

# **INSURING UNDERSTANDING: THE TESTED LANGUAGE DEFENSE**

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## **INSURING UNDERSTANDING: THE TESTED LANGUAGE DEFENSE**

Michelle Boardman\*

Consumers do not read their insurance policies. Insurers return the favor by not writing to their buyers. Or perhaps it is the other way round. Insurers draft policy language to be read by courts, not consumers. Consumers return the favor by not reading what the insurers have written. We could try to figure out who pinched whom first, who stuck out their tongue when, but it wouldn't end the spat.

Communication requires a common language. Insurers often speak in a language not held in common with consumers. I have elsewhere explored how courts unintentionally given insurers incentives to ignore the buying public.<sup>1</sup> This article considers the consumer side of the question: Would insurers be more attentive to their policyholders if the policyholders paid more attention to them?

Consumers make persistent mistakes about their insurance coverage.<sup>2</sup> They have difficulty differentiating between insurance companies. They misjudge the product and fail to judge the sellers. In short, consumers do not pay much attention to what insurers write or how they act. Consumers might not be blamed for this but they are harmed by it.

Consumers' snub spares insurers the full force of reputational pressures that are necessary to a working market. And because the demand for consumer insurance is often inelastic, insurers have insufficient incentives to educate, entice, and satisfy their buyers. This article seeks to break the cycle of insurer inattention to consumers and consumer inattention to insurers. If consumers understood

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<sup>1</sup> Michelle Boardman, *Contra Proferentem: The Allure of Ambiguous Boilerplate*, 104 MICH. L. REV. 1105 (2006).

<sup>2</sup> Law professors do too. See section \_\_, *infra*.

policy language—understood what the contract promised—they would better understand the product and better judge whether a particular insurer had kept its promise. Real reputational effects would return to the market.

For this to happen, insurers must figure out what language consumers understand and then use it. This would be a change, one current incentives fail to initiate. This article proposes the tested language defense, or at least the thought experiment of the defense. For adoption by a legislature or a court, the doctrine states:

*If an insurer uses consumer research to test policy language before adopting it, the insurer can present the results of the research to rebut a finding of ambiguity.*

This defense is offered as a renovation to the current structure of plain language incentives. A renovation beats a solution because some of the forces leading consumers to ignore policy language are intractable and rational. The same holds when insurers ignore consumers. Still, allowing for a natural separation between what insurers write and consumers read does not justify encouraging a chasm.

To raise the defense, insurers have to get up early; it cannot be raised as a mere litigation position. During the drafting stage, an insurer would present test consumers with several variations on a particular clause. To bring the defense in court, the insurer would show that the clause it chose, while not perfectly understood by all consumers, beat out the next best alternatives, drawn from a pool of initially reasonable candidates. This evidence would inform but not control the court's decision.

The defense has three immediate applications: the doctrines of *contra proferentem* and reasonable expectations; and the task of facing complexity.

#### *Contra Proferentem*

First, the defense would modify the doctrine of *contra proferentem*, which instructs courts to construe ambiguities against the drafter. Insurers at times entertain the paranoid fantasy that no language, however clear, can satisfy a court.

Courts, for their part, can entertain the hindsight fantasy that language easily could have been drafted to be more lucid or to anticipate the case at hand.<sup>3</sup> Language drafted, tested, and redrafted would replace these fantasies with some reality.

The consumer research would show, first, whether the relevant audience in truth finds the language ambiguous. Second, where the language is open to two or more reasonable readings, the evidence would show if the policyholder's reading is among them. Finally, the evidence allows courts to decide if the insurer had done its best to make the language readable. This is not to pat the insurer on the back, but to determine if punishing the insurer for not doing better will have any effect. Punishment by *contra proferentem* has costs to consumers; it should be used only where there is a greater benefit.<sup>4</sup>

#### *Reasonable Expectations*

Next, the defense would elicit evidence instead of speculation for courts applying the reasonable expectations doctrine. The original doctrine starts with the premise that "the *objectively* reasonable expectations of [policyholders] . . . will be honored even though a painstaking study of the policy provisions would have negated those expectations."<sup>5</sup> Most states apply the doctrine to ambiguous provisions only

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<sup>3</sup> See, e.g., *Neal-Pettit v. Lahman*, 2008 WL 5259726, \*1 (Ohio App. 8 Dist. Dec. 12, 2008) ("Had Allstate intended otherwise, the policy language could easily have been drafted to reflect that intention."); *State Farm Mut. Auto. Ins. v. Langridge*, 683 N.W.2d 75, 90 (Wis. 2004) ("While State Farm could have very easily drafted its policy language differently so as to preclude [the plaintiffs] claim . . . , it chose not to do so."); *Smith v. American States Ins. Co.*, 586 N.W.2d 784, 787 (Minn. App. 1998) ("American States easily could have drafted its policy to preclude Smith's recovery in this case.")

<sup>4</sup> Where *contra proferentem* gives insurers a precise understanding of the court's interpretation of a clause, the insurer is often willing to keep its unclear language in order to rely on the court's known interpretation. Settled precedent allows courts and insurers to know what the clause means. But policyholders are still in the dark because the unclear policy language stands. See section \_\_, *infra*.

<sup>5</sup> Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 967 (1970) (emphasis added). The precise form of the doctrine varies by state. Its underlying goal is controversial. See section \_\_, *infra*.

and many states replace “painstaking study” with “average reading.”

Consumer evidence would inform the doctrine’s central question: would a reading of the policy language have refuted the consumer’s *a priori* expectation? If so, that pre-policy expectation is no longer “reasonable” and the court will not construe the policy to provide coverage. For those courts that require a showing of ambiguity before inquiring after the consumer’s reasonable expectations, the analysis would parallel that under *contra proferentem*.

#### *Facing Complexity*

Third, the defense permits, and may require, the insurer to submit tested but rejected language—the language rejected as less readable than the winning clause. This allows a court to evaluate whether the chosen clause is better than other obvious options, perhaps foreclosing (or fulfilling) the court’s fantasy that the language could easily have been drafted to say what the insurer means.

From this, a court will at times conclude that *no formulation* is sufficient; insurers simply cannot have the substance they are seeking to convey. This happens now but disingenuously; courts give causes for the failure of a clause other than its substantive incomprehensibility to layman. Insurers attempt to address these causes by redrafting or highlighting a clause, both of which can make the contract even more difficult to read. (Perhaps it is better to allow courts the fiction that the insurer just needs to redraft one more time; this is considered below.)

