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ADJUDICATING INSURANCE POLICY DISPUTES: A CRITIQUE OF PROFESSOR RANDALL'S PROPOSAL TO ABANDON CONTRACT LAW

*Jared Wilkerson**

Introduction

There continues to be stark confusion and tense debate about the proper role of courts in insurance disputes. Recently, commentators have offered numerous proposals on how insurance law — a special blend of contract law and public policy — should be approached by the courts when interpreting insurance policies.¹ This article deals with one of those proposals — that by Professor Susan Randall — in an attempt to calm concerns it raises and to critique its necessity.² Particularly, this article argues that the current system of judicial interpretation of

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¹ Loosely following ERIC M. HOLMES & JOHN ALAN APPLEMAN, HOLMES' APPLEMAN ON INSURANCE 2d § 5.1 (Supp. 2010), I use the term "interpretation" to mean the process of determining the meaning of the contract. Many courts begin interpretation with a question of law: whether the contractual terms themselves are clear and unambiguous to the hypothetical, reasonable person. If they are, interpretation ends. If the terms are ambiguous, however, interpretation sometimes becomes a question of fact that allows for extrinsic evidence — although many courts, as this article will show, resort to the strong *contra proferentem* doctrine before allowing extrinsic evidence. On the other hand, some courts (like those in New Mexico) allow extrinsic evidence at the first stage, that of determining whether the contractual terms are ambiguous. "Construction" is simply the legal effect of contractual terms. Thus, construction takes place after terms' meaning to the parties has been established through interpretation.

² Susan Randall, *Freedom of Contract in Insurance*, 14 CONN. INS. L.J. 107 (2008) [hereinafter Randall, *Freedom of Contract*].

insurance policies as contracts, with regulatory oversight and direction, adequately protects consumers.

Randall's proposal is that courts should begin protecting consumers from the dangers of adhesive contracts by refusing to evaluate insurance policies as contracts at all — instead interpreting them with the goal of effectuating the policy aims of legislatures.³ Necessitating her proposal, Randall sees a supposed recent judicial repudiation of consumer-protective judicial rules, particularly the reasonable expectations doctrine, the strong insurance-specific version of the *contra proferentem* doctrine, and the perceived recent judicial refusal to recognize broad tort-based bad faith remedies against insurers. These alleged problems are set in the context of a perception that legislatures — not private parties — already largely control insurance policies because neither the insurers (due to pervasive legislation regulating insurance policy language and content) nor the insured (because policies are presented as standardized contracts of adhesion) have the ability to freely contract. Thus, judicial ignorance of consumers, in a supposedly sensitive regulated area, leads Randall to propose that public policy and not contract law should be the lens through which courts adjudicate coverage disputes.

This proposal has two flaws: first, there is no current or recent wave of consumer-repudiating actions by courts in the insurance context. In fact, courts have generally adhered to their doctrines quite consistently for many years, giving policymakers an opportunity to address problems against a consistent background of judicial action. Indeed, a review of the states whose common law Randall references when claiming that consumer-protective doctrines have recently begun falling away illustrates that state judicial branches have maintained a relatively steady interpretive approach to insurance policy disputes. Second, Randall's proposal is an unpredictable vote of zero confidence in state legislatures and insurance departments — a direct attack on the legislative power to create and amend policy.⁴ That is, she suggests that some measure of policymaking

³ Randall's proposal deals little with the sophisticated insured, and this article works under the assumption that her proposals would not apply to such large and capable parties that can and should either draft or, at least, understand policy language. For a discussion of sophisticated insureds and particularly their treatment in *contra proferentem* cases, see JEFFREY W. STEMPEL, *STEMPEL ON INSURANCE CONTRACTS*, VOL. 1, § 4.11 (2d ed. 2006).

⁴ Although there are numerous separation of powers arguments to be

power be ceded to courts. Since state legislatures have both the authority and the motivation to regulate insurance in the interest of consumers, business, and efficiency, problems with consumer protection are adequately solved through the lawmaking process.

The problems Professor Randall points to,⁵ even assuming that consumers are currently under-protected by current regulatory schemes, should be addressed by legislatures, which have the ability to balance priorities, recognize long-term and wide-ranging public policy concerns, and provide benefits to the state as a whole rather than to a particular plaintiff alone. Truly, if courts were left to guess the mind and goals of the legislature as Randall proposes, each case would become an opportunity for courts, which are many steps removed from the legislative process, to act as proxy for policymakers in a system that would prevent insureds or insurers from knowing what their agreement means until a court tells them. Insurance policies would become nonbinding suggestions of bilateral duties rather than predictable instruments whose clear language binds both parties.

Instead of using ever-shifting and uncertain legislative goals as their guiding light, courts should be encouraged to interpret legislation and apply the common law in an equitable, consistent, and predictable way — something that most state courts have been attempting to do for decades — and thereby allow legislatures and insurance departments to do their job against a stable adjudicatory backdrop. Legislatures, aware of the current contract-based adjudicatory scheme, rarely alter it and even create laws within it. One must presume that legislatures refrain from changing the scheme because they are comfortable with its protection of consumers — who also happen to be constituent voters. A proposal like Professor Randall's is perilous because it would base judicial decision making on what courts believe legislatures want, rather than allowing lawmakers to conduct informed balancing of consumer protection, insurer

made against Professor Randall's proposal, the article addresses them only superficially, since the note's primary purpose is to address the practical and public policy aspects of what she suggests.

⁵ One obvious problem Randall does not point to is capture of policymakers by the industry — an argument she dealt with in her article *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 FLA. ST. U. L. REV. 625 (1999) [hereinafter Randall, *Insurance Regulation*]. Such an argument, like those she offers in the current proposal, would not necessitate a change in the judiciary. Rather, it would call for changes in lobbying laws.

solvency, accessibility, and the other worthy goals of insurance regulation while answering to the public.

Professor Robert Keeton's ill-fated reasonable expectations proposal — which called on courts to disregard established insurance contract law in favor of validating the ephemeral, reasonable expectations of insureds — parallels Professor Randall's current proposal.⁶ Keeton's proposal was doomed and rejected by nearly all jurisdictions because it did not provide for consistent judicial decision making or the establishment of predictable precedent. Similarly, Professor Randall's proposal, if adopted, would lead to economic and judicial inefficiency that would engender higher rates, higher litigation costs, and less insurance coverage for the very consumers the proposal is meant to protect.

To evaluate and critique Randall's proposal, this article briefly introduces the main designers of insurance regulation and the public interest aspects of insurance policies in Part I, followed in Part II by insurance policies' traditional contractual aspects. In Part III, the article illustrates the special doctrines of insurance interpretation and construction that Professor Randall says courts have recently abandoned: reasonable expectations, *contra proferentem*, and the action of bad faith against insurers. The article then evaluates Professor Randall's proposal in Part IV. Concluding, the article argues that, given legislatures' extensive protection of consumers and lawmakers' ability to adjust the rules that courts apply, judges in each state should continue to treat insurance policies consistently to provide their respective legislatures with a steady judicial setting against which to balance public policy. Courts should not, as Randall advocates, treat insurance contracts as consumer-protecting instrumentalities to be construed in light of the legislature's unstated intent—intent that may change with every election. By relying on consistent principles of statutory application and insurance contract law, courts rightly leave the duty of balancing consumer protection, insurer solvency, access to insurance, and other policy goals to legislatures and insurance departments. This is true regardless of whether the courts employ the reasonable expectations doctrine, a strong *contra proferentem* doctrine, or a cause of action in tort for breach of insurance policy.

⁶ Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions* (Parts I and II), 83 HARV. L. REV. 961 (1970) and 83 HARV. L. REV. 1281 (1970).

Predictability will allow insurance companies to continue gathering relevant data and to underwrite policies with the most reasonable premiums, because predictability allows insurers to estimate losses with relative certainty and to justify their premiums to the marketplace and to regulators based on these empirical, actuarial predictions. Consistency promotes the best protection for consumers as created both by market forces and consumers' own elected representatives.

I. Insurance Law's Roots in State Policy and Regulation

The insurance industry is highly regulated because of its enormous importance to not only individual policyholders, but the public generally.⁷ Indeed, every insurance policy is both a private contract and an implement of public policy. Further, those types of insurance which are more important to the public, like health insurance and workers' compensation, are subject to heavier regulation. Additionally, like banks and other financial institutions, insurance companies hold — and take investment risks with — other peoples' money. There is also ample opportunity for insurance companies to contribute to or even create social stratification and discrimination.⁸ Thus, among other things, regulation must ensure that these companies are solvent while charging reasonable premiums, that they employ sound underwriting standards while avoiding undue discrimination, and that they provide broad access while not spreading capital too thinly.⁹ Both the social and the individual aspects of insurance must be respected by regulation, allowing individuals freedom to contract while encouraging society to treat its members fairly and to protect citizens and their transactions.¹⁰

⁷ See, e.g., STEVEN PLITT, ET AL., *COUCH ON INSURANCE* 3D §2:1 n.2 (2010) (citing 15 U.S.C. § 1011 (2008) (stating "Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance *is in the public interest.* . . .") (emphasis added)) [hereinafter *COUCH ON INSURANCE*].

⁸ See TOM BAKER, *INSURANCE LAW AND POLICY* 637–43 (2d ed. 2008).

⁹ For a general discussion of the rationales behind insurance regulation, see *id.* at 1–21.

¹⁰ Some types of insurance, such as auto and homeowners' insurance, are even seen as playing a gatekeeping role for society: if a person cannot protect others from his own liability (i.e., if he does not have insurance), he should not be able to engage in favored activities (e.g., driving or owning a home). See *id.* at 9–12.

Consequently, insurance is a heavily-regulated industry that often acts as an arm of the government to reflect legislative goals and an arm of civil society to reflect social goals such as trustworthiness, accountability, freedom, and solidarity.¹¹

State legislatures, state insurance departments, and the National Association of Insurance Commissioners (“NAIC”) are the primary official or semi-official players in insurance regulation; in addition to courts, Congress, and the industry itself. To present the public policy of insurance law, it is necessary to introduce these top players.

A. State Legislatures

State regulation of the business of insurance has always been the norm in the United States.¹² In fact, when Congress finally addressed the question in 1944, states had already been regulating insurance for well over one hundred years. The McCarran-Ferguson Act¹³ was simply Congress’s reaction to the Supreme Court’s declaration that insurance was an

¹¹ *Id.* at 12–21.

¹² Federal statutes regulating the corporate nature of insurance companies, such as the tax code, employment laws, and securities laws, always control insurance companies because these do not deal with the “business of insurance.” *See, e.g.*, SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959) (stating variable annuities do not fall under the business of insurance and are therefore subject to SEC registration requirements); SEC v. Nat’l Sec., Inc., 393 U.S. 453 (1969) (holding an Arizona law meant to protect stockholders of insurance companies does not fall under the McCarran-Ferguson Act because it deals with securities and stockholder-company relations rather than insurer-insured relations, i.e., the business of insurance; thus, the SEC can regulate the stockholder-insurance company relations). Additionally, federal laws that overlap with a state’s regulation of insurance but do not directly target insurance or “invalidate, impair, or supersede” the state’s regulatory scheme are often upheld as long as there is no direct conflict and the impact of the federal law does not unduly influence the state scheme. *See generally* Humana Inc. v. Forsyth, 525 U.S. 299, 310 (1999) (stating that, with regard to RICO’s interference of Nevada’s regulation of insurance under 18 U.S.C. § 1012(b), “[w]hen federal law does not directly conflict with state regulation, and when application of the federal law would not frustrate any declared state policy or interfere with a State’s administrative regime, the McCarran-Ferguson Act does not preclude its application.”) (*cited with approval in* Weiss v. First Unum Life Ins. Co., 482 F.3d 254 (3d Cir. 2007) (holding that a cause of action under RICO was possible even though the petitioner was suing an insurance company that was otherwise regulated by New Jersey state law).

¹³ 15 U.S.C. §§ 1011–1015 (2010).

implementation of interstate commerce and, thus, subject to congressional regulation.¹⁴ Before *Southeastern Underwriters*, states regulated insurance thanks in part to tradition and largely because of *Paul v. Virginia*, a counterintuitive Supreme Court ruling in 1868 that insurance was not subject to congressional regulation because “issuing a policy of insurance is not a transaction of commerce.”¹⁵ At the time of *Paul*, after decades of regulation at the state level, many insurers hoped for federal regulation because so much of their business crossed state lines, making them lose time and money by dealing with differing regulatory schemes.¹⁶ The Court halted their hopes.¹⁷

Ironically, the Court also differed from the wishes of many insurers and state regulators in 1944 when it reversed itself in *Southeastern Underwriters*, which frightened both the industry and state regulators by making insurance (including, most importantly, rate-fixing) subject to such broad-reaching federal laws as the Sherman and Clayton Acts and the Federal Trade Commission Act — in addition to potentially stripping the states of some insurance company tax revenue.¹⁸ Thus, three-quarters of a century after *Paul*, industry leaders and regulators were not only happy with the state scheme, they wanted to see it succeed. Thus, they lobbied for the McCarran-Ferguson Act, in which Congress stated:

The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business. . . . No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of

¹⁴ *United States v. Se. Underwriters Ass’n*, 22 U.S. 533 (1944).

¹⁵ *Paul v. Virginia*, 75 U.S. 168, 183 (1868).

¹⁶ See, e.g., Spencer L. Kimball, *The Purpose of Insurance Regulation: A Preliminary Inquiry in the Theory of Insurance Law*, 45 MINN. L. REV. 471, 472–73 (1961) (discussing the beginning of state insurance regulation in the 1820s and its normalization throughout the 1850s and 1860s).

¹⁷ Randall, *Insurance Regulation*, *supra* note 5, at 630–31.

¹⁸ See Spencer L. Kimball & Ronald N. Boyce, *The Adequacy of State Insurance Rate Regulation: The McCarran-Ferguson Act in Historical Perspective*, 56 MICH. L. REV. 545, 553–56 (1958) (describing the desire of the insurance industry for federal regulation until *Southeastern Underwriters* scared them — and state regulators — into lobbying for the McCarran-Ferguson Act).

insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance.¹⁹

McCarran-Ferguson pleased both insurers and state regulators, but Congress maintained its ability to step into insurance regulation if states did not perform well enough. To protect themselves, insurers and state regulators banded together more closely than they had in the past — strengthening the NAIC, which was already decades old — and created model regulations that would allow insurers to avoid seemingly onerous federal laws and permit state regulators to improve the quality and scope of their own regulations while maintaining control and taxation of insurance.²⁰

Thus, Congress has left insurance regulation to state legislatures, unless it passes a federal law that specifically regulates insurance for the entire nation.²¹ Indeed, every state has an insurance code, a detailed body of legislation that governs how the business of insurance is to be conducted within the state. However, even with broad authority in this area, state laws must conform to greater federal and state constitutional concerns that apply to all legislation, such as due process, equal protection, contract impairment, and uncompensated takings, in addition to avoiding federal preemption in those areas that Congress has acted to explicitly regulate insurance.²²

¹⁹ 15 U.S.C. § 1012 (2010).

²⁰ Kimball & Boyce, *supra* note 18, at 555.

²¹ Companies can also step outside the protection of the McCarran-Ferguson Act if they engage in boycotts, coercion, or intimidation. *See generally* Hartford Fire Ins. Co. v. California, 509 U.S. 764 (1993) (interpreting 15 U.S.C. § 1013(b) (2010), which states that “[n]othing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.”).

²² COUCH ON INSURANCE, *supra* note 7, at § 2:2. Since this article deals with insurance contracts — and possible interference of them through more adjudicatory power — it must be noted that the Contract Clause, U.S. CONST. art. I, § 10, cl. 1, has been interpreted liberally in the insurance context. Review of regulations affecting contracts is subject to something akin to rational basis review. If the legislation has a significant and legitimate public purpose and the contract impairment is attributable to reasonable conditions related to the public purpose, it will be upheld. *See generally* Energy Reserves Group, Inc. v. Kansas Power and Light Co., 459 U.S. 400 (1983). However, a small number of such challenges have been upheld: *see, e.g.,* Smith v. Dep’t. of Ins., 507 So. 2d 1080 (Fla. 1987) (a section of the state’s Tort Reform and Insurance Act was found to violate the Contract Clause because it required all

State regulation has been the norm even since the Gramm-Leach-Bliley Act (viz. the Financial Services Modernization Act)²³ of 1999 allowed the consolidation of two federally-regulated industries (banking and securities) with the state-regulated insurance industry, providing for the creation of the “financial services industry” that brought us the sub-prime mortgage/investment-backed securities crisis of 2007.²⁴ In light of the crisis and perceived inefficiencies, many commentators have written proposals to attack state regulation, the most salient suggestion being for a single-licensing, federal charter option that would allow insurance companies to seek a federal charter permitting them access to all fifty states, while maintaining states’ ability to compete over the details not addressed by the minimum federal standards.²⁵ Others, even members of Congress, have proposed more wholesale federal regulation even though, judging by the arguably negative effects of the Gramm-Leach-Bliley Act, federal regulation might not be a good solution.²⁶ The closest federal law has come to broadly regulating insurance is

commercial liability policies in effect between certain dates to provide credits or rebates because of probable benefits stemming from tort reform); *Health Ins. Ass’n of America v. Harnett*, 376 N.E.2d 1280 (N.Y. 1978) (mandatory maternity care could not be required in guaranteed renewal policies).

²³ 15 U.S.C. §§ 6801–6809 (2006).

²⁴ For a discussion of the problems with the Financial Services Modernization Act and its probable connection to the recent financial crisis, see Joseph Karl Grant, *What the Financial Services Industry Puts Together Let No Person Put Asunder: How the Gramm-Leach-Bliley Act Contributed to the 2008–2009 American Capital Markets Crisis*, 73 ALBANY L. REV. 371 (2010); Paul Krugman, *The Gramm Connection*, N.Y. TIMES, Mar. 29, 2008, available at <http://krugman.blogs.nytimes.com/2008/03/29/the-gramm-connection/>.

