 872 F.2d 665 (5th Cir. 1989). "Courts must construe contracts so that they give effect to all provisions and do not produce an unfair and unreasonable result." *Id.* at 668 (citation omitted).

17. See, e.g., *Greer v. Northwestern Nat'l Ins. Co.*, 109 Wash. 2d 191, 743 P.2d 1244, 1249 (1987). See also *Pedersen v. United Services Auto. Ass'n*, 383 N.W.2d 427 (Minn. App.

1986); *First State Underwriters Agency v. Travelers Ins. Co.*, 803 F.2d 1308, 1314 n.5 (3d Cir. 1986). See *Industrial Risk Insurers v. New Orleans Pub. Serv., Inc.*, 666 F. Supp. 874, 879 (E.D. La. 1987). "[W]here the intent of the parties to the contract is not adequately expressed and cannot be discovered by a study of the entire contract, the Court may consider preliminary negotiations leading to the contract and other relevant parole evidence." *Id.* at 879.

18. *Transcontinental Ins. Co. v. Washington Pub. Util. Dists.' Utils. Sys.*, 111 Wash. 2d 452, 760 P.2d 337 (1988). "To determine the parties' intent, the court first will view the contract as a whole, examining its subject matter and objective, the circumstances of its making, the subsequent conduct of the parties, and the reasonableness of their respective interpretations. If the court determines that the policy remains ambiguous even after its consideration of the extrinsic evidence, the court will apply a meaning and construction most favorable to the insured, even though the insurer may have intended another meaning." *Id.* at 340. See *United Equitable Ins. v. Reinsurance Co. of America*, 157 Ill. App. 3d 724, 109 Ill. Dec. 846, 510 N.E.2d 914 (1987).

19. *Eagle-Picher Indus. v. Liberty Mut. Ins. Co.*, 632 F.2d 12, 17 (1st Cir. 1982). (Judge Coffin wrote this opinion, and he is a jurist of the first rank. He is one of the leading writers in America today on the judicial process and may be likened to Benjamin Cardozo. See Coffin, "Grace Under Pressure: A Call for Judicial Self-Help," 50 Ohio St. L.J. 399 (1989). See also F. Coffin, "The Ways Of A Judge: Reflections From The Federal Appellate Bench" (1980).) *Accord William C. Roney & Co. v. Federal Ins. Co.*, 674 F.2d 587 (6th Cir. 1982); *Travelers Indem. Co. v. United States*, 543 F.2d 71 (9th Cir. 1976); *Close-Smith v. Conley*, 230 F. Supp. 411 (D. Or. 1964); *Waterman S.S. Corp. v. Snow*, 222 F. Supp. 892 (D. Or. 1963).

20. *Harbor Ins. Co. v. Omni Constr., Inc.*, 912 F.2d, 1520, 1522 (D.C. Cir. 1990); *Utica Mut. Ins. Co. v. Emmco Ins. Co.*, 309 Minn. 21, 243 N.W.2d 134, 138 (1976). See *Security Mut. Casualty Co. v. Luthi*, 303 Minn. 161, 226 N.W.2d 878 (1975). See also *Quinlivan v. Emcasco Ins. Co.*, 414 N.W.2d 494 (Minn. App. 1988); *Lesicich v. North River Ins. Co.*, 191 Wash. 305, 71 P.2d 35 (1937). In *Lesicich*, the parties stipulated that the law and customs of England would govern a certain maritime insurance policy. Finally see *Stuyvesant Ins. Co. v. Builer*, 314 So. 2d 567 (Fla. 1975).

21. *Caster v. Motors Ins. Corp.*, 28 Ill. App. 2d 363, 171 N.E.2d 425 (1961). See *Freeport Motor Casualty Co. v. Tharp*, 338 Ill. App. 593, 88 N.E.2d 499 (1949). See also *Toren v. Braniff, Inc.*, 893 F.2d 763, (5th Cir. 1990). In determining the existence of an ambiguity, "the court should consider the intent of the parties as evidenced by the terms of the contract and industry custom." *Id.* at 765 (emphasis added).