In other cases, a court may decide to accept unavoidable complexity and let the language stand. If the insurer’s meaning serves an important actuarial function, the fact that it is too complex to explain to lay people need not necessarily mean rejection. To truly face the complexity, however, courts in this case must stop sending insurers the “redraft” signal.

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The point of this interpretive principle—allowing consumer research to disprove ambiguity—is to reward insurers for drafting fairly clear language. The language will always be imperfect, especially as applied to atypical or unanticipated losses. But applying strict liability against

insurers where the language is imperfect has taught insurers the wrong lesson: redrafting “plain” language is unlikely to succeed in court.

Courts apply the doctrine of *contra proferentem* in case after case, confounded that insurers do not clean up their act. What the frustrated court does not realize is that it has fired its last shot, and the insurer knows it. Now that the clause at hand has a judicially settled meaning, the clause has a precise interpretation. Coupled with statistical loss data, the insurer now knows how much to charge for that bit of coverage.

In other words, courts may continue to consider the clause ambiguous, based on the policy language. Insurers now consider the clause defined, based on the court’s interpretation. Better to keep the language clear to the court, even if it means retaining language the court has ruled ambiguous, since at least this language has a settled judicial meaning.

If instead the insurer redrafts the clause as the court suggests, the insurer rolls the dice again. Perhaps the court will accept the new clause, but it may find the redraft ambiguous. Or perhaps it will become clear that the court has no intention of accepting the clause in any form—both *contra proferentem* and the reasonable expectations doctrine can conceal (sometimes barely) a court’s decision to mandate a type of coverage. Insurers are risk averse and this game is not worth the candle. Unless the insurer cannot live with the coverage the court has found in its ambiguous clause, better to provide the coverage and raise the premium.<sup>6</sup>

Readable policy language has thus not emerged under the current structure. If the tested language defense increases clarity, what would follow? The defense does not assume that plain contract language would set off policyholders rushing home to read by the fire, scotch glass in hand. Nor does it assume that policyholders would ask for policies in advance and vigorously comparison shop for content.<sup>7</sup>

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<sup>6</sup> See Boardman, *Contra Proferentem*, 104 MICH. L. REV. 1105, 1115.

<sup>7</sup> Policyholders usually purchase first and receive the written policy second, after which they have a limited time to cancel the contract.

Instead, the premise advanced here is that in insurance, more so than with other consumer contracts, there is a heavy cost to consumers not being able to understand the policy *after* a loss—when the time for the seller’s performance has arrived. This is because consumers do not experience the insurance “product” until a loss has occurred. Until then, the consumer has merely signed a document and a check.

The product being sold in insurance is, in a sense, the contract itself. If the contract is a black box, consumers do not know what their contracting party has promised to do. The insurance consumer is a buyer who does not know what he has bought. If he does not discover what he has bought when the time comes to “use” the product, he will never know if it has succeeded or failed.

When a consumer buys a physical product, say, a vacuum, he may not understand the standardized contract that accompanies it, but at least he knows what he wants the vacuum to do and what failure would look like. The vacuum market works when buyers can discern their own preferences and judge the degree to which a product fulfills those preferences.<sup>8</sup> If buyers do not know what they want or, knowing what they want, do not know if they have received it, the competitive pressure on sellers to provide a good product will be weak.

If the tested language defense succeeds in making insurance contracts more plain, policyholders will more accurately judge whether an insurer has breached, share that judgment with other consumers, share that judgment with the state insurance commissioner, decide to switch insurers, decide to purchase different coverage from the same insurer, decide to act because a risk (flood) or an object (boat) is not covered, or decide to sue.

Part one marks the mistakes consumers make about insurance and insurers, and explores why those mistakes persist. Insurers can be blamed for being poor educators, but a share of the explanation lies with rational consumer

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<sup>8</sup> Given the existence of the \$19,000 Electrolux Ergorapido vacuum, which sports Swarovski crystals, the state of the vacuum market is debatable.

choices. Part two is the core of the article. Part three concludes with an analysis of the benefits that would follow clearer language and entertains some objections to the tested language defense.

## I. CONSUMER MISPERCEPTION

Consumers are mistaken about their insurance coverage. Their misperceptions, and non-perceptions, are partially rational. The time and energy it would take to increase comprehension of any particular point may not be worth the effort. An individual consumer may even conclude that learning *anything* about their coverage is nonsensical; it has some cost and no benefit. After getting price quotes for homeowners insurance from three companies, for example, and selecting the policy with the lowest price for the desired deductible, a buyer will not try to change the policy language and is unlikely to initiate purchasing any endorsements.

But what is rational individually can harm consumers collectively. If consumers ignore policy content, insurers have less incentive to compete on substance or lucidity. There is some evidence that insurers compete on price, and that consumers are price sensitive.<sup>9</sup> By contrast, to read a consumer insurance policy is to know that the language—the manner by which the substance of the deal is to be communicated—was not written with the lay consumer in mind. The language does not entice, encourage purchase, or easily identify risks for which additional insurance should be sought.

### A. MISTAKES

Before going further, it is worth considering in detail the type of mistakes consumers make. Those who are all too aware of consumer mistakes from personal experience may be excused from the recurring trauma of this section. Those wanting to avoid future trauma, read on.

According to a recent survey by the National Association of Insurance Commissioners, consumers

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<sup>9</sup> See J. David Cummins, *Property-Liability Price Deregulation: The Last Bastion?*, in *DEREGULATING PROPERTY-LIABILITY INSURANCE: RESTORING COMPETITION AND INCREASING MARKET EFFICIENCY* 2-3 (J. David Cummins ed., 2002) (finding that the deregulation of markets for consumer property-liability insurance resulted in highly competitive industries); Banks McDowell, *Competition as a Regulatory Mechanism in Insurance*, 19 CT L. REV. 287 (1987).

mistakenly believe they are covered for the following losses, among others, by their homeowners insurance:<sup>10</sup>

- 68% - cars, boats and motorcycles stolen from or damaged on their property.
- 51% - a break in their water supply line.
- 37% - a break in the sewer line on their property connecting to their municipal sewer system.
- 35% - damage from earthquakes.
- 34% - damage from mold.
- 31% - damage from termites, rats, mice and other infestations.<sup>11</sup>
- 22% - pets stolen from or injured on their property.