²⁵ See, e.g., Henry N. Butler & Larry E. Ribstein, *The Single-License Solution*, REGULATION, Winter 2008–2009, at 36 available at <http://www.cato.org/pubs/regulation/regv31n4/v31n4-6.pdf>; Leo Donatucci, *Current Issues in Public Policy: Federal Regulation of the Insurance Industry: One for All and All for Who? How Federal Regulation Would Help the Industry Into the New Millennia*, 7 RUTGERS J.L. & PUB. POL’Y 398 (2010).

²⁶ See, e.g., National Insurance Protection Act, H.R. 1880 (introduced by Reps. Bean (D–IL) and Royce (D–CA) 111th Cong (2009) (proposes the creation of an Office of National Insurance within the Department of the Treasury, with power to license, regulate and supervise national insurers); see also Donatucci, *supra* note 25, at 398; see generally BAIRD WEBEL & CAROLYN COBB, CONG. RESEARCH SERV., RL 31982, INSURANCE REGULATION: HISTORY, BACKGROUND, AND RECENT CONGRESSIONAL OVERSIGHT (2005), available at http://assets.opencrs.com/rpts/RL31982_20050211.pdf.

the creation, within the Department of the Treasury, of the Federal Insurance Office, which was part of the Dodd-Frank Wall Street Reform and Consumer Protection Act.²⁷ This law, passed in July 2010, is a response to the recent recession. Because insurance is often found under the same roof as banking and securities services, and given that players such as AIG contributed to the economic downturn, insurance was a natural target of the Dodd-Frank bill. However, the bill appears to be fairly innocuous as to insurance regulation. In relevant part, the Office is only granted power to monitor and collect data from the insurance industry, to analyze those data, to consult with states on matters of federal and international concern, to make annual reports to Congress and the President, to preempt state laws that treat certain non-United States insurers less favorably than United States insurers, and to give advice to the Secretary of the Treasury and the newly-created Financial Stability Oversight Council on risky insurers. In fact, subsection (k) of § 502 (the section establishing and defining the office) states that the Office is not given “general supervisory or regulatory authority over the business of insurance.” For now, then, insurance regulation at the legislative level is squarely in the hands of states, aside from those few instances in which Congress has specifically affected insurance.²⁸

Legislatures regulate insurance both by passing laws and by empowering state agencies — i.e., insurance departments — to administer many of those laws. Some laws are even written for the courts to apply. For example, many states have rules that restrict courts’ ability to construe insurance applications or policies against the insured.²⁹ With such legislative ability to

²⁷ Pub. L. 111-203 §§ 501–543, 111th Cong. (2010).

²⁸ See, e.g., Employee Retirement Income Security Act of 1974, 29 U.S.C.A. §§ 1001–1461 (West 2010) (preempting state insurance law that operates on self-funded employer health plans).

²⁹ See generally, VA. CODE ANN. §§ 38.2-300–325 (West 2010). A salient example is § 38.2-309 (requiring courts to construe statements on an insurance application as representations rather than warranties and requiring courts to find coverage even in the face of applicant misrepresentations, unless the insurer can prove that it relied on the material misstatement when granting coverage). See also CAL. INS. CODE § 382.5(e) (West 2010) (stating that binders must be construed as insurance policies); N.Y. INS. LAW § 3106 (McKinney 2010) (defining “warranty” and preventing a court from finding avoidance of an insurance contract for breach of warranty unless the breach materially increase the risk of loss under the contract); TEX. INS. CODE ANN. § 542.054

protect consumers even through the courts, one may legitimately question whether Randall's proposal (and others like it³⁰) are solutions in search of a problem. That is, with the legislature protecting insureds both directly and through insurance departments, what reason do commentators have to seek new judicial doctrines that presumably attempt the same thing in a less uniform and predictable way?

B. Insurance Departments

Insurance departments (or bureaus) are the states' administrative agencies that, under power given them by the legislature, regulate insurance.³¹ The power of each states' respective department is usually vested in the hands of an insurance commissioner or superintendent, under whose authority the department can normally (1) create and implement rules regulating insurance (including rates, market conduct, accessibility, pre-approval of insurance policy language,³² construction of policy language, etc.); (2) issue cease and desist orders or bring enforcement actions in court against those breaking rules or statutes related to insurance; and (3) enlist the aid of the Attorney General and state prosecutors when engaged in civil or criminal enforcement.³³ Although these departments are administrative agencies, decision makers and administrative judges within the departments (or, more likely, within a

(Vernon 2005) (requiring that the entire subsection be liberally construed to require prompt payment of claims).

³⁰ See, e.g., Michael B. Rappaport, *The Ambiguity Rule and Insurance Law: Why Insurance Contracts Should not Be Construed Against the Drafter*, 30 GA. L. REV. 171 (1995); Jeffrey W. Stempel, *The Insurance Policy as Social Instrument and Social Institution*, 51 WM. & MARY L. REV. 1489 (2010); Jeffrey W. Stempel, *The Insurance Policy as Statute*, 41 MCGEORGE L. REV. 203 (2010); Jeffrey W. Stempel, *The Insurance Policy as Thing*, 44 TORT TRIAL & INS. PRAC. L.J. 813 (2009).

³¹ In some states, such as New York, the insurance department is an independent state agency; in others, such as Virginia, it is a subsection of a larger department, such as a state corporation commission.

³² From one perspective, the fact that the language of the policy has been approved by the state insurance department suggests that the insured has already been protected — although this view is subject to the criticism that insurance departments are overworked and understaffed, and simply cannot foresee all possible conflicts under policy language.

³³ See, e.g., ALA. CODE § 12.1-16 (2010); CODE OF VA. § 12.1-16 (2010); REV. CODE OF WASH. § 48.02 (2010).

generalist department of administrative adjudication)³⁴ do not normally³⁵ adjudicate insurance policy disputes between

³⁴ See generally Michael Asimow, *The Fourth Reform: Introduction to the Administrative Law Review Symposium on State Administrative Law*, 53 ADMIN L. REV. 395, 398–99 (2001) (discussing the origins and rise of the central administrative judicial panel, noting that a majority of states and many large cities used central panels).

³⁵ Three notable and often consumer-protecting bends in this rule are: (1) the adjudication of unfair trade practices; (2) the adjudication of rights (even perhaps contract rights) that are “incidental to” an agency’s proper adjudicatory authority; and (3) the preliminary adjudication of private disputes that are comprehensively regulated.

First, most states have enacted a version of the Model Unfair Trade Practices act (promulgated by the NAIC as a model act), which is meant to protect consumers from statutorily-defined unfair actions (including improper discrimination) of insurance companies in raising rates or in denying, narrowing, or halting coverage. See BAKER, *supra* note 8, at 710–11. These acts often provide for private causes of action (see *infra*, Part IV(A)(3)), in addition to the ability of the insurance commissioner to bring an action before the agency, which allow a harmed insured to seek damages from the insurer in court. See COUCH ON INSURANCE, *supra* note 7, at § 4:20 (giving examples from various jurisdictions). However, when a statute or the common law (by implying a cause of action from the statute; see, e.g., *Stonewall Jackson Mem’l Hosp. Co. v. Am. United Life Ins. Co.*, 525 S.E.2d 649, 656 (W. Va. 1999)) does not provide for a private cause of action, the investigation and decision of the issue is usually left solely to the state insurance commissioner, who conducts a hearing and rules for or against the insurer, meeting out cease and desist orders or penalties. See COUCH ON INSURANCE, *supra* note 7, at § 4:20. In such cases, the dispute is not between the insured and the insurer but between the commissioner and the insurer. However, since insurers often bring such suits about by the filing of complaints, and since they often testify at the hearing, this can be considered a bend—however slight—in the general rule that administrative adjudications do not involve private contract rights.

Second, it is well established in many jurisdictions that where an administrative adjudication involves private rights that are incidental to and naturally decided together with the agency’s determination of public rights, the agency can decide those private rights. See, e.g., *McHugh v. Santa Monica Rent Control Bd.*, 777 P.2d 91, 104 (Cal. 1989) (citing cases from various states).

Third, the state legislature can create a scheme by which seemingly private rights are adjudicated under a comprehensive regulatory framework. For example, workers’ compensation statutes often provide for administrative adjudication of coverage disputes. See, e.g., *Dee Enters. v. Indus. Claim Appeals Office of State of Colo.*, 89 P.3d 430, 432 (Colo. App. 2003) (citing cases from numerous jurisdictions) (upholding administrative agency’s determination, against the employer’s and the insurance company’s factual and separation of powers objections, that coverage was due the injured worker). Additionally, some states have begun permitting administrative

individuals and their insurers. As one insurance commissioner put it, “I do not adjudicate controversies between consumers and insurers, nor can I direct an insurer to pay a particular claim or amount on a claim. That’s for the courts.”³⁶ Although they do not have the subject-matter expertise of the agencies, courts do have the weight of tradition, common-law stability, and constitutional authority behind them.

Everything the agency does is circumscribed in its enabling statute — all of its actions must be explicitly or implicitly allowed by that statute as written by the state legislature; thus, insurance departments are meant to administer the will of the state legislature.³⁷ Each department’s enabling statute is slightly different, but there are general themes across states. In their quasi-judicial role, the departments often deal with licensing, workers’ compensation appeals, state workers’ group insurance appeals, appeals from disciplined insurance

agencies to preliminarily adjudicate complaints from insureds regarding the improper denial or delay of payments from their insurer. For example, in Maryland, the Courts Article not only provides for an action in bad faith, it also provides for preliminary administrative determination of the insured’s claim. MD. CODE ANN., CTS. & JUD. PROC. § 3-1701 (West 2010). This is the closest administrative agencies come to adjudicating private contractual disputes between insurers and insureds. However, even in such workers’ compensation and bad faith cases, ultimate judicial review of the administrative decision is necessary to enforce payment and thus the decisions lack finality. *Id.*; *Dee Enters.*, 89 P.3d at 434.

All three of these quasi-exceptions to the general rule support the main argument: legislatures, which have accepted the duty to create policy that best balances consumer protection with the other goals of insurance regulation, are protecting consumers both through statute and through insurance departments; the courts have no need to adopt new standards of interpretation and construction.

³⁶ Alfred W. Gross, Virginia Commissioner of Insurance, Address at the William & Mary School of Law (Nov. 30, 2010). It should be noted that an “administrative law of contracts” has been proposed, particularly in the area of adhesive contracts, which proposal would allow contracts to be adjudicated through administrative agencies. W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 533 (1971). This proposal has gained little traction, and even adhesive contracts have largely been left to judicial — rather than administrative — interpretation.

³⁷ COUCH ON INSURANCE, *supra* note 7, at § 2:8 (stating “[a]lthough the insurance commission has a wide range of discretion in discharging the duties and responsibilities imposed upon it, it has no inherent powers and may only exercise those that have been expressly granted to it by constitution or statute, or those that are necessarily or reasonably implied therefrom”).

agents, reimbursement of public hospital medical care costs, etc.³⁸ In their quasi-legislative role, many departments develop and issue binding rules regulating rates, market conduct, discrimination, underwriting procedures, cash reserves and equity requirements, etc.³⁹ In their quasi-executive role, the departments police the market by performing solvency and consumer treatment inspections, initiating investigations into violations of rules and laws, and issuing fines, injunctions, or taking a company through receivership and dissolution. Criminal prosecutions have to be carried out by the state Attorney General's office, often at the department's behest.⁴⁰ Additionally, insurance commissioners may advocate public policy alternatives by working with the legislature to clarify the effect of proposals on citizens and businesses.⁴¹

In none of these activities do insurance departments involve themselves with resolving contractual disputes between an insurer and an insured. They do, of course, issue rules regulating the relationship between insurers and insureds and they also can investigate and enforce rules against insurers who do not treat insureds fairly, but insurance departments do not, in most cases, have authority to adjudicate private contracts — that is, disputes that do not involve a government actor.⁴² Thus, although insurance departments are often granted broad powers to act as an administrative agency, and can therefore help determine the decisional rules of courts,⁴³ they are not given the ability to act as common law courts themselves. Although Randall's proposal does advocate a consumer-interest approach to insurance contract adjudications, she does not go so far as to suggest that these disputes should be carried out by state administrative judges.

Insurance commissioners and, by extension, their

³⁸ HOLMES & APPLEMAN, *supra* note 1, at §§ 170.1–5.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ Gross, *supra* note 36.

⁴² See, e.g., Texas's State Office of Administrative Hearings website, <http://www.soah.state.tx.us/about-us/SOAH-teams.asp>, which details the cases they adjudicate. Although some are appeals from the state's Department of Insurance, none of them are contract disputes between private parties.

⁴³ See, e.g., *In re Allstate Ins. Co.*, 613 N.E.2d 936 (N.Y. 1993) (the Superintendent of Insurance issued regulations that acted as persuasive authority to overturn judicial precedent, causing a later case to be decided differently).

departments, do not work in home-state-centric vacuums. Although their individual authority (including the authority to affect how courts interpret policy language) is binding only in their state, each commissioner is a member of the NAIC, which has de facto authority to, if nothing else, nudge and incentivize individual commissioners to be part of the crowd.

C. NAIC

The National Association of Insurance Commissioners was formed in 1871, shortly after the *Paul* decision.⁴⁴ As an association with no de jure public power, its original mission was to foster economic efficiency by seeking uniformity in insurance regulation — a role that it has continued to play but that has become more important as federal pressure for greater uniformity has continued to grow.⁴⁵ Officially,

[t]he mission of the NAIC is to assist state insurance regulators, individually and collectively, in serving the public interest and achieving the following fundamental insurance regulatory goals in a responsive, efficient and cost effective manner, consistent with the wishes of its members:

Protect the public interest;

Promote competitive markets;

Facilitate the fair and equitable treatment of insurance consumers;

Promote the reliability, solvency and financial solidity of insurance institutions; and

Support and improve state regulation of insurance.⁴⁶

⁴⁴ Randall, *Insurance Regulation*, *supra* note 5, at 630.

⁴⁵ See, e.g., U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-372, INSURANCE RECIPROCITY AND UNIFORMITY: NAIC AND STATE REGULATORS HAVE MADE PROGRESS IN PRODUCER LICENSING, PRODUCT APPROVAL, AND MARKET CONDUCT REGULATION, BUT CHALLENGES REMAIN 6–8 (2009), available at <http://www.gao.gov/new.items/d09372.pdf> [hereinafter U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-372].

⁴⁶ *About the NAIC*, NAT'L ASS'N OF INS. COMM'RS, <http://www.naic.org/>

In furtherance of these somewhat vague goals, the NAIC engages in various activities meant to encourage — or, as some argue,⁴⁷ impose — a baseline of strong, consistent regulation in every state. Randall described these activities in her oft-cited article on NAIC's involvement in insurance regulation:

The NAIC performs centralized duties that mirror those of federal regulators in other industries, including the prescription of standard forms for insurance company annual financial statements; the coordination of regional financial examinations of insurance companies; the creation and maintenance of an extensive system of national databases to facilitate state monitoring of insurers and insurance agents; the rating of non-U.S. insurers for the states; the periodic review and accreditation of state insurance departments; the drafting of model laws and regulations, many of which have been adopted by state legislatures; the valuation of insurance company investments; training of state insurance regulators; the preparation of statistical reports for state regulators; the assistance to state regulators with technical financial analysis; and the assistance to U.S. officials negotiating international trade agreements that concern insurance issues. The NAIC makes most of its money by selling data to states.⁴⁸

Currently, the insurance commissioners from all fifty states and the District of Columbia (plus the four U.S. territories) are members of the NAIC, and the Association strives to walk the thin line between establishing important national standards and allowing the states to adapt these standards to their particular needs. However, avoiding strong de facto impositions on states has been difficult since NAIC started its accreditation system. In

index_about.htm (last visited Oct. 23, 2010).

⁴⁷ See, e.g., Kimberley A. Strassel, *Carbon Caps through the Backdoor: Environmentalists Pressure the Insurance Industry*, WALL. ST. J., Mar. 4, 2010, available at <http://online.wsj.com/article/SB10001424052748703862704575100004067589846.html> (arguing that environmental groups had made NAIC force all commissioners to complete a survey that would coerce states into capping emissions); see also Randall, *Insurance Regulation*, *supra* note 5, at 636, n. 67.

⁴⁸ Randall, *supra* note 5, at 636–38.

the late 1980s, after some large insurers went bankrupt, commentators called for federal regulation of company solvency so as to provide national minimum standards to avoid regulatory races to the bottom and, ultimately, more insolvency.⁴⁹ In response, the NAIC created its solvency-focused accreditation system, called the Financial Regulation Standards Accreditation Program. All states and the District have met minimum requirements and are accredited under this program.⁵⁰ Similarly, in response to a more recent outcry for national regulation of insurance company market conduct, the NAIC is close to implementing its Market Conduct Accreditation Program.⁵¹ The dialogue between federal (often congressional) actors and the NAIC shows how the NAIC (and, by extension, the states) must respond to federal pressure or face preemption. Indeed, the NAIC's bowing to cries for federal reformation is likely part of the reason that Congress has done relatively little — beyond threats that bring the commissioners to agree to standardized regulation — to regulate insurance.

NAIC's existence and involvement in state regulation of insurance demonstrates another layer of protection for consumers. Not only does the NAIC propose homegrown actions, but it also acts as a forum for insurance commissioners from various states to compare and contrast their consumer protections with those of other jurisdictions.⁵² This process of experimentation and communication can lead to consumer protections that are efficient (in both the equitable and economic sense) and applicable to each state. Further, the NAIC has already shown a desire to respond with solutions whenever the federal government looks at state regulation with a critical eye. This also leads to more and, one would hope, improved

⁴⁹ U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-01-948, INSURANCE REGULATION: THE NAIC ACCREDITATION PROGRAM CAN BE IMPROVED 3 (2001), available at <http://www.gao.gov/new.items/d01948.pdf>.