22. 2 G. Couch, *Cyclopedia Of Insurance Law* 2d §15:52 (Rev. ed. 1984). *Accord* 13 J. Appleman, *Insurance Law And Practice* §7389 (1976). The price term involves extrinsic evidence because the significance of that term cannot be determined without going beyond the contract.

23. See *Pan Am. World Airways v. Aetna Casualty & Sur. Co.*, 505 F.2d 989 (2d Cir. 1974); *Muller v. Globe & Rutgers Fire Ins. Co.*, 246 F. 759, 761 (2d Cir. 1917) (both applying New York law).

24. 309 N.Y. 72, 127 N.E.2d 816, 818 (1955) (emphasis added).

25. 645 F. Supp. 525 (D.N.J. 1986), *aff'd*, 831 F.2d 287 (1987).

26. See *Werner Indus. v. First State Ins. Co.*, 112 N.J. 30, 548 A.2d 188 (1988); *Prather v. American Motorists Ins. Co.*, 2 N.J. 496, 67 A.2d 135 (1949); *Pan Am. World Airways v. Aetna Casualty & Sur. Co.*, 505 F.2d 989, 1001; *Close-Smith v. Conley*, 230 F. Supp. 411 (D. Or. 1964); 11 G. Couch, *Cyclopedia Of Insurance Law* 2d §44:261, at 405-06 and n.11 (Rev. ed. 1982 & Supp. 1990). "[T]here is no coverage with respect to a type of claim which falls

directly within a particular coverage clause which was not *purchased* by the insured." *Id.* at 405-06 (emphasis added). Many authorities recognize price as a term that can be used to determine coverage.

27. 446 N.Y.S.2d 743, 745 (1981). See *Golden Eagle Liberia Ltd. v. St. Paul Fire & Marine Ins. Co.*, 685 F. Supp. 393 (S.D.N.Y. 1988); *Zissu v. Bear Stearns & Co.*, 627 F. Supp. 687 (S.D.N.Y. 1986). See also *Hartford Accident & Indemnity Co. v. Wesolowski*, 33 N.Y.2d 169, 305 N.E.2d 907, 350 N.Y.S.2d 895 (1973). New York is not unique. See *The Universal C.I.T. Credit Corporation v. Daniel*, 150 Tex. 526, 243 S.W.2d 154, 157 (1951) (a non insurance case repeatedly cited in Texas insurance cases).

28. During the seventeenth century, in his *Maxims Of The Law* Reg. 3 at 46 (1630), Francis Bacon (1561-1626) put it this way:

But now it is to be noted, that [contra proferentem] is the last to be resorted to, and is never to be relied upon but where all other rules of exposition of words fail; and if any other come in place, this giveth place. And that is a point worthy to be observed generally in the rules of the law, that when they encounter and cross one another in any case, it be understood which the law holdeth worthier, and to be preferred and it is in this particular very notable to consider, that this being a rule of some strictness and rigor, doth not as it were its office, but in absence of other rules which are of more equity and humanity; which rules you shall afterwards find set down with their expositions and limitations.

(Emphasis added.) See D. Walker, *The Oxford Companion To Law* 106 (1980).

29. *Oritani Savings & Loan v. Fidelity & Deposit Co. of Maryland*, 744 F. Supp. 1311, 1315 (D.N.J. 1990). See *Northwest Airlines v. Globe Indemnity Co.*, 303 Minn. 16, 225 N.W.2d 831 (1975). In this case, the court suggested that actual negotiations between sophisticated parties might be important to construing a contract, but *not* when printed form was used. *Id.* at 837 n.2.

30. M. Eisenberg, *The Nature Of The Common Law* 96-99 (1988).

31. We have counted Texas cases with the word "insurance" in the style from 1945 to 1970. Excluding workers' compensation cases, suits involving small business or individuals outnumber those involving large businesses twenty to one.