None of these losses are regularly covered.<sup>12</sup>

Another surprisingly stubborn insurance mistake is believing one is covered for flood damage without buying separate flood coverage. Despite efforts by FEMA (the Federal Emergency Management Agency) to make the public aware of the National Flood Insurance Program,<sup>13</sup> and even *after* Hurricane Katrina, one-third of people surveyed “incorrectly believe flood damages would be covered by standard homeowners insurance policies.”<sup>14</sup>

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<sup>10</sup> See *What Isn't Covered By Your Homeowners Insurance?*, National Association of Insurance Commissioners Press Release, June 4, 2007, available at [http://www.naic.org/Releases/2007\\_docs/homeowners\\_not\\_covered.htm](http://www.naic.org/Releases/2007_docs/homeowners_not_covered.htm). See also Bradley Steffens, *Homeowners Insurance – Six Risks Not Covered*, Mar. 10, 2008, available at <http://www.articlesfactory.com/articles/finance/homeowners-insurance-six-risks-not-covered.html>.

<sup>11</sup> Another source puts this confusion at 47% for termite damage. See *Termite Institute Website Clears Up Consumer Confusion Over a \$5 Billion Problem*, PRNEWswire, Mar. 15, 2007.

<sup>12</sup> Some can be covered for an additional premium, such as state-backed earthquake insurance in parts of California.

<sup>13</sup> See <http://www.fema.gov/business/nfip/>.

<sup>14</sup> *What Isn't Covered By Your Homeowners Insurance?*, National Association of Insurance Commissioners Press Release, June 4, 2007, available at

Some mistakes involve not *what* is covered but *how*. A recent MetLife study found that “nearly one-third of those surveyed believe their homeowners policy would reimburse them for the market value of their homes if they were destroyed by fire or in a storm.”<sup>15</sup> This means that one-third of consumers misunderstand a central part of the contract. The calculation of payment for a destroyed house is one of the most important traits of a homeowners policy. This is not ignorance about a personal watercraft or pet fish exclusion, it goes to the purpose for purchasing the product.

This “market value” belief contains several mistakes. For some consumers, it includes not separating land value from building value. Most homeowners have a sense of the value of their home in that they know approximately how much it would sell for on the open market and they know the local government assessment on which they pay taxes. If this number, the house + land number, is the number that pops into mind when a house is destroyed, the policyholder will be sorely disappointed.<sup>16</sup> Why? The policyholder still has the land and will not be compensated for land not lost.<sup>17</sup>

Two of my savvy colleagues made this mistake for years, paying the premia for policies meant to cover a house worth H but only owning a house worth H – L, where L is the value of the land. In this part of the country, the Virginian suburbs of D.C., not only is L large, it may well be equal to or greater than H. Two law professors capable of running advanced regression analyses failed to subtract the sizable value of their land from the value of their home, reminding us that the cobbler’s children have no shoes.

Perhaps a more common form of the “market value” mistake is to not understand that current market value of the house is not part of the equation at all. Homeowners policies either cover destroyed property at “actual cash

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[http://www.naic.org/Releases/2007\\_docs/homeowners\\_not\\_covered.htm](http://www.naic.org/Releases/2007_docs/homeowners_not_covered.htm).

<sup>15</sup> Eileen Alt Powell, *Many Homeowners Confused About Insurance* (AP Business Wire 6/27/2007).

<sup>16</sup> In the Northern Virginia suburbs of Washington, D.C., to take an extreme example, the value of the land on which a house sits can be two to three times the value of the structure itself.

<sup>17</sup> In the case of flood or earthquake, where infrastructure and neighborhoods are wiped out, the value of the land may indeed be lower, but this is an investment loss for the policyholder, not an insured loss.

value” or “replacement cost.”<sup>18</sup> For the house structure itself, replacement cost, meaning rebuilding cost, is the norm. “Actual cash value,” which includes depreciation and is much lower than replacement cost, is the norm for destroyed personal belongings.<sup>19</sup> More than 70% of those surveyed got this wrong, believing instead that they would be paid enough to replace their lost possessions.<sup>20</sup>

To see the difference, compare the cost of buying a desirable new washer and dryer set with the actual cash value of your midline, 10-year-old pair, pre-loss. The actual cash value of possessions inside the house will often be cents on the dollar it would cost to buy the same possessions new. While this article argues that many insurance misperceptions do not need to be clarified up front because the benefit of clarity can be reaped after a loss, not so here. The “actual cash” mistake is best corrected at the time of sale because the term can be changed. “You have to ask for replacement cost coverage, but . . . it’s worth the extra money,” according to the Director of Product Management for MetLife Auto & Home.<sup>21</sup>

## B. SOME IMPLICATIONS

Missing the opportunity for replacement coverage highlights that insurance buyers are uniquely positioned to benefit from readable contracts. Buyers of computers or coffeemakers do not read the contract before purchase because little can be done to change regrettable clauses. Nor

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<sup>18</sup> Compare Harold H. Reader III, *Modern Day Actual Cash Value: Is It What the Insurers Intend?*, 22 *Tort & Ins. L.J.* 282 (1987) with Johnny Parker, *Replacement Cost Coverage: A Legal Primer*, 34 *WAKE FOREST L. REV.* 295 (1999).

<sup>19</sup> *What Isn’t Covered By Your Homeowners Insurance?*, National Association of Insurance Commissioners Press Release, June 4, 2007, available at [http://www.naic.org/Releases/2007\\_docs/homeowners\\_not\\_covered.htm](http://www.naic.org/Releases/2007_docs/homeowners_not_covered.htm). See also Bradley Steffens, *Homeowners Insurance – Six Risks Not Covered*, Mar. 10, 2008, available at <http://www.articlesfactory.com/articles/finance/homeowners-insurance-six-risks-not-covered.html>.

<sup>20</sup> Eileen Alt Powell, *Many Homeowners Confused About Insurance*, AP NEWS, June 27, 2007.

<sup>21</sup> Eileen Alt Powell, *Many Homeowners Confused About Insurance*, AP NEWS, June 27, 2007.

do they often read after something has gone awry, when the application of contract terms is at hand, because their primary interest is the quality of the product, not the contract.<sup>22</sup>

In insurance, by contrast, there are gains to be had from understanding the contract initially and then again after a loss. When the contract first arrives (after purchase but before finality), insurance consumers have the power to request different terms on questions of real weight, such as switching to replacement value for person property.<sup>23</sup> On the back end, after a loss, is precisely when a policyholder experiences the true operation of the product he has purchased. If the insurance policy is intelligible, this later education takes place on at least two levels.