⁵⁰ See *Financial Standards Regulation Program Accredited States*, NAT'L ASS'N OF INS. COMM'RS, http://www.naic.org/committees_f_accredited_states.htm (last visited Oct. 25, 2010). For some time, New York, which the NAIC itself recognized as having an exemplary system of regulating the solvency of insurance companies, was not accredited by the NAIC because its system, while exemplary, was different than the NAIC requirements. Randall, *supra* note 5, at 652–53.

⁵¹ See generally U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-372, *supra* note 45, at 28–36.

⁵² Randall, *Insurance Regulation*, *supra* note 5, at 634–39.

protections for consumers.⁵³

In sum, state legislatures, insurance departments, and the NAIC are deeply interrelated and all three work — sometimes in concert — to protect consumers by promoting faithful insurer behavior, insurer solvency, broad access to insurance, and even mandated policy language and interpretive mandates. State legislatures have near plenary power over insurance regulation, but they delegate much of the administration of that regulation to their insurance departments, which are headed by insurance commissioners who are members of the NAIC. Under the NAIC's equalizing influence and model laws, in addition to states' desire to be different and attractive to business, insurance is regulated by a system that is nearly uniform in purpose and scope while still being flexible in detail. Particularly, most states declare that their goals are to ensure fair premiums, guarantee insurance company solvency, prevent unfair market conduct, and make insurance coverage widely available.⁵⁴ Under this system, regulation is both predictable and adjustable. Inserting the various common law courts' narrow policy judgments into the regulatory realm, as Randall proposes, would push the entire system toward uncertainty, and uncertainty would lead to inefficiency and injustice for insurers and insureds alike.

II. The Contract Roots of Insurance Law

The roots of insurance in contract law are deceptively simple. They are rested here using broad generalities to remind the reader that, as a natural home, there is no better place for insurance policy interpretation and construction than contract law.

Contracts come by way of offer, acceptance, and consideration. In the insurance context, the offer is generally made not by the insurer but by the potential insured, when she fills out and submits an application for insurance.⁵⁵ A blank

⁵³ *Id.*

⁵⁴ *Id.* at 629 (citing ROBERT H. JERRY, II, UNDERSTANDING INSURANCE LAW § 22 (2d ed. 1996)); Kimball, *supra* note 16, at 477-78; *see also* BAKER, *supra* note 8, at 637-56 (describing the goals of insurance regulation, the role of the NAIC in coordinating state regulatory efforts, and the boundaries of state authority over insurance).

⁵⁵ COUCH ON INSURANCE, *supra* note 7, at § 11:1 (citing various cases from numerous states and giving exceptions to these general rules).

application given to a potential insured is not an offer but a mere proposal to enter into a contractual relationship. Acceptance is generally by the insurer, when it grants coverage based on the completed application.⁵⁶ Consideration is based, for the insured, in the premiums paid for the insurance, and for the insurer, in indemnification when a covered loss occurs.⁵⁷

Nearly all insurance policies are contracts of adhesion, meaning that the applicant (offeror) must either adhere to the terms of the policy written by the company (offeree) or not be granted insurance.⁵⁸ There is some leeway in this statement, such as the ability, in some circumstances, for consumers to mix and match types and amounts of coverage while still being denied the ability to change the mix available for matching or the terms under which each option operates; additionally, some insureds are so sophisticated that they are allowed the privilege of either approving or drafting the policy language.⁵⁹ However, for the most part, insurance contracts are adhesive contracts; indeed, some commentators have gone so far as to label them “super-adhesive” contracts because, even though they are not prohibited from doing so, many insureds do not even see the policy language before applying for coverage and because all insurance companies offer roughly identical coverage.⁶⁰ Adhesive contracts are usually associated with an imbalance of information; in the insurance case, this simply means that the insurance companies, which drafted the contract or chose a standardized form to apply, have much more information regarding the meaning of the

⁵⁶ *Id.* at § 11:3.

⁵⁷ *See, e.g.,* American Int’l Life Ins. Co. v. Hartsfield, 248 S.E.2d 518, 520 (Ga. Ct. App. 1978) (generally, nonpayment of premiums when due results in a forfeiture of the policy); Hargis v. United Farm Bureau Mut. Ins. Co., 388 N.E.2d 1175, 1179 (Ind. Ct. App. 1979) (failure to timely pay premiums can subject the insured to waiver and/or estoppel); Hampton v. Metro. Ins. Co., 528 S.W.2d 17, 18 (Mo. Ct. App. 1975) (insurance policies are contracts; if the premiums are not paid, the policy lapses for want of performance); St. Paul Mercury Ins. Co. v. Hurst, 301 N.W.2d 352, 355 (Neb. 1981) (the regular payment of premiums is the essence of an insurance contract; without it, the policy lapses); *see also* American Hardware Mut. Ins. Co. v. BIM, Inc. 885 F.2d 132, 136 (4th Cir. 1989) (there is no insurance where there is no payment).

⁵⁸ *See generally* KENNETH S. ABRAHAM, INSURANCE LAW AND REGULATION 531–36 (4th ed. 2005).

⁵⁹ *See, e.g.,* Jeffrey W. Stempel, *Reassessing the Sophisticated Policyholder Defense in Insurance Coverage Litigation*, 42 DRAKE L. REV. 807, 831–33 (1993).

⁶⁰ *Id.*; *see also* ABRAHAM, *supra* note 58, at 534.

contract and its contents than the consumer.⁶¹

The fact that a substantial amount of coverage is required by law adds an element of force to the adhesive nature of insurance. For example, automobile liability insurance, homeowner's insurance, and worker's compensation insurance are required in certain circumstances.⁶²

In addition to being contracts of adhesion, insurance policies are standardized contracts, meaning that the language is boilerplate and similar or identical from one insurer (and state)⁶³ to another — indeed, many insurance contracts are chosen by insurers from a list of available options drafted by the Insurance Services Office (“ISO”).⁶⁴ Standardization allows insurance companies and the NAIC to gather data based on comparable language in order to make precise underwriting predictions both within and across states.⁶⁵ A side effect of standardization is that it perpetuates confusing language — not because the insurance companies think that the language is clear to consumers, but because the language is predictable in court.⁶⁶

⁶¹ Randall, *Freedom of Contract*, *supra* note 2, at 125.

⁶² JERRY, *supra* note 54, at 996–98; *See generally* WEST 50 STATE SURVEYS, INSURANCE—UNINSURED/UNDERINSURED MOTORIST COVERAGE (West 2006); ALAN WIDISS, 3 UNINSURED AND UNDERINSURED MOTORIST INSURANCE 22 (Anderson Publishing, 2d ed. 1985).

⁶³ State courts, when interpreting a particular term for the first time, may look to interpretations of the term from other states. *See Fisher v. Tyler*, 394 A.2d 1199, 1202-03 (Md. 1978) (“[T]he application of this policy provision in a factual posture similar to that presented here, has been before the courts of our sister states. The decisions of these jurisdictions have special significance in this context because heretofore this Court has recognized that ‘like a state which adopts, by copying, a foreign statute, . . . parties who adopt an insurance policy, which apparently has had nationwide use and has been judicially construed in five or six states, adopt with it the uniform judicial construction that it has received in other states.’ In other words, while the contract term on its face may be ambiguous, which under other circumstances would ordinarily generate a jury question, . . . the court in this situation may treat the term as unambiguous and, absent any factual dispute, adopt, as a matter of law, that construction placed on the language by the courts of other states.”) (citations omitted). In other words, courts in one state help courts in other states to issue consistent and predictable rulings — contributing favorably to the reliability that federal regulators have been seeking lately.

⁶⁴ *See, e.g.*, STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, at § 4.05[A].

⁶⁵ *Id.*; Randall, *Freedom of Contract*, *supra* note 2, at 124.

⁶⁶ Michelle E. Boardman, *Contra Proferentem: The Allure of Ambiguous Boilerplate*, 104 MICH. L. REV. 1105, 1107 (2006); *Farmers Auto. Ins. Ass’n v.*

Sophisticated insureds are often an exception to standard insurance policy interpretation. The basic reason for treating sophisticated insureds differently than others is that they, or their agents and attorneys, write, bargain for, or at least understand the policy language that binds them; therefore, they should not reap benefits from strong rules meant to protect more vulnerable insureds who effectively do not know what they are getting into.⁶⁷ Sophisticated insureds pose problems for interpreting courts, which have granted protection of the strong *contra proferentem* rule to some sophisticated insureds while withholding it from others; indeed, much depends on the degree to which a sophisticated insured negotiated for particular terms.⁶⁸ Courts and commentators also debate who should be considered a sophisticated insured: should the definition include sophisticated parties just because their attorneys can understand the policy's implications, or should the definition only include those parties that actually draft or, less stringently, negotiate for policy terms?⁶⁹ Such questions form part of the rationale for proposals to reform judicial interpretation and construction of insurance policies because they are examples and sources of the uncertainty surrounding these judicial actions.

Given that insurance policies are contracts — special and problematic contracts, but contracts nonetheless — it makes sense that common law courts interpret them according to contract law. The judiciary, however, has also recognized that insurance contracts are instruments of public policy just as they are examples of private ordering; thus, many have taken pains to place one foot into the realm of individual consumer (plaintiff)

St. Paul Mercury Ins. Co. 482 F.3d 976, 977 (7th Cir. 2007) (“[insurance companies] are reluctant to alter policy language once its meaning has been settled by judicial decision”) (citing sources).

⁶⁷ See, e.g., Stempel, *supra* note 59, at 849–56 (arguing for differential treatment of sophisticated insureds when various factors are weighed against them); *c.f.*, Hazel Glenn Beh, *Reassessing the Sophisticated Insured Exception*, 39 TORT TRIAL & INS. PRAC. L.J. 85 (2003).

⁶⁸ See, e.g., *Morgan Stanley Group, Inc. v. New England Ins. Co.*, 225 F.3d 270, 279–80 (2d Cir. 2000) (holding that, under New York law, where a sophisticated insured has not negotiated for terms, the insured should benefit from the *contra proferentem* doctrine — which in New York allows for extrinsic evidence before application).

⁶⁹ See generally, COUCH ON INSURANCE, *supra* note 7, at § 22:24 (citing numerous cases for the differing approaches to the treatment of sophisticated insureds).

protection while keeping the other firmly grounded on the traditional principles of contract interpretation and construction. The problems of mass-standardization and adhesion sometimes lead courts to give up traditional contract principles in favor of consumer-oriented rules such as those discussed in the next section.

III. Consumer Protection by Courts

Courts treat insurance policy interpretation in various ways because of the issues of standardization and adhesion, as well as insurance's role in protecting public policy. Generally, courts treat insurance policies as contracts with special rules of interpretation and construction. Some of these rules (and those that Randall focuses on as the basis for her proposal) are (1) an especially potent form of the *contra proferentem* doctrine; (2) the pure reasonable expectations doctrine; and (3) liberal availability of bad faith remedies against insurers that act improperly.⁷⁰ Although they have never been uniform, some worry that courts generally have begun to abandon these special consumer-protective rules, leading to proposals like Professor Randall's. This section introduces some of the more salient controversies in the protection of insureds, giving a baseline for the proposal's evaluation in the next section.

A. The Insurance-Tailored (Strong) *Contra proferentem* Doctrine

Contra proferentem, translated literally to "against the offeror,"⁷¹ is a doctrine that courts use to favor an insured's reasonable interpretation of an ambiguous policy term over an

⁷⁰ This article omits another major consumer-protective doctrine, namely that of unconscionability, because Randall does not address it. However, it is important to remember that, in many jurisdictions, where adhesive policy terms are unreasonably favorable to the drafter (insurer), those terms can be modified or struck down. Both courts and legislatures have provided for the unconscionability doctrine to protect consumers. *See, e.g.*, Donald Zupanec, Annotation, *Doctrine of Unconscionability as Applied to Insurance Contracts* 86 A.L.R.3d 862 (1978) (citing numerous cases); TEX. BUS. & COM. CODE ANN. § 17.50 (West 2009) (allowing for actions flowing from unconscionable insurance contracts). Indeed, some courts see insurance policies as being subject to UCC Title 2's prohibition against unconscionable contracts. *See, e.g.*, *Bishop v. Washington*, 480 A.2d 1088, 1093-95 (Pa. Super. Ct. 1984).

⁷¹ *U.S. Fire Ins. Co. v. Gen. Reinsurance Corp.*, 949 F.2d 569, 573 (2d Cir. 1991).

insurer's. In its general form, as used in normal contract interpretation, the doctrine is a rule of last resort that is employed only when a court cannot — by the contract's plain language or even by extrinsic evidence — determine the parties' intent.⁷² However, in the insurance context, the rule has taken on a meaning more favorable to insureds. For example, one conception of the rule as applied to ambiguous exclusions is that:

[I]f a policy is susceptible to more than one reasonable interpretation . . . “Texas law requires an insurance policy to be construed against the insurer and in favor of the insured”—in other words, in favor of coverage. Where an exclusionary provision is ambiguous—that is, amenable to two or more reasonable interpretations—the court must adopt the construction urged by the insured so long as that construction is not unreasonable, even if the insurer's construction “appears to be more reasonable or a more accurate reflection of the parties' intent.”⁷³

Thus, as it is still often construed, even in some of the states that Randall claims have turned against the doctrine, the *contra proferentem* doctrine is stronger when applied to insurance contracts than when applied to contracts in other areas. It often applies before reference is made to extrinsic evidence, and therefore favors insureds upon the discovery of any ambiguity. Professor Randall argues that Texas's approach is among a dying breed: “In recent years, commentators have advocated for adherence to usual contract rules,⁷⁴ and courts have increasingly

⁷² See generally, CORBIN ON CONTRACTS § 24.27 (Joseph M. Perillo ed., 2010).

⁷³ *Pendergest-Holt v. Certain Underwriters at Lloyd's of London*, 600 F.3d 562, 569 (5th Cir. 2010); however, compare *Evergreen Nat. Indem. Co. v. Tan It All, Inc.*, 111 S.W.3d 669, 676 (Tex. App. 2003) (stating that extrinsic evidence can be used before resorting to the *contra proferentem* doctrine, but still holding to the proposition that, once the *contra proferentem* rule is applied in an insurance policy dispute, the reasonable construction of the insured trumps even the more objectively reasonable construction of the insurer).

⁷⁴ Randall, *Freedom of Contract*, *supra* note 2, at 121 (citing ALLAN WINDT, *INSURANCE CLAIMS AND DISPUTES*, § 603 (3d ed. 1995); Scott G. Johnson, *Resolving Ambiguities in Insurance Policy Language: The Contra Proferentem Doctrine and Use of Extrinsic Evidence*, 33 THE BRIEF 33, 37 (2004) (“If ambiguity is present, most courts today will not immediately construe the ambiguity against the drafter but instead will attempt to remove

applied those rules.”⁷⁵ Yet even in states that use the general form of the doctrine, extrinsic evidence is rarely important, due to the lack of extrinsic evidence of the parties’ bargain when adhesive contracts are involved.⁷⁶

To the extent that courts *are* paring back the insurance-tailored *contra proferentem* doctrine, they are presumably doing so for at least the following reasons: first, rashly applying *contra proferentem* before allowing extrinsic evidence can prevent the court from upholding the parties’ intent;⁷⁷ second, the strict *contra proferentem* rule can cause economic inefficiency and uncertainty;⁷⁸ and third, since state legislatures and insurance departments regulate insurance contracts, there is little need for the courts to apply strong doctrines against insurers. On the other hand, according to the doctrine’s supporters, the strong *contra proferentem* rule discourages ambiguity, corrects unfairness, redistributes wealth, and promotes uniformity of meaning in mass-produced contracts for both insurers and insureds using boilerplate-ridden insurance policies.⁷⁹ Randall’s fears in this area are based on a perceived practical difference between the strong *contra proferentem* doctrine and the normal version of that rule. This article will evidence, however, that many states use the strong version of the doctrine, that states are generally consistent in their approach, and that both the strong and normal *contra proferentem* doctrines are largely protective of consumers because of a general lack of extrinsic evidence surrounding insurance policies.

the ambiguity by considering extrinsic evidence to determine the parties’ mutual intent.”); 1 BARRY R. OSTRAGER & THOMAS R. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES 14–18 (15th ed. 2010) (*contra proferentem* should only apply when an ambiguity cannot be resolved by extrinsic evidence).

⁷⁵ Randall, *Freedom of Contract*, *supra* note 2, at 121 (citing cases applying law from New York, Washington, North Dakota, New Jersey, Pennsylvania, Arkansas, Maryland, and New Mexico); *see generally* 2 COUCH ON INSURANCE, *supra* note 7, at § 22:22 (2010) (detailing the different approaches to the *contra proferentem* doctrine in different jurisdictions).

⁷⁶ *See infra* Part IV(A)(2).

⁷⁷ WINDT, *supra* note 74, at § 603.

⁷⁸ Rappaport, *supra* note 30, at 202–06.

⁷⁹ David Horton, *Flipping the Script: Contra Proferentem and Standard Form Contracts*, 80 U. COLO. L. REV. 431, 484–85 (2009).

B. The Reasonable Expectations Doctrine

The reasonable expectations doctrine, propounded by Professor Keeton in 1970 to protect consumers, is simple in its pure form: the consumer's reasonable expectation of coverage trumps policy language to the contrary.⁸⁰ In the ensuing forty years, the doctrine has been debated, praised, and defamed, but it has never been widely followed as proposed. By 2000, most courts that had experimented with the doctrine, fearing inconsistency and unpredictability, narrowed it to follow the insured's reasonable expectations only when construing either ambiguous or unconscionable terms against the insurer, or when applying waiver, estoppel, election, and contract reformation.⁸¹ Since the insured's reasonable expectations only trumped policy language that was ambiguous, unconscionable, or otherwise inequitable, the doctrine had been so modified as to become unrecognizable just three decades after its proposal. By 2008, courts had moved even further from the pure doctrine, with only Alaska and Hawaii applying Keeton's once-attractive approach.⁸²

⁸⁰ See Peter Nash Swisher, *A Realistic Consensus Approach to the Insurance Law Doctrine of Reasonable Expectations*, 35 TORT & INS. L. J. 729, 733 (2000) (citing Keeton, *supra* note 6).