32. Note, "Insurance as Contract: The Argument for Abandoning the Ambiguity Doctrine," 88 Colum. L. Rev. 1849 (1988); Ostrager & Ichel, "Should the Business Insurance Policy Be Construed Against the Insurer? Another Look at the Reasonable Expectations Doctrine," 33 Fed. Ins. Cons. Q. 273 (1983); Ostrager & Ichel, "The Role of Bargaining Power Evidence in the Construction of the Business Insurance Policy: An Update," 18 Forum 577 (1983).

33. 13 J. Appleman, *Insurance Law & Practice* §7402, at 300-301 (1981); A. Windt, *Insurance Claims And Disputes* 6.02 (1987).

34. 712 F.2d 4 (2d Cir. 1983).

35. It is not universally honored, however, even in its own small circuit. One court has limited the sophisticated insurance purchaser exception to situations in which the insured, through its broker, entirely drafted the policy. *Ogden Corp. v. Travelers Indem. Co.*, 681 F. Supp. 169, 174 (S.D.N.Y. 1988).

36. 540 F.2d 1257 (5th Cir. 1976).

37. 632 F.2d 1068 (3d Cir. 1980). See *Aerial Agricultural Serv. of Montana, Inc. v. Till*, 207 F. Supp. 50, 57 (N.D. Miss. 1962) for an earlier statement of roughly the same view.

38. See *First State Underwriters Agency v. Travelers Ins. Co.*, 803 F.2d 1308, 1311-12 (3d

Cir. 1986). See also *Oliver B. Cannon & Son, Inc. v. Fidelity & Casualty Co.*, 519 F. Supp. 668, 671-72 (D. Del. 1981) (discussing Pennsylvania law). But see *Commercial Union Ins. Co. v. Pittsburgh Corning Corp.*, 553 F. Supp. 425 (E.D. Pa. 1981) (rejecting sophisticated insurance purchaser exception under Pennsylvania law.); *ACand S Inc. v. Aetna Casualty & Sur. Co.*, 764 F.2d 968, 973 (3d Cir. 1985) (rejecting sophisticated insurance purchaser exception under Pennsylvania law).

39. 920 F.2d 1058 (1st Cir. 1990).

40. 36 Cal. 3d 426, 204 Cal. Rptr. 435, 682 P.2d 1100 (1984).

41. 51 Cal. 3d 807, 274 Cal. Rptr. 820, 799 P.2d 1253, (1990).

42. As applied to the particular facts of the *AIU Ins.* case, the court found that the elements of the California version of the exception were not met. FMC unquestionably had both legal sophistication and substantial bargaining power; indeed, one of its subsidiaries was in the insurance business. However, there was no evidence before the court suggesting joint drafting or even common agreement and that certain terms would have technical meanings. *Id.* at 1265.

43. Some of these complexities were taken up in *McLaughlin v. Connecticut Gen. Life Ins. Co.*, 565 F. Supp. 434 (N.D. Cal. 1983).

44. *Insurance Co. of N. Am. v. John J. Bordlee Contractors*, 543 F. Supp. 597, 602 (E.D. La. 1982) (emphasis added). *Accord Industrial Risk Insurers v. New Orleans Pub. Serv.*, 666 F. Supp. 874, 881 (E.D. La. 1987); *Nationwide Mut. Ins. Co. v. United States Fidelity & Guar. Co.*, 529 F. Supp. 194, 197 (E.D. Pa. 1981); *McNeilab, Inc. v. North River Ins. Co.*, 645 F. Supp. 525 (D.N.J. 1986).

45. See Thomas, "Risk Management in the New Europe: Insurance & Financial Management Issues," *The European Economic Community: Products Liability Rules & Environmental Policy* (1990). (This volume was a course handbook for the Practising Law Institute.)

46. 645 F. Supp. 525 (D.N.J. 1986).