First, his mind is focused on a particular loss, which engages a limited number of the contract clauses. Instead of poring over a long contract with untold hypothetical losses in mind, the policyholder can take four interactive clauses and apply them to set facts. Second, after a loss the policyholder also learns about the quality of the seller; he learns about the insurer's service and what it takes to get the insurer to keep its promises.

Of course, in order to do this the policyholder has to have some idea that insurance might cover the loss in the first place. Consumers are mistaken about their homeowners coverage in both directions; they assume they are covered for more causes of loss—like flood or mold—and for more money—like replacement cost—than they are. This confusion creates a missed opportunity to buy better-suited coverage.

But the evidence also suggests people fail to file claims for losses that are covered, for which they have paid

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<sup>22</sup> If the seller fixes the problem, the consumer is happy and may again buy the product in the future. If the seller fails to fix the problem, the consumer is unlikely to repurchase, whatever rights the contract grants.

<sup>23</sup> Many consumers may also want to consider purchasing expanded coverage for business materials, including computers and electronically stored data that are used while working at home, even if the consumer usually works in an outside office. Consumers with more than a few thousand dollars worth of jewelry—less than the value of many wedding rings—may also want to purchase additional coverage.

premiums. In the homeowners context, here are a few examples of compensable losses that are foreign to many:

- credit card theft/fraud, in limited amounts<sup>24</sup>
- personal items lost while traveling or stolen from hotel rooms<sup>25</sup>
- loss of construction and repair materials<sup>26</sup>
- damage to tombstones and burial vaults in a cemetery<sup>27</sup>

Unless it occurs to a policyholder to check whether these losses are covered, even the plainest language will not help the policyholder file a claim.

In short, even if every court to hear a policyholder's complaint granted the policyholder coverage, ongoing mistakes cost consumers at the front and back ends of their insurance experience.

### C. WHY MISTAKES PERSIST: MISPERCEPTION AND NO PERCEPTION

How does a homeowner judge his homeowners insurance and his insurer after a loss? Consumers only know what they want in a product or service by learning what they want through experience, usually repetitive experience.<sup>28</sup> For repetition to provide cumulative feedback about preferences, however, a number of conditions must be

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<sup>24</sup> "We will pay . . . [for t]he legal obligation of an 'insured' to pay because of the theft or unauthorized use of credit cards issued to or registered in an 'insured's' name." HO3-Special, HO 00 03 10 00, Section I Property Coverages, E. Additional Coverages, § C.1. (ISO 1999).

<sup>25</sup> "We cover personal property owned or used by an 'insured' while it is anywhere in the world." HO3-Special, HO 00 03 10 00, Section I Property Coverages, C. Personal Property, § 6.a.(1) (ISO 1999).

<sup>26</sup> "[M]aterials and supplies located on or adjacent to the residence premises for use in the construction, alternation or repair of the dwelling or other structures on the residence premises" are covered. HO3-Special HO 00 03 10 00, Section I Property Coverages, § A.1.b. (ISO 1999)

<sup>27</sup> "We will pay up to \$5,000 for grave markers, including mausoleums, on or away from the 'residence premises' for loss caused by" certain perils. HO3-Special, HO 00 03 10 00, Section I Property Coverages, E. Additional Coverages, § 12 (ISO 1999).

<sup>28</sup> When "people have not yet learned what they like (for example, children) . . . decision utility [can] deviate from experienced utility." Colin F. Camerer, *Wanting, Liking, and Learning: Neuroscience and Paternalism*, 73 U. CHI. L. REV. 87, 91 (2006).

met. First, the feedback must be decipherable. Did the product fail from poor quality or because some percentage of all products fail? With a toaster perhaps a consumer does not need to know; he can just move on to another brand of toaster and, in the aggregate, the brand with the fewest spontaneous combustions wins. But with insurance, consumers may be in a different bind—can the consumer know that the product failed at all or did it merely disappoint?

Second, the consumer must be able to compare sellers. If he does some research, he will find that, as a group, homeowners insurers have about a 50% favorable (and thus unfavorable) rating. We do not have the data to know if this maps directly to the percentage of claims made by policyholders that are paid and denied. Some percentage of consumers may take *any* denial of a claim, their own or a neighbor's story, as a sign of insurer failure. These skeptics will have a hard time developing a preference for a particular insurer or type of insurance.

For others, the gathering of experience and reputational data is lengthier but not necessarily more accurate.<sup>29</sup> Consider a consumer who purchases Allstate homeowners insurance for 10 years. In year 10 he experience a loss, for which Allstate denies coverage. He looks around for alternatives. Neighbor Right is happy to recommend his insurer, Liberty Mutual, but he has never had a loss. Neighbor Left uses State Farm and was happy with State Farm's payment of her only claim. The consumer has learned little.

The non-skeptical consumer will not take every denial as a failure but he will not have an easy time deciding when an insurer has failed him. He can tell whether service is pleasant and timely. But can he confidently judge whether the insurer has fulfilled its promise to him? If the insurer pays the full loss, he is satisfied. He will likely stick with the insurer and may tell others of his positive review. A readable contract will not measurably increase his compensation contentment. It should increase his chances of finding such contentment, however, by uncovering unexpected areas of coverage.

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<sup>29</sup> See section \_\_, *infra*, for online methods consumers can use to compare insurers.

If the insurer does not pay or pays only partially, the homeowner is unhappy. The homeowner attempts to judge whether the insurer has fairly denied a claim or has broken its promise. In order to do this, he must be able to differentiate between losses that should be paid and those that should not; he must have some sense of what the insurer promised. That sense comes in part from sources outside the policy, to be sure, but if the policy does not help the homeowner judge, he will often misjudge the product and its seller. This muddies reputational effects and his own ability to better satisfy himself with the next contract. Or perhaps he won't misjudge so much as withhold judgment, with the same consequences for his next purchase and the market.

In theory, standardized products promote consumer learning from personal repeat experiences and from those of others'.<sup>30</sup> Such enduring confusion over a standardized product in a competitive market is unexpected. Richard Epstein and Oren Bar-Gill have debated whether serious consumer mistakes can (or do) persist in a working market.<sup>31</sup> Both conclude that it "is probably correct" that "mistakes about a *standardized* product are not sustainable."<sup>32</sup>

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<sup>30</sup> See Matthew Osborne, *Consumer Learning, Switching Costs, and Heterogeneity: A Structural Examination*, Economic Analysis Group Discussion Paper, 2007 (testing the effect of consumer learning on the purchase of laundry detergents); Tulin Erdem, Michael P. Keene, Sabri Oncu, & Judi Strebler, *Learning About Computers: An Analysis of Information Search and Technology Choice*, 3 *QUANTITATIVE MARKETING & ECON.* 207 (2005) (personal computers); Gregory C. Crawford & Matthew Shum, *Uncertainty and Learning in Pharmaceutical Demand*, 73:4 *ECONOMETRICA* 1137 (2005) (pharmaceuticals).