⁸¹ *Id.* at 735–47; See, e.g., *Flomerfelt v. Cardiello*, 997 A.2d 991, 996 (N.J. 2010) (using the reasonable expectations doctrine after an ambiguity was shown).

⁸² Randall, *Freedom of Contract*, *supra* note 2, at 111–18. Hawaii's approach, however, does not appear to be as pure as Keeton's original proposal; in describing the law of contract interpretation, the Hawaii Supreme Court refers to various contract principles that limit the scope of the reasonable expectations doctrine, not the least of which is that reasonable expectations are found not with the insured, but in the plain language of the contract terms. The Hawaii Supreme Court stated that, "It is well settled in Hawai'i that 'the objectively reasonable expectations of policyholders 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.' These 'reasonable expectations' are *derived from the insurance policy itself*, which is '*subject to the general rules of contract construction.*' This involves construing the policy 'according to the entirety of its terms and conditions,' and 'the terms themselves ... *should be interpreted according to their plain, ordinary, and accepted sense in common speech* unless it appears from the policy that a different meaning was intended.' 'Because insurance policies are contracts of adhesion and are premised on standard forms prepared by the insurer's attorneys, we have long subscribed to the principle that they must be construed liberally in favor of the insured and any ambiguities must be resolved against the insurer.'" *Del Monte Fresh Produce*

Thus, the reasonable expectations doctrine has become, for most courts, merely an expansion of the insurance-tailored *contra proferentem* rule: where there is an ambiguous term, the court favors the insured by ruling according to her reasonable interpretation of the language.⁸³ As demonstrated below, Randall gives a good overview of this doctrine's history, but even that history shows that the doctrine is neither pervasive nor helpful to consumers.

C. Tort-Based Bad Faith Actions Flowing from the Insurer's Breach

"Bad faith" claims arising out of insurance policy disputes are meant to deter insurers from treating their insureds unfairly, particularly since so many claims involve catastrophic events in the lives of insureds, and to make insureds whole for injuries suffered due to their insurer's improper actions. These claims, based in the implied covenant of good faith and fair dealing found in any contract, come in many forms — from breach of duty to settle to failure to pay a claim.⁸⁴ There is a further division between first- and third-party claims: third-party claims are for liability insurance, in which the insurer and the insured

(Haw.), Inc. v. Fireman's Fund Ins. Co., 183 P.3d 734, 745 (Haw. 2007) (citations and brackets omitted) (emphasis added). Alaska seems to follow a more insured-centered approach, asking whether, from the perspective of the insureds claiming coverage, the terms of the contract would have provided coverage for the loss incurred. See C.P. *ex rel.* M.L. v. Allstate Ins. Co., 996 P.2d 1216, 1223-25 (Alaska 2000).

⁸³ Perhaps the best explanation of the modern view is from the Michigan Supreme Court: "The rule of reasonable expectations clearly has no application to unambiguous contracts. That is, one's alleged "reasonable expectations" cannot supersede the clear language of a contract. Therefore, if this rule has any meaning, it can only be that, if there is more than one way to reasonably interpret a contract, i.e., the contract is ambiguous, and one of these interpretations is in accord with the reasonable expectations of the insured, this interpretation should prevail. However, this is saying no more than that, if a contract is ambiguous and the parties' intent cannot be discerned from extrinsic evidence, the contract should be interpreted against the insurer. In other words, when its application is limited to ambiguous contracts, the rule of reasonable expectations is just a surrogate for the rule of construing against the drafter." *Wilkie v. Auto-Owners Ins. Co.*, 664 N.W.2d 776, 786-87 (Mich. 2003).

⁸⁴ See generally, RONALD D. KENT & WILLIAM T. BARKER, *NEW APPLEMAN INSURANCE BAD FAITH LITIGATION* § 1.01 (2d ed. 2010).

are “on the same side” against the third party. These claims often arise in automobile, homeowner’s, commercial general liability, professional liability, and directors and officers insurance. They usually involve a duty to reasonably defend the insured against a third party, a duty to reasonably settle with the third party or insured (who will then settle with the third party), and a duty to indemnify the insured if the case is lost. First-party claims are between an insured, who makes the claim for herself, and the insurer.

Third-party bad faith claims have been available for a very long time, sounding both in contract and in tort.⁸⁵ This early acceptance of third-party claims by the states was likely due to the fiduciary, “same-team” relationship between the insured and the insurer,⁸⁶ the ease with which insurers could manipulate insureds to pay part of the claim,⁸⁷ and the enormous liability and litigation uncertainty to which insureds are exposed in third-party cases.⁸⁸ All states recognize the third-party bad faith claim, with some allowing it in tort and others in contract.⁸⁹

First-party claims, on the other hand, are relatively new. Of the forty-nine states that have addressed the issue, most states (and a continually growing number of them) allow for tort-based claims, a substantial minority allow expanded tort-like damages with the cause of action based in contract, and only five reject

⁸⁵ *Brassil v. Maryland Cas. Co.*, 104 N.E. 622 (N.Y. 1914) (seminal case finding an implied duty of good faith and fair dealing in insurance contracts); *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 202 (Cal. 1958) (allowing for bad faith in tort or contract, at the plaintiff’s election, for third-party refusal to settle cases); *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032, 1042 (Cal. 1973) (finding first-party bad faith against fire insurer and allowing for tort damages); see generally Victor E. Schwartz & Christopher E. Appel, *Common-Sense Construction of Unfair Claims Settlement Statutes: Restoring the Good Faith in Bad Faith*, 58 AM. U. L. REV. 1477, 1482–86 (2009).

⁸⁶ See *Beck v. Farmers Ins. Exch.*, 701 P.2d 795, 799–801 (Utah 1985) (noting that, in third-party situations, the insurer is a fiduciary to the insured because the insurer and insured are on the same side against the third-party claimant, while in the first-party situation, the relationship between the insured and the insurer is more adversarial).

⁸⁷ See JOHN M. BJORKMAN, ET AL., 3 LAW AND PRAC. OF INS. COVERAGE LITIG. § 29:19 (2010).

⁸⁸ See STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, at § 10.03[D][3] (illustrating the uncertainty and possible liability by giving an example of a homeowner whose guest, an outfielder for the Red Sox, slips on a banana peel and suffers a career-threatening injury).

⁸⁹ BJORKMAN, ET AL., *supra* note 87, at § 29:20.

first-party claims altogether.⁹⁰

In addition to these common-law remedies for bad faith, states are active in passing consumer-protective legislation, much of which provides for attorneys' fees, interest, and even penalties against insurers who, for certain types of insurance, act in bad faith toward consumers.⁹¹ Legislatures are generally not shy about stepping into the traditional realm of common law contract if they find something that demands change. The extension of bad faith remedies in the last few decades is another reminder that legislatures are addressing the insured-insurer relationship. In other words, Professor Randall is incorrect in saying that remedies for insurer bad faith have shrunk recently; courts and legislatures alike have actually been expanding this protection.

IV. Professor Randall's Proposal

This section analyzes and critiques Professor Randall's recent proposal that judges stop using contract law, the focus of which is parties' intent, and instead use legislative goals to interpret insurance policies. In her words, "[a]cknowledgment of legislative and administrative involvement through mandated provisions and policy approvals shifts the interpretative focus from effectuating the parties' intent to effectuating regulatory goals."⁹² She argues that it is necessary to move away from contract law and toward regulatory goals because consumers are being harmed by courts' supposedly recent consumer-damaging movement away from the reasonable expectations doctrine, the strong version of the *contra proferentem* doctrine, and the availability of bad faith actions in tort. This problem of declining consumer protection, she says, comes against the sensitive background of insurance policies as adhesive, standardized instruments into which neither the insurer nor the insured can insert preferred language (and whose contents reflect legislative

⁹⁰ STEPHEN S. ASHLEY, *BAD FAITH ACTIONS LIABILITY & DAMAGES* § 2:15 (2010).

⁹¹ See, e.g., ARK. CODE ANN. § 23-79-208 (West 2010) (allowing both penalties and attorneys' fees for various types of insurance); GA. CODE ANN. § 33-4-6 (West 2010) (allowing penalties and attorneys' fees for bad faith claim denials); 215 ILL. COMP. STAT. 5/155 (West 2010) (allowing penalties and attorney's fees for unreasonable denial or delay in paying claim); LA. REV. STAT. ANN. §§ 22:656–22:658 (2010) (allowing penalty, interest, and attorneys' fees). See generally ASHLEY, *supra* note 90, at § 9:15 (2010).

⁹² Randall, *Freedom of Contract*, *supra* note 2, at 135.

mandates rather than the intent of the parties). The solution to this problem, she argues, is for courts to make public policy and legislative intent — rather than contract law — the framework for determining insurance policy disputes.

By analyzing Professor Randall's proposal, this article demonstrates that (1) courts have not recently shifted away from consumer-protective doctrines; (2) notwithstanding adhesion, mandated content, and pre-approval of forms, there is plenty of room left for contract law and statutory regulations to consistently coexist in insurance; (3) consumers are in fact better protected than ever by state legislatures — whose job it is to dictate public policy; and (4) even if there is a problem with consumer protection, it should not be addressed through narrow adjudicatory processes but through the broad legislative process — which can best function against a backdrop of predictable judicial interpretations of law rather than unpredictable judicial beliefs of what legislatures desire. Particularly, the implementation of Professor Randall's proposal would lead to both judicial and economic unpredictability, violations of democratic and republican principles, and impractical, consumer-harming uncertainty and litigation.

As a threshold matter, even though she is at times vague on this point, it is assumed that Randall advocates some greater exercise of judicial power than courts currently use. She does say, rightly, that:

The normal exercise of judicial power permits a court to determine that policy provisions are ambiguous, deceptive, unfair, or contrary to public policy *within the meaning of the statute* and to construe the provisions to avoid statutory violations occasioned by an insurance regulator's approval, accomplishing the legislative objective of protecting insurance consumers.⁹³

This, of course, is merely a statement of what courts already do. A call for courts to start better protecting consumers surely promotes judicial action beyond the status quo. Simply suggesting that statutes be followed is not the purpose of her proposal. Rather, she proposes interpretation based on vague

⁹³ Randall, *Freedom of Contract*, *supra* note 2, at 141 (emphasis added).

“policy goals,” not just written statutes and the common law.

A. Demise of Consumer-Protective Common Law Doctrines?

Professor Randall sees a problem in what she considers to be a judicial move away from consumer-protective doctrines — particularly the strong *contra proferentem* doctrine, the reasonable expectations doctrine, and the availability of bad faith actions in tort for an insurer’s inappropriate actions.⁹⁴ As authority, Randall cites numerous cases from various jurisdictions, which, she says, prove that courts have recently decided to no longer treat insurance policies as special, and instead to treat them as ordinary contracts subject to ordinary contract principles.⁹⁵ However, on closer examination, many of the cases she cites either do not lend support to her argument or actually articulate some or all of the principles she says are dead.⁹⁶

Additionally, many of the cases she uses are from federal courts, which by definition have no binding precedential

⁹⁴ *Id.* at 109–10.

⁹⁵ *Id.* at 110, n. 9.

⁹⁶ *See, e.g.*, *Kessler v. Shimp*, 640 S.E.2d 822, 824–25 (N.C. Ct. App. 2007) (quoting *McLeod v. Nationwide Mut. Ins. Co.*, 444 S.E.2d 487, 491–92) (advocating a strong *contra proferentem* doctrine, which does not allow for extrinsic evidence before construing ambiguities against the insurer); *Axis Reinsurance Co. v. Melancon*, 2007 WL 60968, at *3 (E.D. La. 2007) (simply stating that, where an insurance company complies with statutes and regulations, it can provide for clearly-stated exclusions in maritime insurance contracts); *Federated Mut. Ins. Co., Inc. v. Vaughn*, 961 So.2d 816, 818–19 (Ala. 2007) (where a statute clearly gives a right to insurers to deny uninsured motorist coverage, the insurer has the right to act on such a provision in its policy); *ABT Bldg. Prod. Corp. v. Nat’l Union Fire Ins. Co. of Pittsburgh*, 472 F.3d 99, 116 (4th Cir. 2006) (stating the strict *contra proferentem* doctrine under North Carolina law); *United Servs. Auto. Ass’n v. Riley*, 899 A.2d 819, 833 (Md. 2006) (where an insurance policy is unambiguous in light of what a reasonable person would understand by reading it, the job of the court is finished); *Moscarillo v. Prof’l Risk Mgmt. Servs., Inc.*, 921 A.2d 245, 251 (Md. 2007) (quoting *Litz v. State Farm Fire & Cas. Co.*, 695 A.2d 566, 569 (Md. 1997)) (“An insurance contract, like any other contract, is measured by its terms unless a statute, a regulation, or public policy is violated thereby”; the court, at 571, also recognized the *contra proferentem* rule as used in *St. Paul Fire & Marine Ins. Co. v. Pryseski*, 438 A.2d 282, 288 (Md. 1981), which allows the rule only after extrinsic evidence is allowed; thus, Maryland seems to be one state that truly does apply ordinary contractual principles to insurance policies).

authority to abandon or modify state courts' consumer protections. Further, most of the cases cited are merely persuasive authority and would be of little help to her argument if they were binding authority. In some cases, courts give lip service to traditional contractual principles only to go on to apply insurance-specific doctrines meant to protect consumers. Thus, in many of the states with which she finds fault, courts state that they will apply ordinary contract principles in one sentence but then invoke consumer-protective doctrines in the next.⁹⁷ In her discussion, Randall does not show that any specific state, recently or otherwise, has moved away from consumer protection. Further, she does not demonstrate that the differences in consumer protection across states mean that state courts across the country are *generally* abandoning consumers. The opposite is true: consumers are more protected today than ever, thanks to both legislative and judicial action.

This section addresses each of Randall's three doctrinal concerns in turn, illustrating that both the courts and legislatures are well aware of consumers, as illustrated by the existence and use of the three doctrines she discusses, in addition to the doctrine of unconscionability and numerous statutory protections.

1. Strong *Contra Proferentem* Doctrine

Randall asserts that her claim is immediately necessary because courts have recently begun applying ordinary contract law in resolving insurance policy disputes by using *contra proferentem* only as a last resort.⁹⁸ To support this claim, she cites cases from New York, Washington, North Dakota, New Jersey, Pennsylvania, Arkansas, Maryland, and New Mexico that turn out, under close examination, to be of little help to her thesis both because these states are internally consistent and because the cases themselves do not repudiate consumer protection. These cases do not recently reject consumer protection because (1) the current *contra proferentem* rules in these jurisdictions are not "recent;" (2) some of them actually provide peculiarly strong

⁹⁷ As a clear example, see *Pendergest-Holt v. Certain Underwriters at Lloyd's of London*, 600 F.3d 562, 569 (5th Cir. 2010), quoted in Part III(A). There, the court states that it will apply traditional contract principles, but then goes on to articulate the strong version of the *contra proferentem* doctrine. *Pendergest-Holt*, 600 F.3d at 569.

⁹⁸ Randall, *Freedom of Contract*, *supra* note 2, at 120.

protection for consumers; and (3) even in those jurisdictions without the strong rule, *contra proferentem* acts as the strong rule in most cases because there is no extrinsic evidence to apply.

Randall begins with a case applying New York law,⁹⁹ one that oddly did not involve *contra proferentem* or the construction of language against the drafter. There, the Seventh Circuit found that a shipyard corporation had to pay continuing benefits to a worker harmed while on the job because it did not notify the secondary insurer of its obligation for some five months after the primary insurer's insolvency and the Department of Labor's notification to the shipyard of the corporation's continuing duties.¹⁰⁰ Under the policy's plain terms, the court found that New York law applied and precluded coverage.¹⁰¹ In its background section, the court *did* state that extrinsic evidence cannot be used unless there is an ambiguity in the contract,¹⁰² perhaps implying that the *contra proferentem* doctrine could not apply until extrinsic evidence had been explored. However, the court did not have a chance to apply this possibility because neither party claimed that the contract was ambiguous. Indeed, the Seventh Circuit had no authority to move New York law away from consumer protection even if it had tried. Due to the case's irrelevance to her thesis, Professor Randall's purpose for using it is unclear.¹⁰³ A better summary of the New York law of *contra proferentem* is seen in the case *In re Liberty Mut. Fire Ins. Co. (Malatino)*,¹⁰⁴ which states that "[g]enerally, 'policies of insurance are to be construed liberally in favor of the insured and strictly against the insurer.'"¹⁰⁵ It also states that, "[w]here ambiguity exists as to coverage, doubt should be resolved in favor of the insured."¹⁰⁶ These cases paint a much more liberal usage of *contra proferentem* in New York than Randall implies; indeed, the cases indicate that courts are to liberally construe insurance

⁹⁹ *St. Paul Travelers Cos., Inc. v. Corn Island Shipyard, Inc.*, 495 F.3d 376 (7th Cir. 2007) (applying New York law).

¹⁰⁰ *Id.* at 379, 384–87.

¹⁰¹ *Id.* at 386.

¹⁰² *Id.* at 383.

¹⁰³ *Id.* at 384.

¹⁰⁴ 75 A.D.3d 967 (N.Y. App. Div. 2010).

¹⁰⁵ *Id.* at 967–69 (quoting *Penna v. Fed. Ins. Co.*, 28 A.D.3d 731, 731, (N.Y. 2006)) (also citing *Gov't Empls. Ins. Co. v. Kligler*, 366 N.E.2d 865 (N.Y. 1977); *Turkow v. Erie Ins. Co.*, 20 A.D.3d 649, 650 (N.Y. App. Div. 2005)).