47. *Oliver B. Cannon & Son, Inc. v. Fidelity & Casualty Co.*, 519 F. Supp. 668, 673 (D. Del. 1981); *Di Santo v. Enstrom Helicopter Corp.*, 489 F. Supp. 1352, 1362-63 (E.D. Pa. 1980) (reasoning from an insurance case).

48. 112 N.J. 30, 548 A. 2d 188 (1988).

49. For a recent discussion of the doctrine of reasonable expectations see Comment, A Critique of the Reasonable Expectations Doctrine, 56 U. Chi. L. Rev. 1461 (1989). Not every New Jersey court has followed either *McNeilab* or *Werner Industries*. See *CPS Chemical Co., Inc. v. Continental Ins. Co.*, 222 N.J. Super. 175, 536 A.2d 311 (1988).

50. 924 F.2d 633 (7th Cir. 1991).

51. *Eastcoast Equip. Co. v. Maryland Casualty Co.*, 207 Pa. Super. 383, 218 A.2d 91, 98 (1966). The court goes on to say, somewhat inconsistently, that "[t]his is not to say that the interpretation of insurance policies should vary according to the sophistication of the purchaser, but only that legal realism demands that the adjudication of disputes arising out of policy language be based upon principles with more than ephemeral connection to the facts." *Id.* at 98. According to Professor Melvin Eisenberg, when courts draw obviously inconsistent distinctions, they are on the verge of overturning a norm. M. Eisenberg, *The Nature Of The Common Law* 136-140 (1980).

52. Russell, Levine, & Jackson, "Insurance Policy Construction and the Non Sequitur of the 'Sophisticated Insured,'" 3 *Envtl. Claims J.* 3 (1990) (hereinafter, "Russell").

53. They also argued against this exception on the grounds of doctrine of reasonable expectations. That is a matter distinct from this paper, so we will not consider it. See Cohen & Quaintance, *Role of Contra Proferentem In Interpretation of Insurance Contracts*, 2 *Envil. Claims J.* 13 (1989) (discussion of the doctrine of reasonable expectations).

54. The Russell paper is somewhat ambiguous on the strength of CIAN. In the first-half of the paper, it seems to suggest the rules are automatic, and are not defeated by any other rules of construction, except for the plain meaning doctrine. This is EFT. Russell, *supra*, at 6 and 20. The last section of the paper tends to concede that CIAN is defeated by rules requiring the examination of available extrinsic evidence. *Id.* at 22. However, it does not explore, at all, the type of extrinsic evidence which might be admissible, and the only extrinsic evidence considered is evidenced contrary to the view of the insurer.

55. D. Malecki & J. Gibson, *The Additional Insured Book* (1991)

56. As stated, standardization is a mixed blessing for insurers. As a practical matter, standardization implies brevity. Indeed, brevity is mandated by state statutes in some jurisdictions. Brevity implies the use of highly general terms, and the use of general, abstract terms leads to arguments over meaning which could be eliminated by more detailed contractual provisions.

57. Prof. Kenneth Abraham put the matter, "[I]nsurance deals best with risk, or predictable probabilities, and not with uncertainty, or unpredictable probability of loss." Abraham, *Environmental Liability and the Limits of Insurance*, 88 *Colum. L. Rev.* 942, 946 (1988).

58. Prof. Abraham has discoursed on this topic ably:

The crucial problem for the insurer is to quantify the future impact of existing liability rules on the parties whom it insures and to anticipate potential changes in those rules.

The new environmental liability tests the limits of insurance in three ways. First, it has created new forms of statutory liability against which it is difficult to insure. Second, judicial strategies of interpretation have made it difficult for insurers to rely on the meaning of insurance policy language designed to avoid covering uninsurable risks. Third, the distinct threat of other, common-law expansions of liability creating additional uninsurable risks that cannot be reliably excluded by policy language renders the scope of an insurer's future obligations uncertain. . . .