<sup>31</sup> See Richard A. Epstein, *The Neoclassical Economics of Consumer Contracts*, 92 *MINN. L. REV.* 803 (2008); Oren Bar-Gill, *The Behavioral Economics of Consumer Contracts*, 92 *MINN. L. REV.* 749 (2008). Their answers speak to "the long-standing debate over the extent to which market failures pave the way for government regulation," as Epstein puts it. Epstein, *Neoclassical Economics of Consumer Contracts*, 92 *MINN. L. REV.* at 803-4. Or, as Bar-Gill puts it, the question is whether the cognitive and decisional mistakes consumers make are "mistakes that merit legal intervention." Bar-Gill, *Behavioral Economics of Consumer Contracts*, 92 *MINN. L. REV.* at 749.

<sup>32</sup> Bar-Gill, *Consumer Contracts*, 92 *MINN. L. REV.* at 750. (emphasis added).

Bar-Gill points out, correctly, that the question is ultimately empirical. Epstein takes the position that in markets of standardized products, “voluntary actions by individual consumers and their advisors, as well as by competitive sellers, tend to close an information gap” between the seller’s knowledge and the consumers’.<sup>33</sup>

Insurance may be the exception. Under any reasonable conception of standardization, homeowners insurance policies are a standardized product, yet consumer mistakes persist.<sup>34</sup> Whether from imperfect information and taints of monopolistic collaboration<sup>35</sup> or bounded rationality and limited risk heuristics<sup>36</sup>, the market falters.

In order to purchase wisely, consumers need to learn about the products for sale *and* about their own preferences. Some will argue that consumers’ preferences are easy to discern; a consumer’s preference is revealed by what he buys.<sup>37</sup> But in attempting to determine consumer preferences from behavior, and before honoring that behavior as an efficient market outcome, we need to look at

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<sup>33</sup> Epstein, *Neoclassical Economics of Consumer Contracts*, 92 MINN. L. REV. at 809. Epstein then raises two objections even accepting persistent consumer mistake; first to “any one-size-fits-all regulation” and second to the market distortions or barriers to entry caused by regulation. *Id.* at 809-810.

<sup>34</sup> Neither Epstein nor Bar-Gill directly defines standardization. Epstein critiques Bar-Gill for too narrowly defining the term, but in doing so he does not specifically define it himself. See Epstein, *Neoclassical Economics of Consumer Contracts*, 92 MINN. L. REV. at 817. Rather, he writes the Bar-Gill removes from the category of standardized products those goods “that often provide potential customers with offers that vary in two or more dimensions.” *Id.* Epstein argues that such products are in fact compatible with the use of standardized agreements because the use of standardized options makes comparisons across products more transparent. *Id.* at 818.

<sup>35</sup> Epstein at 804-05 (“There are . . . two sets of well-recognized circumstances in which the neoclassical theory accepts that some government intervention may make sense: private monopoly and imperfect information.”).

<sup>36</sup> See Bar-Gill, *Consumer Contracts*, 92 MINN. L. REV. at 759.

<sup>37</sup> See Paul A. Samuelson, *A Note on the Pure Theory of Consumer’s Behaviour*, 5 *Economica* 61, 65 (1938) (original mathematical work); see also, John Beasears et al., *How are Preferences Revealed?*, 92 *Journal of Public Economics*, 1787-1794 (August 2008) (identifying the circumstances where revealed preferences are most likely to diverge from normative preferences).

whether the consumer has developed preferences. Even Vilfredo Pareto (of Pareto optimality) required “repeated actions” before taking the observable act—buying—as evidence of a revealed preference for the thing bought.<sup>38</sup>

A man who buys a certain food for the first time may buy more of it than necessary to satisfy his tastes, price taken into account. But in a second purchase he will correct his error, in part at least, and thus, little by little, will end up procuring exactly what he needs. We will examine this action at that time when he has reached this state.<sup>39</sup>

In order to pursue their preferences in the marketplace consumers do not have to be perfectly rational but they do have to know roughly (1) what their preferences are and (2) whether a product satisfies them.

What do consumers of insurance policies know about their preferences? Given the rarity of feedback from their insurance purchases, and the potential opacity of that feedback, consumers may know little. We can assume the basics of what consumers prefer:

- to pay less rather than more
- more coverage to less, at a set price
- a policy one can read and understand
- covered claims paid without hassle

A consumer’s ordering of his preferences will vary with time. Once a consumer has experienced a loss, he would rather be compensated for it. Before a loss, he would rather purchase cheaper insurance for certain losses only. In order to purchase wisely, a consumer needs to modulate his preferences.<sup>40</sup>

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<sup>38</sup> Vilfredo Pareto, *MANUAL OF POLITICAL ECONOMY* at 103 (Augustus M. Kelley 1971), discussed to great effect in Colin F. Camerer, *Wanting, Liking, and Learning: Neuroscience and Paternalism*, 73 U. CHI. L. REV. 87 (2006).

<sup>39</sup> Pareto, *Manual of Political Economy* at 103.

<sup>40</sup> Your present self has a fiduciary duty to your future selves. See, e.g., Richard A. Posner, *Address at Yale University’s Tanner Lectures on Human Values: Euthanasia and Health Care: Two Essays on the Policy Dilemmas of Aging and Old Age*, at 40 (Oct. 10 & 11, 1994) (available in

It is not obvious how to give consumers more “experience” with their insurance products because the “use” of an insurance policy is triggered by an outside event, unrelated to the policy. Either the consumer experiences a loss or he does not. In the years that he does not, he has little experience with the policy; he answers a few questions, pays, and receives another copy of the policy. He may have some small sense of the insurer’s customer service but barely.