¹⁰⁶ *Id.* (citing *Handelsman v. Sea Ins. Co.*, 647 N.E.2d 1258 (N.Y. 1994); and *Penna*, 28 A.D.3d at 731).

policies in favor of the insured. Finally, it is worth noting that in *Malatino*,¹⁰⁷ *Penna*,¹⁰⁸ and other New York cases,¹⁰⁹ the court did not resort to extrinsic evidence until after construing an ambiguity in favor of the insured, even though some federal courts applying New York law have used extrinsic evidence in their analysis.¹¹⁰ Thus, New York law has been stable and protective of consumers for a very long time.

After New York, Randall moves on to Washington, implying that courts there have recently repudiated the strong *contra proferentem* doctrine; she cites *Willing v. Cmty. Ass'n Underwriters of Am., Inc.*¹¹¹ In that case, the court did not rely on extrinsic evidence of the parties' intent; rather, it construed the contract against the insurer without reference to extrinsic evidence — even though it stated that the general *contra proferentem* rule in Washington would allow for extrinsic evidence before construing the contract against the insurer.¹¹² There was no extrinsic evidence to apply in *Willing*, as is often true in policy disputes, because “contracts of insurance ordinarily consist either of provisions required by statute or of preprinted, industry-drafted forms that are rarely subject to the sort of negotiation that would produce useful extrinsic evidence.”¹¹³ Therefore, the law in Washington is that if an ambiguity is detected, extrinsic evidence (which will likely be available only if the insured is sophisticated enough to actually negotiate, or at

¹⁰⁷ *Malatino*, 75 A.D.3d at 970.

¹⁰⁸ *Penna*, 28 A.D.3d at 731–32.

¹⁰⁹ *Nassau Plaza Assocs., L.P. v. Greater N.Y. Mut. Ins. Co.*, 74 A.D.3d 1159 (N.Y. App. Div. 2010); *Markotsis v. Zurich Ins. Co.*, No. 4723/07, 2008 WL 2446332 (N.Y. Sup. Ct. April 15, 2008); *Liberty Mut. Fire Ins. Co. v. Nat'l Cas. Co.*, 47 A.D.3d 770, 771 (N.Y. App. Div. 2008) (citing *Hartol Prods. Corp. v. Prudential Ins. Co. of Am.*, 47 N.E.2d 687, 690 (N.Y. 1943)); *NIACC, LLC v. Greenwich Ins. Co.*, 51 A.D.3d 883, 884 (N.Y. App. Div. 2008) (citing *Mostow v. State Farm Ins. Cos.*, 668 N.E.2d 392, 423 (N.Y. 1996), which held that “ambiguities in an insurance policy should be construed in favor of the insured and against the insurer” and did not apply extrinsic evidence before using the *contra proferentem* doctrine).

¹¹⁰ *See, e.g., Morgan Stanley Group Inc. v. New England Ins. Co.*, 225 F.3d 270, 276 (2d Cir. 2000) (citing other federal cases to support the notion that extrinsic evidence is to be used before applying *contra proferentem*).

¹¹¹ No. C06-1357RSL, 2007 WL 1991038 (W.D. Wash. July 5, 2007).

¹¹² *Id.* at *2.

¹¹³ *Andres v. Am. Std. Ins. Co. of Wis.*, 134 P.3d 1061, 1063 (Or. App. 2006). Extrinsic evidence in insurance cases is, as Randall recognizes in note 41 of her article, rare. Randall, *supra* note 2, at 121 n. 41.

least debate or explain, policy terms) is allowed before the *contra proferentem* rule is applied. However, since extrinsic evidence is normally unavailable as to the parties' intent, the *contra proferentem* rule in Washington usually functions like the strong *contra proferentem* rule in resolving ambiguities in favor of insureds — particularly because Washington courts first look to the plain, ordinary, and popular meaning of undefined terms rather than the parties' particular meaning, providing more opportunity to the court to find ambiguity since the insurer's specialized meaning is not permitted.¹¹⁴ Additionally, the rule is even more favorable to consumers in certain contexts: "The rule strictly construing ambiguities in favor of the insured applies with added force to exclusionary clauses which seek to limit policy coverage."¹¹⁵ Finally, even if Washington's rule is a slight practical departure from the strong *contra proferentem* rule, it is not a recent departure that the state legislature has had time, if desired, to address.¹¹⁶

Professor Randall also implies that North Dakota common law has recently moved away from the strong *contra proferentem* doctrine, citing *Sloan v. Hartford Life & Accident Ins. Co.*, which used the doctrine in the context of an ERISA plan—a context governed by federal law.¹¹⁷ There, the federal district court, which was reviewing a Social Security Administration decision de novo, noted that "[t]he district court may admit evidence outside the record in a case involving the denial of ERISA benefits if the participant shows good cause."¹¹⁸ While *contra proferentem* might not be as strong in North Dakota courts when evaluating administrative adjudicatory pronouncements over ERISA plans, North Dakota generally has adhered to a strong

¹¹⁴ See *Holden v. Farmers Ins. Co. of Wash.*, 239 P.3d 344, 347 (Wash. 2010).

¹¹⁵ *Am. Star Ins. Co. v. Grice*, 854 P.2d 622, 625 (Wash. 1993), *aff'd en banc*, 865 P.2d 507 (Wash. 1994).

¹¹⁶ See, e.g., *Shotwell v. Transamerica Title Ins. Co.*, 588 P.2d 208, 212 (Wash. 1978) (applying extrinsic evidence and stating the general rule that ambiguities should be construed against insurer).

¹¹⁷ 433 F. Supp. 2d 1037, 1048 (D.N.D. 2006), *aff'd*, 475 F.3d 999 (8th Cir. 2007) (if ERISA plan is deemed ambiguous, extrinsic evidence may be considered; "any ambiguities should be construed against drafter only as a last step").

¹¹⁸ *Id.* at 1038–39 (citing *Ferrari v. Teachers Ins. & Annuity Ass'n*, 278 F.3d 801, 807 (8th Cir. 2002)).

version of *contra proferentem* in insurance policy disputes.¹¹⁹ The extremely limited and federally-controlled area of ERISA should not guide, and it is no indicator of, North Dakota's stance on insurance policy interpretation generally.

Next, Randall cites a New Jersey case, *McNeilab, Inc. v. North River Ins. Co.*,¹²⁰ as an example. In a federal decision more than twenty years old, the court in *McNeilab* simply noted that, while the general rule in New Jersey is to strictly construe insurance contracts against the insurer, large, sophisticated insureds (here, the enormous Johnson & Johnson) should not be subject to the same favorable treatment.¹²¹ Indeed, the general New Jersey rule is as follows:

If the terms are not clear, but instead are ambiguous, they are construed against the insurer and in favor of the insured, in order to give effect to the insured's reasonable expectations. This is so even if a 'close reading' might yield a different outcome, or if a 'painstaking' analysis would have alerted the insured that there would be no coverage.¹²²

This combination of reasonable expectations with the ambiguity doctrine offers particularly strong protection for New Jersey

¹¹⁹ *Fisher v. Am. Family Mut. Ins. Co.*, 579 N.W.2d 599, 602 (N.D. 1998) (“[A] term in an insurance policy should be construed ‘to mean what a reasonable person in the position of the insured would think it meant.’ ‘Limitations or exclusions from broad coverage must be clear and explicit.’ ‘[W]hen the language of an insurance policy is clear and explicit, the language should not be strained in order to impose liability on the insurer.’ However, any ambiguity or reasonable doubt as to the meaning of an insurance policy is strictly construed against the insurer and in favor of the insured. ‘If the language in an insurance contract will support an interpretation which will impose liability on the insurer and one which will not, the former interpretation will be adopted.’”) (internal citations omitted). Note that there is no mention or use of extrinsic evidence of the parties' intent at the time of contract formation. However, there may be certain instances in which extrinsic evidence is allowed: “[I]n rare [insurance] cases, parol evidence may be used to decipher the intention of the parties.” *Hanneman v. Cont'l W. Ins. Co.*, 575 N.W.2d 445, 451 (N.D. 1998).

¹²⁰ 645 F. Supp. 525 (D.N.J. 1986).

¹²¹ *Id.* at 546.

¹²² *Flomerfelt v. Cardiello*, 997 A.2d 991, 996 (N.J. 2010) (internal citations omitted).

consumers.¹²³ However, at least in the context of coverage disputes between sophisticated insurance companies, extrinsic evidence is allowed.¹²⁴

Next, Professor Randall uses Pennsylvania law as an example, citing *Rich Maid Kitchens, Inc. v. Pa. Lumbermens Mut. Ins. Co.*¹²⁵ The court in that case did not apply *contra proferentem*.¹²⁶ The general Pennsylvania rule is: “Where a provision of a policy is ambiguous [(meaning that it is reasonably susceptible to different constructions and capable of being understood in more than one sense)], the policy provision is to be construed in favor of the insured and against the insurer.”¹²⁷ Although this definition does not preclude the use of extrinsic evidence, such use is rare outside the context of sophisticated insureds.¹²⁸ Further, the principles found in Pennsylvania’s rules have been around for many years, suggesting that regulators have had plenty of time to recognize and resolve problems with contract interpretation that may harm consumers.¹²⁹

Professor Randall cites Arkansas law next, namely *State Auto Prop. & Cas. Ins. Co. v. Ark. Dep’t of Env’tl. Quality*.¹³⁰

¹²³ See *Doto v. Russo*, 659 A.2d 1371, 1376–77 (N.J. 1995) (giving clear explanation of full protection afforded by the mixed doctrines of reasonable expectations and *contra proferentem*).

¹²⁴ *Chubb Custom Ins. Co. v. Prudential Ins. Co. of Am.*, 948 A.2d 1285, 1289 (N.J. 2008) (stating that extrinsic evidence can be used in the context of one insurance company suing another over meaning of insured company’s policy; court went on to use history of disputed term to inform interpretation). For more on the special *contra proferentem* application for sophisticated insureds and insurer disputes, see COUCH ON INSURANCE, *supra* note 7, at § 22:24.

¹²⁵ 641 F. Supp. 297 (E.D. Pa. 1986).

¹²⁶ *Id.*

¹²⁷ *Madison Const. Co. v. Harleysville Mut. Ins. Co.*, 735 A.2d 100, 106 (Pa. 1999); see also *Kropa v. Gateway Ford*, 974 A.2d 502, 508 (Pa. Super. Ct. 2009).

¹²⁸ See, e.g., *Sunbeam Corp. v. Liberty Mut. Ins. Co.*, 781 A.2d 1189, 1192 (Pa. 2001) (allowing trade usage of term, to inform court’s decision as between Sunbeam Corp. and its insurer, even though contract was unambiguous); *Harbor Ins. Co. v. Lewis*, 562 F. Supp. 800, 803 (E.D. Pa. 1983) (allowing extrinsic evidence to inform the meaning of terms of an agreement between sophisticated parties); see also 1 BJORKMAN, ET AL., *supra* note 87, at § 1:11 (noting that *contra proferentem* rule in Pennsylvania is usually strict against insurer, unless insured has negotiated terms of contract).

¹²⁹ See, e.g., *Brams v. N.Y. Life Ins. Co.*, 148 A. 855, 856 (Pa. 1930) (stating general rules of *contra proferentem*).

¹³⁰ 258 S.W.3d 736 (Ark. 2007); see also *Gilstrap v. Jackson*, 601 S.W.2d

There, the court noted that the general rule of insurance policy interpretation was that any ambiguities would be “construed liberally in favor of the insured”; the holding went on to recognize that “an exception to this general rule [is] where disputed extrinsic evidence is offered to establish what the ambiguous language means.”¹³¹ However, the Arkansas courts sometimes use extrinsic evidence to *create* an ambiguity, which can then be construed against the insurer.¹³² This consumer-friendly option would normally be precluded by the more general rule that an ambiguity only arises if two reasonable interpretations can be made when the term is construed in its “plain, ordinary, popular sense.”¹³³ Additionally, as is common of insurance contract disputes elsewhere, many cases in Arkansas do not use extrinsic evidence before applying the *contra proferentem* doctrine.¹³⁴ It appears that courts either use the doctrine loosely to justify their holdings, or more likely have no extrinsic evidence to apply. Finally, Arkansas is not a state that has only *recently* repudiated the strong *contra proferentem* doctrine or created uncertainty as to the rule; as with other states, the legislature has had many years to resolve any problems it sees with courts’ protection of consumers.¹³⁵

Randall also uses Maryland law as an example, citing *Collier v. MD-Individual Practice Ass’n*.¹³⁶ The *Collier* court stated that, in Maryland, “[w]e do not follow the rule, adopted in some states, that insurance policies are to be construed most

270 (Ark. Ct. App. 1980); *Elam v. First Unum Life Ins. Co.*, 57 S.W.3d 165 (Ark. 2001).

¹³¹ *State Auto*, 258 S.W.3d at 743.

¹³² *McGrew v. Farm Bureau Mut. Ins. Co. of Ark., Inc.*, 268 S.W.3d 890 (Ark. 2007).

¹³³ *Norris v. State Farm Fire & Cas. Co.*, 16 S.W.3d 242, 244 (Ark. 2000); accord Hon. Randall H. Warner, *All Mixed Up About Contract: When Is Contract Interpretation A Legal Question and When Is It A Fact Question?*, 5 VA. L. & BUS. REV. 81 (2010).

¹³⁴ See, e.g., *Norris*, 16 S.W.3d at 246 (where mother of boy who injured appellant’s son — a very sympathetic plaintiff — was found to be covered by insurer’s duty to defend and provide liability coverage due to ambiguity); *Gawrieh v. Scottsdale Ins. Co.*, 117 S.W.3d 634, 640 (Ark. Ct. App. 2003) (finding ambiguity in night club’s liability policy, thereby requiring partial coverage for shooting death and injuries).

¹³⁵ See, e.g., *Pizza Hut of Am., Inc. v. W. Gen. Ins. Co.*, 816 S.W.2d 638 (Ark. Ct. App. 1991).

¹³⁶ 607 A.2d 537, 539 (Md. 1992).

strongly against the insurer.”¹³⁷ Thus, the rule is that when ambiguity is still present after the court considers extrinsic evidence, the term will be construed against the drafter. This rule seems to be followed in both first-party¹³⁸ and third-party coverage.¹³⁹ Even though most cases of ambiguity will have little extrinsic evidence to apply, Maryland’s rule is not an iteration of the strong *contra proferentem* doctrine. Yet, contrary to Randall’s inference, nothing about Maryland’s rule is a “recent” departure from the strong *contra proferentem* doctrine; its rule has been consistent for more than one hundred years.¹⁴⁰ Further, as noted in subsection IV(a)(3), *infra*, Maryland’s legislature is well aware of consumers.

Finally, Randall uses the New Mexico case of *Bird v. State Farm Mut. Auto. Ins. Co.* as an example of courts’ repudiation of the strong *contra proferentem* doctrine.¹⁴¹ There, extrinsic evidence was allowed to inform an ambiguity before the contract was construed against the insurer.¹⁴² However, one key to modern policy interpretation in New Mexico is that, as in Arkansas, the courts follow an express policy of allowing extrinsic evidence to *create* an ambiguity that then benefits the consumer. When a rule allows the *creation* of ambiguities in a contract that is clear and unambiguous within its four corners, and when those ambiguities will, by the rule’s definition, favor the insured, that rule provides a protection to consumers that even the strong version of *contra proferentem* — which applies only when an ambiguity arises from the four corners of the document — does not provide. The New Mexico Supreme Court applied this doctrine in *Ponder v. State Farm Mut. Auto. Ins. Co.*,¹⁴³ in which nothing within the four corners of the insurance policy was ambiguous.¹⁴⁴ The policy clearly excluded the plaintiff from recovering a large sum of money from her parents’ automobile

¹³⁷ *Id.*

¹³⁸ *See, e.g., Nat’l Union Fire Ins. Co. v. CSX Corp.*, 131 F.3d 135 (4th Cir. 1997) (concerning life insurance policy).

¹³⁹ *See, e.g., Chang v. Brethren Mut. Ins. Co.*, 897 A.2d 854, 858 (Md. Ct. Spec. App. 2006) (concerning liability policy).

¹⁴⁰ *See Planters’ Mut. Ins. Co. v. Deford*, 38 Md. 382, 403 (1873); *see also Pac. Indem. Co. v. Interstate Fire & Cas. Co.*, 488 A.2d 486, 489 (Md. 1985).

¹⁴¹ *Bird v. State Farm Mut. Auto. Ins. Co.*, 165 P.3d 343 (N.M. Ct. App. 2007); *see also Rummel v. Lexington Ins. Co.*, 945 P.2d 970 (N.M. 1997).

¹⁴² *Bird*, 165 P.3d at 347.

¹⁴³ 12 P.3d 960 (N.M. 2000).

¹⁴⁴ *Id.* at 965.

insurer because at the time of her accident she was both married and living away from home, but the court allowed an ambiguity to be created by way of extrinsic evidence and then construed that ambiguity in favor of the insured.¹⁴⁵ Even in many states with “strong” *contra proferentem* rules, the plaintiff’s case would have ended when the court saw how clear the policy language was. Thus, even though ambiguities arising out of the four corners of the document can be resolved by extrinsic evidence — something that weakens the strong *contra proferentem* doctrine — the fact that ambiguities can be created by extrinsic evidence in the first instance allows the *contra proferentem* doctrine to favor the insured in situations otherwise precluding recovery. Finally, in addition to this strong protection, New Mexico courts have been using their version of the doctrine for some time.¹⁴⁶

Assuming that Randall cites the cases most favorable to her argument, her claim that the courts are moving away from the protection of the *contra proferentem* doctrine, particularly that they are moving away rapidly or recently, is simply invalid. In fact, even the normal *contra proferentem* doctrine, which allows extrinsic evidence to clarify an ambiguity before construing the contract against the insured, almost certainly protects nearly all insureds as much as the strong *contra proferentem* doctrine because, given the standardized application process, there is little or no evidence of the parties’ intent for courts to apply before favoring the insured; additionally, even where extrinsic evidence is allowed, insureds often want it admitted because it will favor them (or at least reflect their intent), either by its clarification or its reinforcement of ambiguity, which will almost certainly be resolved in their favor.¹⁴⁷

¹⁴⁵ *Id.* at 965–66.