These developments are not unique to the law of environmental liability, but they are an order of magnitude more severe in this field than in any other. No field of liability involves more far-reaching statutory civil liabilities than those imposed by federal Superfund and similar state regimes. And while judge-made insurance is a common phenomenon, many of the most expansive readings of policy provisions appear in environmental liability coverage disputes, and these readings have more impact because of the enormous sums that are so often at stake.

Id. at 955-56. Prof. Abraham goes on to point out that judge-made insurance for connected losses destabilizes the insuring function. *Id.* at 960.

Judicial decisions in a number of environmental liability insurance disputes, however, have departed from [the] traditional constraints [of consumer protection and conceptually discrete losses]. They have created coverage even in the face of contrary policy language [and] where the policyholder was a business entity with access to counsel. . . . [A]n

unexpected judicial interpretation extending coverage beyond what was intended works like a mandatory retroactive price decrease. Insurers suffer an immediate financial loss, lose a measure of confidence in the fairness of the judicial system, and come to doubt their ability to predict future judicial developments.

Id. at 960-61.

59. *Pan American World Airways, Inc. v. Aetna Casualty & Sur. Co.*, 505 F.2d 989, 1003 (2d Cir. 1974).

60. Russell, *supra*, at 52.

61. *Oliver B. Cannon & Son, Inc. v. Fidelity & Casualty Co.*, 519 F. Supp. 668, 672 (D. Del. 1981).

62. *Id.* at 447.

63. Could a CGL contract with a pollution exclusion possibly be an adhesionary contract during that historical interval when Environmental Impairment Liability insurance was available?

64. *Oliver B. Cannon & Son, Inc. v. Fidelity & Casualty Co.*, 519 F. Supp. 668, 672 (D. Del. 1981).

65. *Id.* at 672. See *C & J Fertilizer, Inc. v. Allied Mut. Ins. Co.*, 227 N.W.2d 169, 174 (Iowa 1975). Another way to look at adhesion contracts is this. The law prohibits, and therefore voids, contracts of adhesion. Each contract involves oppression and necessity. The theory of contract of adhesion is that the offeror is powerful and the offeree is powerless, but in need of the agreement or relationship. The more a contract resembles a contract of adhesion, the more it will be construed in favor of the powerless and oppressed party. *Brokers Title Co. v. St. Paul Fire & Marine Ins. Co.*, 610 F.2d 1174, 1179-80 (3d Cir. 1979). There is yet another way to put this point which is conceptually different but practically identical: courts regard all contracts of adhesion with suspicion; if one is particularly oppressive, it will be voided; others will be construed very favorably to the promisee; boiler-plate language if oppressive will be ignored, although the remainder of the contract will be enforced. See Rakoff, "Contracts of Adhesion: An Essay in Reconstruction," 96 Harv. L. Rev. 1174 (1983). See also Slawson, "The New Meaning of Contract: The Transformation of Contracts Law by Standard Forms," 46 U. Pitt. L. Rev. 21 (1984).

66. *McLaughlin v. Connecticut Gen. Life Ins. Co.*, 565 F. Supp. 434, 447 (N.D. Cal. 1983).

67. *Schnuck Markets, Inc. v. Transamerica Ins. Co.*, 652 S.W.2d 206, 211 (Mo. App. 1983).

68. *Puerto Rico Electric Power Authority v. Philipps*, 645 F. Supp. 770, 773 (D. P.R. 1986) (relying in part on Spanish law).

69. Slawson, "The New Meaning of Contract: The Transformation of Contracts Law by Standard Forms," 46 U. Pitt. L. Rev. 21 (1984).

70. See Rakoff, "Contracts of Adhesion: An Essay in Reconstruction," 96 Harv. L. Rev. 1174 (1983).

71. *Id.* at 50-55. We do not discuss the doctrine of reasonable expectations as applied to insurance contracts. That doctrine is distinct from CIAN.

72. *Id.* at 1239.

73. See Schmidt & Roth, "Cost Effectiveness of Risk Management Practices," 57 J. Risk & Ins. 455 (1990) (summarizing activities of risk management departments and containing an extensive bibliography on risk management activities).