In the years that he experiences a loss, we can initially divide the loss into “obviously” covered, “obviously” not covered, or unclear. The problem with the first two categories is that what is “obvious” to a consumer may be flatly incorrect. Plain language policies would correct for some of this, but by no means all. We can further subdivide the policyholder’s attempts to judge a loss outcome:

1. loss obviously covered:

Lightening strikes the house, causing a roof fire. The loss is mitigated by sprinkler systems, smoke detectors, and the absence of inappropriately stored flammable materials.<sup>41</sup>

2. loss “obviously” covered, but not covered in fact:

A tree falls on the garage, damaging the boat, motorcycle, or car within.<sup>42</sup>

3. loss obviously *not* covered:

Policyholder sets fire to his house and is caught. An innocent co-insured may be covered, however.<sup>43</sup>

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The University of Utah’s Tanner Lectures collection). In discussing compulsory pension programs, Posner explains how an individual at working age ( $A_w$ ) owes a duty to himself at retirement age ( $A_r$ ) to plan accordingly for retirement.  $A_w$  serves as a trustee of  $A$ , the body that both  $A_w$  and  $A_r$  inhabit, and thus a compulsory pension program impose a fiduciary duty on  $A_w$ .

<sup>41</sup> The roof is likely covered at replacement value, unless the policyholder has purchased extra coverage for market value. Some policyholders will be surprised by this difference but the policyholder will be right that the loss is covered.

<sup>42</sup> One “misconception held by more than two-thirds of policyholders is the belief that cars, boats or motorcycles stolen from their property or damaged on their property are covered by homeowners policies,” according to the National Association of Insurance Commissioners CEO, Cathy Weatherford. See Eileen Alt Powell, *Many Homeowners Confused About Insurance*, AP NEWS, June 27, 2007.

4. loss “obviously” not covered, but covered in fact;

On vacation, a gold necklace is stolen from a hotel room.<sup>44</sup>

5. policyholder uncertain, loss is covered:

Damaged construction materials on the premises during a renovation.<sup>45</sup>

6. policyholder uncertain, loss is *not* covered:

Stolen construction materials on the premises during construction of an addition or separate structure like a pool house or stand-alone garage.<sup>46</sup>

or

Exploding frozen pipes, where the homeowner has failed to properly heat or drain pipes.<sup>47</sup>

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<sup>43</sup> If the policy is jointly held between husband and wife, the non-arsonist has suffered an unintentional loss; whether that loss is covered depends on the contract and the state. See Susan Randall, *Freedom of Contract in Insurance*, 14 CONN. INS. L.J. 107, 144-45 (2007). “Whether the intentional acts of a co-insured will defeat coverage for an innocent co-insured turns on the exclusionary language used in the policy. A policy excluding losses caused by intentional acts of ‘any insured’ or ‘an insured’ creates a joint obligation among co-insureds and bars coverage for both the malefactor and innocent co-insureds. Where the policy uses the words, ‘the insured’, the obligation is several, and the exclusion applies only to the insured who intended the act and caused injury, not an innocent co-insured.” *Id.* See also *N.J. Mfr Ins. Co. v. Carney*, No. 3:04-CV-2465, 2006 WL 2092571 at \*3-4 (M.D. Pa. July 26, 2006) (holding the intentional act of one insured excludes coverage for the innocent co-insured under the language “an insured” or “any insured”; but a wife’s arson does not stop her husband’s recovery when he is the sole owner.).

<sup>44</sup> “We cover personal property owned or used by an ‘insured’ while it is anywhere in the world.” HO3-Special, HO 00 03 10 00, Section I Property Coverages, C. Personal Property, § 6.a.(1) (ISO 1999). Jewelry is covered at limits in the few thousands, which can be increased by enumerating the pieces and paying an additional fee.

<sup>45</sup> “[M]aterials and supplies located on or adjacent to the residence premises for use in the construction, alteration or repair of the dwelling or other structures on the residence premises” are covered. HO3-Special HO 00 03 10 00, Section I Property Coverages, § A.1.b. (ISO 1999)

<sup>46</sup> The loss is excluded if it is “[c]aused by . . . (3) Theft in or to a dwelling under construction, or of materials and supplies for use in the construction until the dwelling is finished and occupied.” HO3-Special HO 00 03 10 00, Section I Perils Insured Against, § A.2.c.(3) (ISO 1999).

<sup>47</sup> The loss is excluded if it is “[c]aused by (1) Freezing of a plumbing, heating, air conditioner or automatic fire protective sprinkler system or of

The “uncertain” category is extensive. It includes those losses about which the policyholder is not confident in either direction; the policyholder does not have a preconceived notion about whether the loss is covered and a lay reading of the policy neither clearly includes nor excludes the loss.

The puzzle is why categories two, four, five, and six—misperceptions of being covered, misperceptions of not being covered, and no perception—are so common in insurance. Consumer insurance policies, like homeowners and car insurance, appear to be the ultimate standardized product. Not only are policies standardized across users, they are in various ways standardized across sellers.

This “hyperstandardization,” it turns out, may be part of the problem. For promoting consumer learning about a product, and therefore market efficiency for that product, there is a sweet spot of standardization, beyond which increasing standardization hampers learning.

As discussed below, consumers lose much of the incentive to learn if unchangeable products are the same across sellers. There remains some incentive to learn about the product because the consumer still has to decide if he wants to buy it at all and how much to rely on the product. In consumer insurance, however, whether to buy may not be an open question. A homeowner may be compelled to purchase homeowners insurance (to secure a mortgage) or at least feel compelled (it is “what’s done”) and believe he will not change his own safety behavior based on its content. Whether he is right in this second assumption, his incentive to learn about the content of his homeowners policies *at purchase* and *before a loss* is weak.

The debate over whether consumer mistakes about standardized product/contracts endure includes the underlying premise that standardization has value for the consumer. Both Epstein and Bar-Gill start from the position that there is greater reason to expect correction over time of mistakes about standardized products than mistakes

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a household appliance, or by discharge, leakage or overflow from within the system or appliance caused by freezing. This provision does not apply if you have used reasonable care to: (a) Maintain heat in the building; or (b) Shut off the water supply and drain all systems and appliances of water.” HO3-Special HO 00 03 10 00, Section I Perils Insured Against, § A.2.c.(1) (ISO 1999).

about non-standard products. This is plausible; consumers are able to learn from the experience of many others, all of whom have purchased the same product a new buyer would be purchasing. The more consumers using the product, the more accurate a picture the buyer will compose.