¹⁴⁶ For a discussion of the history of New Mexico courts’ usage of extrinsic evidence to inform ambiguities, see *Jaramillo v. Providence Wash. Ins. Co.*, 871 P.2d 1343, 1347 (1994) (stating that the Supreme Court moved away from the four corners approach in 1987 for contracts generally, and that in 1991 and 1993 it had specifically applied the new rule to insurance contracts; note that the court, even in 1994, recognized that extrinsic evidence was to be used to “determine whether the parties’ words are ambiguous,” thereby leaving the door open for courts to create ambiguities out of consideration of extrinsic evidence.).

¹⁴⁷ See STEMPER ON INSURANCE CONTRACTS, *supra* note 3, at § 4.08[E] (“In insurance cases, the theoretically disadvantaged often have more effective weapons at their disposal and may argue for the admission of extrinsic

Even in states applying the normal *contra proferentem* doctrine, extrinsic evidence is only remotely possible, but certainly not a necessary, antecedent to applying the doctrine. This is evidenced by the many cases that, although decided in a state allowing extrinsic evidence, do not hold that such evidence may be part of the equation; such economy of words is likely brought on because in those cases there is no extrinsic evidence as to the parties' mutual intent. Finally, if there is extrinsic evidence of mutual intent, it would be at the very least an indication that the insured understood what she was purchasing and thus is not the passive, hapless consumer that the strong version of the doctrine is meant to protect.

2. Reasonable Expectations Doctrine

Professor Randall attempts to prove that the pure form of Professor Keeton's¹⁴⁸ reasonable expectations doctrine, which allows an insured's reasonable expectations to trump even clear policy language, has all but disappeared, even while failing to show that it ever held much sway in its original form. She states, "[t]he doctrine of reasonable expectations *has given way* to firm judicial pronouncements about enforcing unambiguous policies as written."¹⁴⁹ Actually, the reasonable expectations doctrine never took hold in most states in its pure form, was confusing and uncertain in jurisdictions that did use it, and is commonly seen as a failed and untenable doctrine.¹⁵⁰ Today, as Professor Randall states, a majority of jurisdictions apply reasonable expectations as a complement to the *contra proferentem* doctrine; after an ambiguity is shown, the reasonable expectations of the insured will trump the insurer's explanation of the policy's terms either before or after the use of extrinsic evidence to clarify the ambiguity.¹⁵¹ Thus, while it is true that the pure form of the

evidence.”).

¹⁴⁸ Keeton, *supra* note 6.

¹⁴⁹ Randall, *Freedom of Contract*, *supra* note 2, at 111 (emphasis added).

¹⁵⁰ See Roger C. Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L.J. 823, 824 (1990) (stating that only sixteen states had adopted the doctrine, some of which never accepted its pure form); Susan M. Popik & Carol D. Quackenbos, *Reasonable Expectations after Thirty Years: A Failed Doctrine*, 5 CONN. INS. L.J. 425 (1998) (concluding that problems inherent in the doctrine itself account for its failure to develop into a coherent, principled body of law).

¹⁵¹ Randall, *Freedom of Contract*, *supra* note 2, at 114–15.

reasonable expectations doctrine does not currently exist in almost all states, the doctrine was never popular, rarely predictable, and not even theoretically justified.¹⁵² There is little wonder why most states that ever used it have rejected it.

The doctrine in its pure form would appear to be helpful to consumers, but it would almost certainly harm them by contributing to inconsistency and unpredictability that would raise transaction costs, including litigation costs.¹⁵³ That is, the doctrine would harm consumers by creating uncertainty; moreover, insurance underwriters would not know whether their clear, unambiguous contractual language — although approved by the insurance department of both the state in question and those of other states — would be held up in court.¹⁵⁴ This uncertainty would lead to higher premiums and/or narrower coverage since insurers would have to spend more time and money negotiating terms, understanding and recording the consumer's expectations from the outset, litigating disputes, and paying attorneys' fees.

Further, with judges making ad hoc decisions based on each plaintiff's potentially reasonable expectations, precedent could hardly guide present or future decisions. Indeed, each successful plaintiff, with different traits and under divergent circumstances, could be seen as creating a new standard. As one commentator observed on the economic disincentives such a doctrine would create: “[i]nsurers must know with certainty that contract language will be judicially respected. Absent such certainty, only the most cavalier insurer would attempt to write business.”¹⁵⁵ With such uncertainty, insurers would have to begin

¹⁵² Jeffrey E. Thomas, *An Interdisciplinary Critique of the Reasonable Expectations Doctrine*, 5 CONN. INS. L.J. 295, 296 (1998) (noting that insureds are unlikely to develop specific expectations from interactions with their agents and that insureds generally misunderstand basic coverage and exclusions anyway; thus, the theoretical justification for the doctrine that insureds have expectations when they purchase coverage is unjustified).

¹⁵³ For one of the many economic arguments against the pure reasonable expectations doctrine, see Stephen J. Ware, *A Critique of the Reasonable Expectations Doctrine*, 56 U. CHI. L. REV. 1462, 1476–93 (1989) (showing that the reasonable expectations doctrine is harmful from an economic standpoint, since it would decrease predictability and certainty, thereby leading to higher transaction costs — including court costs).

¹⁵⁴ Popik & Quackenbos, *supra* note 150, at 431–32.

¹⁵⁵ Michael E. Bragg, *Concurrent Causation and the Art of Policy Drafting: New Perils for Property Insurers*, 20 FORUM 385 (1985).

charging premiums that accurately reflected the risk to them, which would necessarily include the risk that a court might determine a particular plaintiff's expectations to be reasonable. In short, to remain solvent, insurers would either increase rates or narrow the breadth of coverage offered – both exacerbating the effects on a likely already-vulnerable consumer.¹⁵⁶

Additionally, since the pure doctrine would in a sense call the entire contract into question in every instance, and since each plaintiff would offer a fact-intensive problem of whether she in fact had a reasonable expectation of coverage at the time she signed her application, transaction costs in the form of attorney's fees and court costs would skyrocket, further raising rates.¹⁵⁷

Thus, the pure reasonable expectations doctrine was a failure from the start, especially from a consumer standpoint, and nearly all courts have rightly rejected it or applied it only after ambiguity is shown. Given its anti-consumer effects, Professor Randall's advocacy of the doctrine is peculiar to say the least.

3. Bad Faith Actions Sounding in Tort

Professor Randall claims that courts have recently begun shifting bad faith from a cause of action in tort to one arising under contract alone; as a result, she asserts, insureds in many third-party cases (and some first-party cases) suffer because they can only recover consequential damages if they are covered by the insurance policy; whereas, if they were allowed a private action in tort, they would be able to recover for consequential damages regardless of whether they were covered by the insurance policy.¹⁵⁸ There are numerous problems with her position. First, courts have been largely consistent over the years, steadily finding the bad faith cause of action to sound in contract, tort, or both. Second, in most states, remedies are largely the same regardless of whether the cause of action sounds in tort or in contract. Finally, the protection from bad faith has in fact been expanding lately, not shrinking, and consumers are heavily defended both by statute and common law.

Professor Randall does not indicate how a tort-based rather than a flexible, contract-based cause of action would be so favorable to insureds in this area, and even states that “[t]he

¹⁵⁶ Popik & Quackenbos, *supra* note 150, at 432.

¹⁵⁷ *Id.*

¹⁵⁸ Randall, *Freedom of Contract*, *supra* note 2, at 118–19.

classification may be inconsequential in some instances, since contract remedies, flexibly applied, can afford full compensation in many cases.¹⁵⁹ Significant differences between a bad faith contract claim and a bad faith tort claim can arise in certain cases, but not all of these differences favor tort as the preferred consumer-protective source. Perhaps the main differences between allowing a bad faith claim in tort versus contract are: “(1) [where] the claim is characterized as a tort, generally a shorter limitation period applies; (2) classifying it as a contract claim may affect whether the claim is assignable to a third party; . . . (3) if the claim sounds in tort, a broader measure of damages may be available to the insured”;¹⁶⁰ and (4) the strict liability standard of care in bad faith contract cases is easier for consumers to meet than the negligence or intentional standards of bad faith tort cases¹⁶¹ — that is, if the cause of action is found under contract, the question is often not whether the insurer negligently or intentionally caused harm, but only whether the insurer breached.¹⁶² From a consumer standpoint, two of these factors — (1) and (4) — favor contract, and the remaining two favor tort. The superiority of a tort claim is unclear where states apply contractual remedies flexibly, especially in insurance cases.

“In addition to insurance custom and practice and common law judicial precedent, statutory law usually establishes a right of action for any policyholder who is the victim of an unfair claim practice.”¹⁶³ Even statutes that do not provide a cause of action can establish a benchmark against which courts can measure insurer actions to determine whether common law bad faith is established. At the very least, violation of the statute is evidence that the insurer acted in bad faith.¹⁶⁴ Additionally,

¹⁵⁹ *Id.* (citing JERRY, *supra* note 54, at § 25G, (3d ed. 2002)).

¹⁶⁰ BJORKMAN, ET AL., *supra* note 87, at § 29:20.

¹⁶¹ BAKER, *supra* note 8, at 111.

¹⁶² *See, e.g., Id.* (citing *Hayseeds, Inc. v. State Farm Fire & Cas.*, 352 S.E.2d 73, 78–79 (W. Va. 1986), for proposition that insureds should be entitled to strict liability standard against their insurers.). In *Hayseeds*, the court stated: “[W]e hold today that when a policyholder substantially prevails in a property damage suit against an insurer, the policyholder is entitled to damages for net economic loss caused by the delay in settlement, as well as an award for aggravation and inconvenience.” *Id.* at 80. An exception to this dichotomy is found in *Pickett v. Lloyd’s*, 621 A.2d 445 (N.J. 1993) (applying quasi-negligence standard to bad faith stemming from contract).

¹⁶³ STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, at § 10.03[E].

¹⁶⁴ KENT & BARKER, *supra* note 84, at § 10.05

states have adopted, usually with minor modifications, a version of NAIC's Unfair Methods of Competition and Unfair and Deceptive Practices in the Business of Insurance model act, under which the states provide an avenue for insurer punishment and, in some jurisdictions, another private cause of action, whether explicit or implied in the statute.¹⁶⁵

Indeed, states have generally been expanding the availability of bad faith claims both by the common law and by statute. Both legislatures and courts have been well aware of this issue for some time. Particularly, many of the cases that Professor Randall cites come from jurisdictions with either a common law or statutory remedy for bad faith. For example, she cites a first-party case¹⁶⁶ based on Maryland law as one of a "significant number of recent decisions stat[ing] that contract rather than tort provides the theoretical basis for bad faith breach in first-party as well as third-party actions."¹⁶⁷ Yet the explicit Maryland rule that common law bad faith actions are based in contract dates at least to 1961, with roots extending to 1904.¹⁶⁸ More importantly, in 2007, the Maryland legislature passed a law giving insureds the ability to sue insurers for first-party bad faith in property and casualty disputes.¹⁶⁹ This statute is perhaps the starkest example of why Professor Randall's proposal should not be adopted by courts. The Maryland courts, by applying consistent contract-based law for decades, gave the legislature a predictable judicial landscape against which elected lawmakers could adopt a rule fitting the policy needs of the state, which in this instance was a private cause of action for first-party breach of good faith claims. Since the passage of the statute, it has been liberally construed to

¹⁶⁵ See *id.* at § 10.04 (citing numerous state approaches and giving nuances of each).

¹⁶⁶ *Hartz v. Liberty Mut. Ins. Co.*, 269 F.3d 474, 476 (4th Cir. 2001).

¹⁶⁷ Randall, *Freedom of Contract*, *supra* note 2, at 118.

¹⁶⁸ See *Mesmer v. Md. Auto. Ins. Fund*, 725 A.2d 1053, 1059 (Md. 1999) ("[I]t is only when a breach of contract is also a violation of a duty imposed by law that the injured party has a choice of remedies.") (quoting *Heckrotte v. Riddle*, 168 A.2d 879, 881–82 (Md. 1961). See also *Samuel v. Novak*, 58 A. 19, 20 (Md. 1904). Randall gives no indication that this long-standing doctrine has ever been used differently in insurance cases in Maryland. Indeed, even as early as 1988, the Court of Special Appeals of Maryland stated, "We are aware of no Maryland cases which recognize as a tort action the bad faith failure of an insurer to pay a first party claim." *Johnson v. Fed. Kemper Ins. Co.*, 536 A.2d 1211, 1213 (Md. Ct. Spec. App. 1988). Thus, this is not a new concept in Maryland.

¹⁶⁹ MD. CODE ANN., CTS. & JUD. PROC. § 3-1701 (West 2010).

favor insureds.¹⁷⁰

Other cases from jurisdictions that are currently moving bad faith from tort to contract are similarly unresponsive of Randall's argument that consumers are at a disadvantage in first-party¹⁷¹ and third-party¹⁷² claims. Additionally, there is little

¹⁷⁰ See, e.g., *Cecilia Schwaber Trust Two v. Hartford Acc. & Indem. Co.*, 636 F. Supp. 2d 481, 486 (D. Md. 2009) (rejecting, in favor of a broad interpretation of the statute, the oft-limiting "fairly debatable standard" used by many courts to allow bad faith suits only where payment is not fairly debatable).

¹⁷¹ Randall, *Freedom of Contract*, *supra* note 2, at 118 n.31. For example, she offers *Coleman Dupont Homsey v. Vigilant Ins. Co.*, 496 F. Supp. 2d 433, 437 (D. Del. 2007), but first-party claims of bad faith have been based in contract in Delaware for fifteen years. See *Tackett v. State Farm Fire & Cas. Ins. Co.*, 653 A.2d 254, 256 (Del. 1995). Further, Delaware allows recovery under the contractual remedy of bad faith for costs and fees, plus expectation and consequential damages. See, e.g., Sharon Tennyson & William J. Warfel, *The Emergence and Potential Consequences of First-Party Insurance Bad-Faith Liability*, 28 J. INS. REG. 3, 7 (2008). Under Virginia law, for which Randall cites *HHC Assocs. v. Assurance Co. of Am.*, 256 F. Supp. 2d 505, 508 (E.D. Va. 2003), bad faith actions have sounded in contract law since at least 1966. See, generally, *Aetna Cas. & Sur. Co. v. Price*, 146 S.E.2d 220, 228 (Va. 1966). However, Virginia courts allow for expanded, tort-like damages in bad faith claims. See *Levine v. Selective Ins. Co. of Am.*, 462 S.E.2d 81 (Va. 1995). Further, a Virginia statute, VA. CODE ANN. § 38.2-209 (West 2010), and its citing decisions (including *Price*) have addressed this issue, providing that individuals who win bad faith disputes against insurers are able to recover, in addition to the contractual payment, costs and fees rather than tort damages. Thus, at least in Virginia, Randall's fear that courts have been recently reverting to contract principles is unfounded; further, the legislature has spoken on the issue and is thus aware of judicial interpretations. Randall's New Jersey example, *Pickett v. Lloyd's*, 621 A.2d 445, 452 (N.J. 1993), clearly cuts against her argument because there the court states that, "Compensation should not be dependent on what label we place on an action but rather on the nature of the injury inflicted on the plaintiff and the remedies requested. An insurance company's breach of the fiduciary obligation imposed by virtue of its policy, by its wrongful failure to settle, 'sounds in both tort and contract.'" *Pickett*, 621 A.2d at 452 (citing *Rova Farms Resort, Inc. v. Investors Ins. Co. of Am.*, 323 A.2d 495 (N.J. 1974)). The court went on to expand the remedies available under contract, while imposing a negligence-like standard of care. With *Rova Farms*, New Jersey became one of the first states to address the first-party cause of action sounding in tort by mixing it with contract law shortly after California led the way in 1973. *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032 (Cal. 1973). For a discussion, see *Walsh Sec., Inc. v. Cristo Prop. Mgmt., Ltd.*, No. 97-CV-3496 DRD, 2009 WL 5064757 (D.N.J. Dec. 16, 2009). She also cites *Bhattacharyya v. Quincy Mut. Fire Ins. Co.*, 799 N.Y.S.2d 158 (N.Y. App. Div. 2004), in which the court simply stated that the plaintiffs had not pleaded facts sufficient to rise to the level of a tort of bad faith.

reason to worry about consumers who, in states allowing only a cause of action under contract, might be improperly precluded

Bhattacharyya, 799 N.Y.S.2d at 158. The New York first-party rule is, like the New Jersey Rule, that although the cause of action sounds in contract, broad tort-like remedies are available under it. *Panasia Estates, Inc. v. Hudson Ins. Co.*, 886 N.E.2d 135 (N.Y. 2008); *Bi-Economy Mkt., Inc. v. Harleysville Ins. Co. of N.Y.*, 886 N.E.2d 127 (N.Y. 2008); *See generally* Charles Platto et al., *New York's New "Good Faith" Standard—What Does It Mean for "Bad Faith"?*, 30 NO. 6 INS. LITIG. REP. 165 (2008). Next, Randall cites *Zenor v. Standard Ins. Co.*, No. Civ. 01-1226-FR, 2002 WL 31466503, at *1 (D. Or. Apr. 3, 2002). Oregon indeed is a state whose courts have stayed away from a first-party cause of action in tort altogether, allowing only contract-style recovery for these plaintiffs. *Employers' Fire Ins. Co. v. Love It Ice Cream Co.*, 670 P.2d 160, 165 (Or. Ct. App. 1983); *Strader v. Grange Mut. Ins. Co.*, 39 P.3d 903, 905-06 (Or. Ct. App. 2002). Interestingly, however, the legislature in Oregon—which has already provided for unfair claim settlement complaints and attorneys' fees for winning plaintiffs—has begun to consider proposals for a bad faith statute. *See, e.g.*, H.B. 2791, 75th Leg. Assem., Reg. Sess. (Or. 2009) (would allow for a private action in contract or tort for both first- and third-party claims).

¹⁷² Randall, *Freedom of Contract*, *supra* note 2, at 119 n.32. For example, she gives New York, citing *New England Ins. Co. v. Healthcare Underwriters Mut. Ins. Co.*, 352 F.3d 599, 606 (2d Cir. 2003), which applied New York law. In New York, however, the contract roots of third-party bad faith, even in the insurance context, have been present since at least 1976. *Roldan v. Allstate Ins. Co.*, 544 N.Y.S.2d 359, 366 (N.Y. App. Div. 1989) (citing *Town of Poland v. Transamerica Ins. Co.*, 385 N.Y.S.2d 987 (N.Y. App. Div. 1976) (holding that a bad faith claim did not sound in negligence but in breach of contract, and that the statute of limitations was therefore six years)). Randall also uses Missouri as an example, citing *Ross v. Am. Family Mut. Ins. Co.*, No. 06-0811-CV-W-FJG, 2007 WL 1774443 (W.D. Mo. June 18, 2007) as a case that has recently stated that bad faith action for refusal to defend is contract-based, while a bad faith action for refusal to settle sounds in tort. Yet, as with other states, this principle has been around in Missouri for decades. *Zumwalt v. Utilities Ins. Co.*, 228 S.W.2d 750, 756 (Mo. 1950) (holding that bad faith actions for refusal to settle are based in tort, even though they arise out of contracts); *See also* *Landie v. Century Indem. Co.*, 390 S.W.2d 558 (Mo. Ct. App. 1965) (detailing the difference between bad faith actions for refusal to settle, which are based in tort, and bad faith actions for duty to defend, which are based in contract; the court also notes, as Professor Jerry did later (*see* JERRY, *supra* note 54), that even if the plaintiff recovers only under the duty to defend, he still must recover such an amount, including attorney's fees, as to put him in the position he would have been in had the defendant not breached the contract). Further, both New York and Missouri have statutes under which insureds can recover, at least, interest and attorney's fees when suing their insurer. N.Y. INS. LAW § 5106 (McKinney 2010); MO. REV. STAT. §§ 375.296, 375.420 (West 2010) (allowing for penalty). She cites cases from various other jurisdictions, most of which have similar statutes.

from having their legitimate claims heard. After all, if an insurer has no relationship with the consumer, then there is no duty of good faith connecting the insurer to the consumer. Alternatively, if there is a relationship and the insurer unreasonably denies coverage, then that act alone is likely to be seen as a breach of the duty of good faith.¹⁷³ Randall herself cites, with no apparent disfavor, Professor Jerry's assertion that the difference in a bad faith claim arising from contract as opposed to one in tort is of little consequence because contract remedies are often applied flexibly enough to give full compensation.¹⁷⁴ Thus, Randall's call to arms — to combat “recent decisions” that have supposedly turned against the widespread use of bad faith as a tort arising out of a breach of insurance policy — is largely unnecessary.

In fact, it appears that a shift has occurred in the *opposite* direction, even regarding the relatively new doctrine of first-party bad faith: “Recent decisions . . . have tipped the scales decisively in favor of the first-party tort and have clearly established it as the majority rule.”¹⁷⁵ As of this writing, twenty-eight states recognize the bad faith cause of action in tort and five more allow for tort-like damages; thirteen have rejected the bad faith tort; one requires a malicious mind on the part of the insurer before finding bad faith in tort; and Massachusetts has yet to decide (it has little reason to do so, since its statutory remedies are so strong).¹⁷⁶ The trend, then, is for more, not less, protection of consumers by courts and legislatures in the realm of bad faith.

4. Conclusion

The strong *contra proferentem* doctrine is still alive and well in many of the jurisdictions that Randall implies to have recently deserted it, and, given the lack of extrinsic evidence for passive insureds, most consumers are protected just as well by the doctrine in jurisdictions applying the normal-version as those in

¹⁷³ See, e.g., *Hardy v. Hartford Ins. Co.*, 236 F.3d 287, 293 (5th Cir. 2001) (illustrating how surprising it would be for a court to find bad faith where the insurer was reasonable in its denial of coverage: “[T]he district court did not err in failing to conclude that Hartford lacked good faith even as a matter of law, because Hartford had no duty to provide a defense or coverage to Hardy.”).

¹⁷⁴ Randall, *Freedom of Contract*, *supra* note 2, at 118 n.30 (citing JERRY, *supra* note 54, at § 25G).

¹⁷⁵ ASHLEY, *supra* note 90, at § 2:15.

¹⁷⁶ *Id.*

strong-version jurisdictions. Additionally, the pure reasonable expectations doctrine is a consumer-harming principle that never took hold in most courts, and its demise is a happy event. As for bad faith protection, it is actually on the rise. These three doctrines in their varying forms, when coupled with such ubiquitous measures as the unconscionability doctrine¹⁷⁷ and statutory remedies, prove that consumer protection is at the forefront of insurance law.

Legislatures have, in almost every instance, had many years to contemplate consumer-protective rules where they see failures in the common law. Indeed, the area of consumer protection has been, and continues to be, heavily addressed by state legislatures in favor of insureds. Randall, in support of her argument that courts have recently begun ignoring consumers in favor of rigid, insurer-favoring contract doctrines, cites case law from various jurisdictions. She fails to show, however, any reason why consistent differences between different states, with some states using more liberal protections than others, should be viewed *generally* as a judicial movement away from consumer protection warranting such a drastic proposal. That is, courts in one state, using more or less consumer-protective doctrines, do not directly affect courts in other states.

Further, Randall has not tied the states together or shown that the courts in any *one* state have stopped caring about consumers. The closest she comes to noting a trend is in her discussion of the reasonable expectations doctrine. But that doctrine is harmful, encouraging costly litigation and creating uncertainty for consumers and insurers alike; judges have acted prudently and in consumers' interest by rejecting this doctrine. Finally, Randall fails to show that courts in any one state have, through time, repudiated the plight of consumers in favor of traditional contract law or that legislatures are providing inadequate consumer protections. In short, her evidence, which is not logically tied to interstate *or* intrastate movement away from consumer protection, fails to support her thesis.

Consequently, the problems Randall finds with judicial interpretation are in fact not problems at all for consumers. Giving her the benefit of any doubt, however, this article will now address what she offers as her second reason for reform: that

¹⁷⁷ See *supra* note 70 for a very brief overview of the unconscionability doctrine.

the supposed current movement away from consumer-protective doctrines is made within the special context of contracts subject not to private agreement but, rather, to legislative intent. Her proposal – namely that judicial interpretation and construction be reformed in light of regulatory goals — is a dangerous plan that would harm consumers by creating uncertainty, instability, and, consequently, higher rates or reduced coverage.

B. Insurance Policies Are Special, but They Are Still Contracts

In explaining and bolstering her proposal to protect consumers from what she sees as judicial movement away from consumer-protective doctrines, Professor Randall argues that insurance policies are not really contracts between private parties and therefore should not be evaluated by courts as such. She states that consumers have no freedom of contract because consumer insurance is doled out in the form of adhesive, standardized instruments. Consumers are faced with the choice to either purchase insurance coverage for a risk or not—there is no negotiation of terms. Insurers, likewise, have no freedom of contract because of statutorily-mandated inclusions and required departmental approval of policy language.¹⁷⁸ This lack of freedom to contract, she argues, suggests that insurance policies are not really contracts to be evaluated according to the intent of parties buying and selling coverage as reflected in contractual language. Indeed, she says, “[N]o intent of the parties’ undergirds the substantive terms and provisions of the policy,”¹⁷⁹ indicating instead that the intent of the legislature undergirds those terms. In this view, the legislature and insurance department — not the parties — have effectively created the agreement, and when the language of that agreement reaches a court for interpretation, the court should seek the intent of the legislature and insurance department — not that of the parties. Because both consumers and insurers are constrained in their ability to create or modify terms, Randall says, “[T]he routine judicial invocation of the principle of freedom of contract in insurance cases is a fundamental error.”¹⁸⁰

Her thesis is imperfect because: (1) insureds, as a group, benefit from the lower transaction costs of adhesive, standardized

¹⁷⁸ Randall, *Freedom of Contract*, *supra* note 2, at 126–35.

¹⁷⁹ *Id.* at 108.

¹⁸⁰ *Id.* at 124.

contracts and are not precluded from reading their policies or clarifying meaning with their insurance agents; (2) insurers also benefit from the lower transaction costs that come with adhesive, standardized contracts and have the ability to create and modify the language of their policies—legislatures do not mandate nearly enough language to, for example, put the ISO out of business; and (3) legislatures mandate language *because* they expect insurers to include it in standardized, adhesive contracts so that consumers will be predictably and uniformly protected by it. If what Professor Randall says is true, that legislative and not private intent is reflected in insurance relationships, then legislatures have the ability to cleanly modify the interpretive system if they choose. Legislative acquiescence in and encouragement of judicial interpretation under contract law speaks volumes about how legislatures want to protect the public. When legislatures want coverage or protection for consumers, they mandate it; courts then comply with the mandate. This simple system is not broken. Professor Randall's proposal that judges predict the thoughts of legislatures in interpreting insurance policies places the third governmental branch ahead of the first.

“On any view, parties need not bargain when the cost of doing so outweighs the gains from customizing the transaction.”¹⁸¹ By purchasing adhesive contracts that are subject to efficiency-enhancing and consumer-protecting regulation,¹⁸² insureds benefit from lower premiums and lower opportunity cost. As Randall

¹⁸¹ Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173, 1208 (1983).

¹⁸² There is a concern that adhesive contracts are agreed to by boundedly rational consumers, who take only some contractual terms (especially price) into account when deciding to purchase insurance. Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1203 (2003). This can lead to insurers writing terms favorable to themselves in areas that consumers ignore, thereby keeping more of the cooperative surplus of the deal for themselves. *Id.* One solution to this problem is to have legislatures correct this market failure by mandating terms and pre-approving language. *Id.* This is exactly what legislatures do. Where legislatures fail to protect consumers, courts pick up the slack by using doctrines such as unconscionability, *contra proferentem*, and bad faith against insurers. Professor Korobkin's suggestion that courts go farther, evaluating adhesive contracts based on consumers' bounded rationality (as predicted by social science) and economic forces, would be impossible for generalist judges to apply. Such specialized and broad-reaching decisions should be made by legislatures.

recognizes,¹⁸³ insurers need standardized data to make accurate actuarial predictions, to charge relatively low premiums, and to offer insurance as widely as possible. Standardized data requires near-standardization of forms, and the Insurance Services Office has grown to both gather data and offer such standardization.

While it is true that many consumers do not read their insurance policies, insurers do not prevent them from doing so. At the very least, concerned consumers could read and understand the plain language of the policy and address questions and clarifications with their insurance agents, thereby coming to know what is and is not covered. Indeed, consumers in jurisdictions like New Mexico and Arkansas could, if they wished, even create helpful extrinsic evidence through this clarification process.¹⁸⁴

Randall claims that insurance policies should not be treated as contracts because insurers cannot freely include all of the terms they want, and must include some terms that they perhaps do not want. Her claim in this area is that regulators impose rules on insurers to protect consumers, yet she admits that, “These limitations obviously do *not* preclude invocation of the principle of freedom of contract in policy interpretation. However, the scope and extent of regulatory control over the content of insurance policies strongly suggests that freedom of contract is not an appropriate analytical starting point.”¹⁸⁵ Thus, her argument seems to be that insurers have some freedom of contract, but not enough to actually use contract as an interpretive judicial paradigm. In her words:

The extensive regulation of insurance policy language, ranging from legislatively-mandated provisions to required administrative approval of policies, renders the model of private contract and the principle of freedom of contract irrelevant in interpretation of insurance policies. Courts should approach the construction of insurance policies mindful that they are not individually negotiated bargains but highly regulated documents; the judicial goal should be ascertaining and effectuating regulatory goals, rather than the

¹⁸³ Randall, *Freedom of Contract*, *supra* note 2, at 124.

¹⁸⁴ See *supra* Part IV(A)(1).

¹⁸⁵ Randall, *Freedom of Contract*, *supra* note 2, at 126 (emphasis added).

illusory intent of the parties.¹⁸⁶

Additionally, contrasting her proposal with the present system, she argues:

[W]here policies are viewed not as a bargain between parties, but as *standard documents governed by statute and requiring regulatory approval*, the analysis changes. Considerations external to the policy become relevant, including the statutory framework and the intent of the legislature; the power of the regulator and the nature and aims of the approval process, as well as the role of the judiciary in reviewing administrative actions; and broad public policy concerns, as defined by statute, regulation, and decisional law.¹⁸⁷

That is, she not only advocates applying statutes, but applying vague purposes that may be discovered by evaluating the statutory framework, in addition to broad public policy concerns that might be gleaned from laws, departmental regulations, and even common law. Thus, Randall incorrectly bases her proposal on the notion that the language of insurance policies has little, if anything, to do with private parties — even the intent of the insurance company is ignored and is, from its rates to its terms, controlled and dictated by state regulators. A few areas do have commonly mandated forms, such as state fire and workers' compensation policies.¹⁸⁸ Generally, however, the state simply mandates specific coverage provisions or precludes some exclusions, and the policy language used to reach those goals is a decision resting with the company.¹⁸⁹ If states generally wrote policies, those policies would be public law that courts, subject to constitutional limitations, would have to follow. Additionally, if insurance policies were really created by legislatures, then any claim that they do not protect consumers would be a direct

¹⁸⁶ *Id.* at 146–47.

¹⁸⁷ *Id.* at 108 (emphasis added).

¹⁸⁸ See, e.g., N.Y. INS. LAW § 3404 (McKinney 2010) (providing New York's standard fire insurance form); TEX. INS. CODE ANN. § 2052.002 (Vernon 2010).

¹⁸⁹ See Randall, *Freedom of Contract*, *supra* note 2, at 129–34, for a general discussion.

attack, not on courts, but on those elected by the public to create protective laws.

However, as Randall admits,¹⁹⁰ insurance policies are *not* public laws passed by legislatures. They are regulated, to be sure, but setting regulatory boundaries does not make policies more or less than contracts; today, nearly all contracts — not just insurance contracts — are standardized, adhesive forms into which legislatures willingly insert themselves, either by way of the UCC or other legislation.¹⁹¹ Most contracts that consumers enter into are very much like insurance policies from a freedom of contract perspective, and ending the application of contract law to insurance contracts would likely lead to unprofitable disruptions in other areas of contract law. More importantly, insurance companies need uniformity and predictability when providing insurance to large numbers of people, and they therefore welcome standardized language — even language mandated by a legislature — as long as it is predictable.¹⁹² As Stempel puts it:

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. . . . [T]hey not only lower transaction costs but facilitate risk spreading through developing a risk pool of policyholders all subject to the same contract language.¹⁹³

¹⁹⁰ *Id.* at 126 (no longer claiming that insurance policies are all but statutes, she merely says that freedom of contract is “significantly limited for companies as well [as] for policyholders”).

¹⁹¹ See Slawson, *supra* note 36, at 529 (“Standard form contracts probably account for more than ninety-nine percent of all the contracts now made. Most persons have difficulty remembering the last time they contracted other than by standard form; except for casual oral agreements, they probably never have. But if they are active, they contract by standard form several times a day. Parking lot and theater tickets, package receipts, department store charge slips, and gas station credit card purchase slips are all standard form contracts.”).

¹⁹² See, e.g., Boardman, *supra* note 66, at 1105-06 (explaining that insurance companies need consistency and predictability; therefore, even language that courts interpret against them will continue to be used as long as the court rulings are predictable, this argument is easily extended to statutorily-mandated language).

¹⁹³ Stempel, *supra* note 59, at 830.

Additionally, most terms in a given insurance policy are not mandated by law. The insurer chooses or modifies ISO language, or creates its own language within statutory parameters and requirements. In almost every instance, it is the insurer who submits its forms to the regulators for approval — not the regulators who submit forms to the insurer to employ.

Randall's own discussion, in which she looks to regulatory goals as the guiding light for judges, demonstrates that legislatures, not courts, have the duty to protect consumers through new laws. Doctrines such as unconscionability, *contra proferentem*, fraud, and bad faith allow courts to protect consumers while preserving legislative policymaking power. As she recognizes, rate regulation; pre-approval of policy forms' content, readability, and format; mandated inclusion of specific types of coverage; limits on an insurer's ability to cancel policies; and other safeguards have largely been the province of legislatures¹⁹⁴ — legislatures that create these laws while choosing not to fundamentally modify consistent interpretive judicial frameworks. Legislatures do protect consumers by mandating some policy terms and prohibiting some insurer actions. However, legislatures have left most insurance decisions to the private contracts, through which private parties buy and sell insurance subject to approved language. Nothing about this scheme chosen by legislatures suggests that courts could capably take the place of lawmakers by judging insurance disputes on the basis of unstated regulatory goals, and state regulators suggest their comfort with judicial use of contract law by not regulating more.

Everything about the current system, with state policymakers regulating insurance and state courts interpreting insurance policies as regulated contracts, points to legislative contentment with the mechanisms by which consumers are protected. Indeed, legislatures have, thus far, refused to turn insurance into something akin to a public utility, even though they presumably could if they wished. Legislatures, in the very act of mandating and approving policy language, indicate that they *want* insurance policies to be treated as contracts. Truly, by making laws within the framework rather than modifying that framework, legislatures manifest their desire to treat insurance

¹⁹⁴ Randall, *Freedom of Contract*, *supra* note 2, at 126–35.

policies as contracts.

Courts are required to apply insurance laws,¹⁹⁵ and they have to give deference to authoritative administrative pronouncements,¹⁹⁶ such as those from insurance commissioners. Randall does not suggest that courts are ignoring their legislatures or insurance departments when a law or regulation applies. Instead, she wants the courts to take over the legislative role where judges consider that legislatures have not done enough in reaching their own goals. Additionally, Randall does not recognize that insurers themselves acquiesce to mandated policy language because, mandated or not, such language is predictable.¹⁹⁷ Predictability is the watchword of all actuarial work, and without it, insurance companies would have to narrow the scope of their coverage or increase rates. Even if a mandated term appears to impede upon insurance companies' freedom of contract, the companies prefer fixed, predictable language over the alternative. Indeed, much more important than the separation of powers problem is the problem of implementation and what effect judges' use of regulatory goals to interpret insurance policies would have on insurers and insureds alike.