On the other hand, the downsides of standardized contracts are familiar. No one has ever complimented a contract with the labels “adhesive” or “boilerplate.”<sup>48</sup> “The drafting of standard forms by national enterprises has properly been described as ‘unilateral private ordering by the dominant party,’ and has been denounced by a prominent scholar as the equivalent of legislation by the likes of unelected . . . firms that present standard forms to consumers on a take-it-or-leave-it basis.”<sup>49</sup>

While it stops short of electing policyholders to an insurer’s board of directors, the tested language doctrine could diminish these objections to standardization. The tested language defense would encourage a “democratization” of the drafting process. Policyholders would not become drafters but they would become part of the process. As portions of the policy become understood by and known to consumers, insurers might even find that research on what consumers want, in addition to what they

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<sup>48</sup> *But see Rissman v. Rissman*, 213 F.3d 381 (7th Cir. 2000) (Judge Easterbrook) (“[T]he fact that language has been used before does not make it less binding when used again. Phrases become boilerplate when many parties find that the language serves their ends. That’s a reason to enforce the promises, not to disregard them.”)

<sup>49</sup> Joseph M. Perillo, *Neutral Standardizing of Contracts*, 28 PACE LAW REVIEW 179, \*5 (2008), quoting Irma S. Russell, *Got Wheels? Article 2A, Standardized Rental Car Terms, Rational Inaction, and Unilateral Private Ordering*, 40 LOYOLA L.A. 137, 138 (2006) and citing W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529 (1971). See also Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX L. REV. 1581, 1585-86 (2005) (“[F]orm contracts used in transactions with consumers tend to be one-sided because they are drafted by firms, trade associations, or professional associations, which want such contracts to be slanted in their favor.”); *Henningsen v. Bloomfield Motors, Inc.*, 16 A.2d 69, \_\_ (N.J. 1960). (“Such standardized contracts have been described as those in which one predominant party will dictate its law to an undetermined multiple rather than to an individual. They are said to resemble a law rather than a meeting of the minds.”)

understand, is profitable.<sup>50</sup> This would not result in the collaborative consumer process that Joseph Perillo has recently proposed, in which the American Law Institute would “take its hand at the drafting of commonly used standard forms for consumer transactions after receiving input from all stakeholders involved in the transaction-type,” including “business leaders, consumer activists and their lawyers.”<sup>51</sup> Nonetheless, it would bring consumer opinion more solidly into the ring.

#### D. INSURERS ARE POOR EDUCATORS

Why do insurers not try to fix policyholder misperceptions through advertising or customer relations?<sup>52</sup> The President of the Insurance Information Institute, Gordon Stewart, argues that insurers suffer from what I will call reputational defeatism.<sup>53</sup> Going beyond consumer misperception, he identifies “enduring misperceptions” held by the industry. These include “the conviction that the industry’s supposedly low standing with the public is a kind of ‘state of nature.’”<sup>54</sup> A “state of nature” has two relevant traits; it is inescapable and it is exogenous.<sup>55</sup> If it is inescapable, the insurers have no incentive to attempt to improve their reputation, individually or as an industry. If the cause is external—led by media, political attacks or the

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<sup>50</sup> Going a long step further, insurers could enter into collaborative drafting with a consumer interest group representing current and future policyholders. See Perillo, *Neutral Standardizing of Contracts*, 28 PACE L. REV. at \*8-9 (discussing the collaborative, “paternalistic,” and “collective bargain” approach to drafting neutral standard form contracts).

<sup>51</sup> Perillo, *Neutral Standardizing of Contracts*, 28 PACE L. REV. at \*17. See also Shmuel I. Becher, A “Fair Contracts” Approval Mechanism: Reconciling Consumer Contracts and Conventional Contract Law, 42 U. MICH. J. OF LAW REFORM \_\_ (2009).

<sup>52</sup> There is a rich, largely theoretical, literature about the incentives sellers may have to educate consumers. See, e.g., Xavier Gabaix & David Laibson, *Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets*, 121 Q.J. ECON. 505, 507-11 (2006); R. Ted. Cruz & Jeffrey J. Hinck, *Not My Brother’s Keeper: The Inability of an Informed Minority to Correct for Imperfect Information*, 47 HASTINGS L. J. 635, 659 (1996).

<sup>53</sup> See Gordon Stewart, *Can Reputations be “Managed”?*, 31 THE GENEVA PAPERS 480 (2006).

<sup>54</sup> Stewart, *Can Reputations be “Managed”?* at 487.

<sup>55</sup> *Id.*

intractable complexity of the product—and thus not caused by insurer behavior, there is no incentive to improve behavior.

The view that reputation can be shifted somewhat, not by deed but by image, “lead[s] to periodic calls for massive reputation campaigns.”<sup>56</sup> Campaigns that seek to raise the reputation of the industry as a whole, as opposed to any individual insurer, are most likely aimed at regulators and legislatures. Given the relative inelasticity of consumer demand for insurance, improving *consumers’* views of the industry as a whole is not calculated to increase sales. Insurers cannot count on consumers’ affection but they can count on their business: a stage set for neglect.

The inelasticity of demand can also decrease buyers’ attentiveness to insurance decisions. In order to own and drive a car, state law requires automobile insurance. In order to have a home mortgage, banks require homeowners insurance. In these cases, the consumer does not ask whether to purchase insurance and does not seriously consider not doing so. The question is from whom and for how much. If the consumer supposes that all insurers are pretty much the same and are all selling the same basic product, the question dwindles to “how much”.

The reputational defeatism view is quite dire but plausible. A combination of attitudes may account for insurers failing to take seriously the ability to educate or attract consumers with facts instead of images. On the one hand, in addition to industry lobbying, individual insurers do engage in ad campaigns, suggesting that they at least believe in the value of having their name before the buying public. On the other hand, insurance ads say very little about the product itself and make only the vaguest claims about insurer behavior.

If cars were advertised by insurers, the ad copy would read, “You can trust Our Cars!” or “You’re in a good car with Our Car.”<sup>57</sup> There would be no specifics about why the car is trustworthy, no discussion of airbags or crash test ratings,

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<sup>56</sup> *Id.*

<sup>57</sup> Allstate Insurance Company: “You’re in Good Hands with Allstate.”

no acceleration time given for zero to sixty.<sup>58</sup> It is not shocking that insurers rarely mention the substance of coverage, as it will vary little from competitors'.<sup>59</sup> But nor do insurance ads regularly tout their customer satisfaction numbers, the number of claims agents per customer, turnaround time, or litigation rate. Instead, we hear versions of: "We drive where you drive."<sup>60</sup>; "Cars. Because Driving Happenz."<sup>61</sup>; and "Our Car. The Car You Keep."<sup>62</sup>

Recently, State Farm has seized directly on the public perception that insurers play word games.<sup>63</sup> In their "Hidden Camera" ad series, State Farm stories vendors who rely too heavily on the literal meaning of a phrase, to customers' surprise and disgust: a vendor whose sign reads "Hot Dogs" doesn't provide buns; a "Shoe Shine" refers to one shoe, not two; and paying for a "Car Wash" does not include a car rinse. These ads ask variations on, "Is your insurer selling you a hot dog without the bun?" and close with the slogan "Find Out. State Farm."<sup>64</sup>

These ads acknowledge a negative perception that insurers play "gotcha" with language that might technically be narrow but is commonly understood more expansively.