C. The Practical Effects of Professor Randall's Proposal

Randall appears to advocate, as does most everyone, that courts continue to apply the law where the legislature clearly speaks. She states, however, that when the legislature has not mandated policy language by law:

[C]ourts should rely on interpretive constructs that

¹⁹⁵ For example, where an insurance policy violates a statute, the policy or the offensive term must be struck down — even though the insurance department gave implicit approval of the policy by not rejecting it. *See, e.g., Gonzalez v. Assocs. Life Ins. Co.*, 641 So. 2d 895 (Fla. Dist. Ct. App. 1994).

¹⁹⁶ Although implicit policy approval does not normally warrant much deference because the department's inaction causes such approval, where the department acts authoritatively, it is normally given deference. *See, e.g., Craley v. State Farm Fire & Cas. Co.*, 895 A.2d 530, 537 (Pa. 2006).

¹⁹⁷ *See, e.g., City of Los Angeles Dep't of Water and Power v. Manhart*, 435 U.S. 702 (1978) (recognizing the need for and legitimacy of predictability in the actuarial process even while striking down a retirement plan provision requiring women to pay longer than men given their longer average lifespan. However, the ban did not apply retroactively to plans already in place because of the presumed good faith with which pension fund administrators used actual science in reaching their conclusions).

emphasis [sic] regulatory goals and strategies: solvency of insurance companies, fairness to consumers, and availability of insurance¹⁹⁸. . . . Courts often approach the task of interpretation of insurance provisions without acknowledgment of the legislative and administrative role in the drafting and approval of insurance policies. . . . Acknowledgment of legislative and administrative involvement through mandated provisions and policy approvals shifts the interpretative focus from effectuating the parties' intent to effectuating regulatory goals.¹⁹⁹

This appears to be a call for courts to ask, "What would the legislature do?" In easy cases — those that have a statute directly on point, for example — there would be no need to surmise the legislature's intentions regarding solvency, fairness, or availability because the statutory directive would be clear. However, courts would have to guess what the legislature would want in the innumerable situations that have heretofore been governed by the common law or, subject to mandated language, are still subject to more than one interpretation.²⁰⁰ Under this scheme, a new, unpredictable common law of insurance contracts would arise — one that is based not on relatively consistent judicial decisions, but rather on what particular judges think particular legislatures would want if called upon to resolve particular disputes between litigants.

Among the practical problems with this proposal are: a lack of political accountability for the new judicial policymakers; economic inefficiency both within and between states; and a litigation explosion, with legislative intent becoming relevant to the discovery process, and insurance policy language being uncertain until ruled on by a court in light of the legislative goals presented.

First, the role of judges is not to weigh policy goals; their purpose is to adjudicate disputes under law; even though many

¹⁹⁸ Randall, *Freedom of Contract*, *supra* note 2, at 108.

¹⁹⁹ *Id.* at 135.

²⁰⁰ The fact that there are disputes over coverage in areas with mandated forms, such as fire insurance and workers' compensation, shows that even legislatively-creative language might be up for interpretation on some occasions.

judges²⁰¹ acquire their positions by election and are subject to political implications of their decisions.²⁰² But no judge, at the trial level or otherwise, can weigh and balance the public interest of an entire state. Judges, elected or appointed, simply cannot do the legislature's job.

Second, Professor Randall's proposal would not only harm intrastate consistency by creating inconsistency from term to term and from election to election, but also the generally consistent application of terms between states. Policy language — generated by the ISO or otherwise — frequently becomes popular across many states, and states interpreting contract terms for the first time are often aided by decisions of other states' courts that have interpreted the term. Courts may even find a term unambiguous as a matter of law if it has been interpreted consistently by other states' courts.²⁰³ Under Randall's proposal, when interpreting and construing un-mandated insurance policy language, courts in each state would have to look first, and perhaps exclusively, to the goals of their own legislature. They could not seek help from other states' courts unless they were convinced that the regulatory goals in each state, under the current legislatures of each state, were substantively identical. Thus, Randall's proposal would contribute to harmful interstate inconsistency of term interpretation, leading almost certainly to higher administrative costs for insurers, higher premiums for insureds, more federal

²⁰¹ Currently, thirty-nine states elect at least some of their judges. *Republican Party of Minn. v. White*, 536 U.S. 765, 790–91 (2002) (O'Connor, J., concurring); *Caperton v. A.T. Massey Coal Co., Inc.*, 129 U.S. 2252, 2274 (2009) (Scalia, J., dissenting); Peter Paul Olszewski, Sr., *Who's Judging Whom? Why Popular Elections are Preferable to Merit Selection Systems*, 109 PENN. ST. L. REV. 1 (2004) (describing and critiquing the general systems of judicial elections and appointments).

²⁰² In these states, “[E]lected judges — regardless of whether they have announced any views beforehand — always face the pressure of an electorate who might disagree with their rulings and therefore vote them off the bench.” *White*, 536 U.S. at 782. There is little doubt that elected judges would, if asked to explicitly consider policy arguments, favor those arguments that they think will get them re-elected in their district. Thus, Randall's proposal would be even more problematic in these states, where adjudications of insurance policy disputes would be made by a single person who is politically accountable to a limited geographic constituency.

²⁰³ See *Fisher v. Tyler*, 394 A.2d 1199, 1202–03 (Md. 1978); *Hanneman v. Cont'l W. Ins. Co.*, 575 N.W.2d 445, 451 (N.D. 1998) (finding the interpretations of other states' courts persuasive in determining the meaning of the term “borrow”).

discomfort with state regulation of insurance, and, ultimately, to federal regulation.

Playing down the significance of her proposal in encouraging inconsistency, however, Professor Randall states that the outcome of many disputes will be the same regardless of whether courts evaluate insurance policy language from a contractual or a regulatory perspective.²⁰⁴ This, she says, is because “the legislative and administrative role in mandating or approving policy language suggests that the language of policies should be enforced.”²⁰⁵ Thus, she reasons that legislatures and insurance departments are so heavily involved in regulating insurance policies that their intent is reflected in policy language, and, therefore, there is apparently little need for a shift in judicial interpretation. This article has already shown, not least by the very existence of the ISO, that this notion is unfounded. However, admitting that legislatures and insurance departments have near plenary power over insurance policies, even if they choose not use it, which is what Professor Randall seems to ignore, is fatal to her proposal because within that admission is a recognition that the legislature, well aware of what courts are up to, can increase or decrease their hold over insurance at any time. In other words, Randall recognizes that legislatures and insurance departments already hold the power to regulate, mandate, and approve insurance policies. With so much power to dictate what courts see and how they construe language, it is natural to assume that regulators have not been more explicit because they (and, by extension, their constituents) are content with courts interpreting insurance policies as regulated contracts between private parties, rather than legislation.

Third, underlying Randall’s proposal is a concern for consumers, yet consumers would almost certainly be harmed by her plan. She laments that “[i]n recent years, courts have been inclined to enforce insurance policies as written, with the goal of effectuating the intentions of the parties and the result that the insurance company typically prevails.”²⁰⁶ Thus, she argues, if courts interpret insurance agreements with the sole purpose of effectuating the intent of legislatures and insurance departments,

²⁰⁴ Randall, *Freedom of Contract*, *supra* note 2, at 108.

²⁰⁵ *Id.*

²⁰⁶ *Id.* at 107. This statement is logically inconsistent with her claim just one page later that under both contract interpretation and under her proposal, courts will in most instances uphold the policy language.

“courts can protect consumers’ substantive rights regarding insurance coverage, rather than an illusory freedom of contract.”²⁰⁷ This underlying goal to help consumers is one of the considerations that state legislatures, which actually hold the power to make improvements to the system, take into account when creating laws that regulate insurance.²⁰⁸ That it is not the *only* consideration belies the fact that Professor Randall overlooks, in this article at least, the purposes of regulation beyond consumer protection. Randall’s proposal is basically to turn courts into policymaking consumer advocates that attempt to act for the legislature when the legislature has not acted. Legislatures struggle to do what is best for the public in light of all of the goals of insurance regulation, including consumer protection, insurer solvency and profit margins, consumer access to insurance protection, and pricing standards.²⁰⁹ Advising courts to consider only one of those goals in making their decisions is incredibly narrow and would be detrimental to the balance that legislatures attempt to strike between all of the legitimate, sometimes competing goals of regulation.

However, courts, if they begin following Randall’s proposal at all, might not take her underlying purpose of consumer protection as their main goal; they might, in fact, try to balance all of the policy considerations surrounding insurance regulation. The fact that legislatures acquire mountains of information from economic, fiscal, and political analysts when deciding how to balance regulatory goals begs the question of how courts might be expected to carry out this process. Courts must judge cases on the evidence and arguments before them—that is, the facts and the legal and policy arguments that the parties present in relation to those facts. Parties find facts to insert into the record mainly through the discovery process.

Under Randall’s proposal, legislative facts and regulators’ legal and policy arguments would become the focus of litigation. Assuming the insurance department or some other regulatory

²⁰⁷ *Id.* at 109.

²⁰⁸ Of course, some laws — such as those ensuring solvency of all insurers, thereby preventing guaranty fund action — do benefit responsible insurers, but it must be recognized that most insurance regulations have a pro-consumer intent. *See, e.g.*, N.Y. INS. LAW § 7009 (McKinney 2010) (allowing insurance superintendent to prohibit or limit a captive insurer’s investments so as to promote solvency).

²⁰⁹ Baker, *supra* note 8, at 637–56.

representative did not intervene to represent public policy, an attacking insured would have to prove that consumer protection is the policy goal that needs following. Alternatively, insurers would likely argue for insurer solvency or some other favorable regulatory purpose. Whatever their arguments, the parties would have a pecuniary interest in the outcome of the litigation—in striking contrast to legislative ideals, in which the deliberative process promotes the public, as opposed to the litigant's, interest. Private interest would push litigants to use the discovery process to emphasize their strengths and downplay their opponent's. They would likely issue subpoenas to the insurance department and might even seek information from the state legislature in seeking to prove that their interpretation of legislative goals is most valid. Such a system, in which legislative facts, pronouncements, and regulatory intentions would become relevant to particular court cases, would explode the discovery process, making it veritably boundless. In such a system, consumer plaintiffs would almost certainly be overcome by the vast resources of insurance companies that could be used to seek out, sift through, and present policy arguments that support their position. Judges would have the unenviable task of sitting in the legislature's stead, attempting to protect the plaintiff while weighing other policymaking goals presented by the parties and deciding what the current legislature would do with the narrow question presented by the litigants.

If Randall's proposal is implemented and judges follow her suggestions by ignoring regulatory balancing and focusing mainly on consumer protection, the regulatory framework will crumble, leading toward insolvency, higher rates, and restricted coverage. If, on the other hand, judges sit as proxy for the legislature but give weight to insurers' evidence of the balance that should be struck, then insureds will almost certainly be unable to maintain the pace and breadth of discovery and trial preparation that the resourceful companies will display. Either way, transaction and litigation costs will increase, uncertainty of coverage will be rife, and consumers will lose.

As a final note, Professor Randall does not address the fact that consumers are more protected than ever, both by judicial doctrines, including, perhaps most importantly, the unconscionability doctrine, and legislative fiat. Further, she does not recognize that legislatures, not courts, are those with the power to regulate the business of insurance under the McCarran-Ferguson Act. More importantly, she does not address the burden

of unpredictability and, ultimately, costs to both insurers and consumers that would result if her proposal were implemented.

1. Professor Randall's Proposal Is Much Like the Failed Reasonable Expectations Doctrine

As this article has shown,²¹⁰ Professor Keeton's reasonable expectations doctrine failed because it was unpredictable and would have led to increased litigation, higher premiums, and less coverage. Indeed, under that doctrine, an insured could not know what his policy meant until a judge made a ruling on its meaning—perhaps not in accord with the insured's wishes. The doctrine would have allowed clear, unambiguous policy language to be trumped by the policyholder's reasonable expectations, and “[t]he shape of the analysis in a particular case will depend on the structure and provisions of individual state insurance codes, administrative procedure acts, and regulations, as well as the particulars of the department's review and approval process.”²¹¹ Such destabilization and unpredictability is rightfully eschewed by courts. As stated by one:

There is no logic nor reason to create an obligation contrary to and beyond the clear, plain language of a policy and Professor Keeton provides none. To create such would oblige a party at the whim of one whose personal interests are served by the conversion of an expectancy to a right. It would permit the rewriting of a contract by a court, without limitation except by what is reasonable for an insured to expect.²¹²

Professor Randall's proposal would also have courts ignore clear policy language, and would fail for the same reason that the pure reasonable expectations doctrine failed: unpredictability. If no statute spoke directly to a litigated issue or if the issue was unclear even in the face of a legislative mandate, that issue would go to the court, and the court would have to consider legislative goals in deciding the question. However,

²¹⁰ See *supra* Part IV(A)(2).

²¹¹ Randall, *Freedom of Contract*, *supra* note 2, at 136.

²¹² *Progressive Cas. Ins. Co. v. Marnel*, 587 F. Supp. 622, 624 (D. Conn. 1983).

where there is no statute on point, the court would either have to ask what past legislatures would have done—analogizing to statutes perhaps in other areas of the insurance code—or what the current legislature would do with the question. Whether the legislature actually wanted to decide that question would be irrelevant; whether the legislature wanted the courts to continue applying specialized contract law to insurance policies would also be beside the point. The court would have to look at the parties (which would certainly be few) and the issue in the case (which would necessarily be narrow), rely on counsels' arguments (which would vary in quality and depth with the wealth of the litigants), and attempt to adjudicate the dispute by balancing regulatory goals (which would always be broad, deep, varied, and distorted by the lens of litigation). Nobody would know, either from court to court at any given time or legislature to legislature through time, what un-mandated policy language meant. Insurers, also uncertain, would not be able to predict risk and return; they would have to protect themselves by charging higher rates, narrowing the scope of coverage, or leaving the state. Consumers would pay higher prices for insurance, would more often litigate, and would be uncertain of the scope of their insurance coverage—uncertain, that is, until the *legislature* somehow mandated clearer language, wrote forms itself, or possibly authorized the insurance department to write unambiguous forms based on regulatory goals that only the legislature can know and balance. Since Randall proposes that courts look to legislative goals, and since legislative goals are uncertain from day to day and from election to election, the uncertainty of judicial decision making under the proposal could only be solved by the legislature actually writing or mandating language by law. In other words, Randall's proposal, if adopted, would circle back to the true, authoritative regulators of insurance: legislatures.

But the proposal should not reach that point. It should be immediately dismissed, and courts should be left to continue their relative and, hopefully, predictable approaches to interpreting contracts. Legislatures, too, should be left to balance consumer protection with the other goals of insurance regulation against a predictable judicial backdrop.

V. Conclusion

This article has demonstrated that insurance is a heavily regulated industry, and that regulation has always been at the

level of state legislatures. Legislatures, with the help of insurance departments they create, have the duty and ability to issue laws and regulations and to approve forms and mandate coverage. Legislatures can, and sometimes do, even regulate the interpretation and construction of contract language and consumer representations. This scheme, which keeps rates relatively low, coverage broad, and insurers solvent, should not be shaken by Professor Randall's proposal.

Although her ire is directed at courts for not protecting consumers, the true problem, if any, is that legislatures, conscious of the largely constant judicial approach within each state, are not doing enough to protect consumers. Randall does not accuse the courts of disregarding legislative mandates or administrative suggestions. Instead, she accuses the courts of applying contract law to contracts. The courts exist to resolve cases and controversies by applying law to facts—not to create law in the legislature's stead. As recognized in *Couch*,²¹³ where the legislature has mandated language or interpretive rules, courts should apply that law; if their concern is for consumers, courts can best serve by consistently applying the insurance-specific contractual principles already in place and allowing legislatures to weigh policy concerns.

Legislatures have the power to protect consumers by creating laws in light of the large amounts of information needed to weigh competing policy purposes. To her credit, Randall asks that courts apply legislative mandates where available—but this is something that courts have always done. The problem with her proposal arises in the areas of insurance that legislatures have left to private parties' contractual agreements. There, Randall asks that courts apply "regulatory goals"—not laws or longstanding principles of interpretation—to resolve disputes. This scheme would lead to uncertainty for consumers and insurance companies, infringement upon legislatures' mandate to create laws, increasing litigation, and a widening discovery process, all

²¹³ "The rules of statutory interpretation, rather than the *contra proferentem* rule, apply when the terms of an insurance contract are dictated by statute; in such circumstances, the real question is or ought to be the intent of the legislature, not the intent of the parties to a contract in which neither has any real say as to the terms of the agreement." *COUCH ON INSURANCE*, *supra* note 7, § 22:22 (citing *Matarese v. N.H. Mun. Ass'n Prop. Liab. Ins. Trust, Inc.*, 791 A.2d 175 (N.H. 2002); *Chenard v. Commerce Ins. Co.*, 799 N.E.2d 108 (Mass. 2003)).

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while raising transaction costs and insurance premiums.

Thus, where the legislature has passed a law, the court should follow it. Likewise, where the insurance department has issued a rule, the court should give it deference. Otherwise, judges should be left to apply predictable contract doctrines, extra-protective of consumers or otherwise, against which informed and deliberative legislatures can further protect consumers if such protection is in the interest of the state. To borrow Judge Dorsey's language: "There is no logic nor reason to create an obligation contrary to and beyond the clear, plain language of a policy and Professor [Randall] provides none. To create such would . . . permit the rewriting of a contract by a court, without limitation except by what [judges think legislatures would do with the question]."²¹⁴

²¹⁴ Progressive Cas. Ins. Co., 587 F. Supp. at 624.