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<sup>58</sup> Of course, there is a genre of car ads showing only the car exterior, driving down a winding autumn road, Vivaldi's "Four Seasons" in the background.

<sup>59</sup> Car *insurers* advertise almost exclusively on the basis of price, although this may make sense. Differences in car insurance really do come down to deductibles, caps, extent of coverage, and price, in other words, to money. Each car insurer sells different packages of deductibles, caps, and coverage; the choices do not vary much. Nor do the perils to cars and drivers vary much; special forms of coverage sold by one insurer but not another

<sup>60</sup> State Farm Insurance Company: "We live where you live."

<sup>61</sup> Zurich Insurance Group: "Zurich. Because Change HappenZ."

<sup>62</sup> New York Life Insurance Company: "New York Life. The Company You Keep." In fairness, the double entendre of the New York Life slogan is lost when "car" supplants "company." Still, either slogan simply says you will like the product enough to retain it.

<sup>63</sup> For an excellent analysis of State Farm's advertising, read "March Madness Makes It 'Official': State Farm Embraces the Reasonable Expectations Doctrine and Rejects Linguistic Literalism," posting of Jeffrey W. Stempel to Insurance Law Blog, <http://law.lexisnexis.com/practiceareas/Insurance-Law-Blog/Insurance> (Mar. 22, 2009, 21:50 EST).

<sup>64</sup> *Id.*

The set-up of the ads also contrasts what is advertised—a shoe shine—with what is delivered—one shiny shoe. Perhaps it is too subtle a thread to unwind from a T.V. commercial but these two “admissions” about the insurance industry are separate. The first claim is *ex post*; after a loss insurers (save State Farm, presumably) fall back on overly technical readings of policy language to support providing as little as possible. The second claim is *ex ante*; insurers hoodwink consumers into buying one product while planning to deliver a lesser.

The other three ads in the same “Hidden Camera” series are more random. A beachside bike rental place takes the customer’s \$5, only to wheel out a bike with no seat. As with the hot dog eater, this customer is getting less than anticipated but not because of a linguistic ruse. “Hot dog” can refer both to the meatlike object and to the combination of meatlike object with bun, but “bike” does not refer both to a usable bike and to a bike frame with tires but no seat. In the next ad, walkersby are disappointed to find that the boardwalk “foot massage” consists of a person fluttering their hands about the foot, without touching it and without even removing the shoes. Again, this action does not fit any definition, however technical, of a foot massage. In the last ad, a man in an ice cream truck hands out frozen novelties without sticks or cups; children have to hold the popsicle in their hands as they eat it. A popsicle without a stick is akin to a hot dog without a bun but the ad does not play it that way; customers are simply getting less than expected.

What doesn’t make for a great commercial may still be the best analogy.<sup>65</sup> Customers run after the ice cream truck, expectations in hand. Those who do not read the “Ice Cream” sign on the side of the truck have the *identical* expectation to those who do—both expect a stick. Customers who purchase from the “insurance truck” likewise have a set of expectations without reading word one of the policy. It isn’t the sign that misleads the buyers nor does the seller hide behind the language; he just shrugs off his customers’ desire for a stick.

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<sup>65</sup> The foot massage analogy is terrible.irate policyholders do not believe their insurers perform a different service from the one desired, they believe they fail to perform altogether.

Is State Farm claiming to communicate more clearly or simply give customers what they expect? Insurance scholar Jeffrey Stempel reads State Farm to be embracing the reasonable expectations doctrine.<sup>66</sup> Some of the ads end with the question, “Is your insurance company giving you less than you expected?”<sup>67</sup> If so, State Farm has taken an astounding counterposition to the tested language doctrine. Instead of starting out with a conception of what to cover actuarially, and working from that to discover how to convey that fixed conception in a common language, State Farm would have to start with what consumers expect and work to change policy language to deliver it.<sup>68</sup>

State Farm’s new ads are not the only insurance ads ever to address consumer expectation or disappointment. Bu they are unusual, as a brief survey of current television ads reveals.<sup>69</sup>

Traveler Insurance commercials focus on the synergistic nature of their products. Ads such as the “delivery” commercial,<sup>70</sup> where a 25-foot umbrella is used to solve various problem (transporting people who have lost their boat, fixing a broken bicycle) and ends with the umbrella coming to rest over an office building. The inference is that Travelers, and its umbrella of coverage, can help solve a variety of insurance problems.<sup>71</sup> Traveler’s other

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<sup>66</sup> “March Madness Makes It ‘Official’: State Farm Embraces the Reasonable Expectations Doctrine and Rejects Linguistic Literalism,” posting of Jeffrey W. Stempel to Insurance Law Blog, <http://law.lexisnexis.com/practiceareas/Insurance-Law-Blog/Insurance> (Mar. 22, 2009, 21:50 EST).

<sup>67</sup> See “State Farm Hidden Camera – Ice Cream Truck” available on State Farm’s YouTube channel, <http://www.youtube.com/user/statefarm>.

<sup>68</sup> In the alternative, State Farm could simply increase the types of claims it pays to meet expectations without changing the language. Consumer complaints that an insurer has paid despite policy language denying coverage must be rare, if not chimerical.

<sup>69</sup> A broader review of insurance commercials can be seen on [coloribus.com](http://coloribus.com).

<sup>70</sup> All Travelers ads reviewed are available at Traveler’s YouTube page, available at: <http://www.youtube.com/user/TravelersInsurance>

<sup>71</sup> Travelers also has an ad that shows how they can insure against all worries, such as dust, trees, and shopping carts, which turn out to be threats to a computer manufacturing business, a home, and a car – illustrating once again how they have the ability to cover a variety of objects.

ads focus on security; a dog tries to find a way to protect his “most prized possession”—a bone. After burying it, dreaming of its capture, digging it up, putting it in a safe deposit box, and fearing a bank heist, the dog ends up “insuring” it with Travelers. The Traveler message: We can keep what you care about secure.

Many of MetLife’s advertisements<sup>72</sup> follow one pattern—illustrating how MetLife can help consumers with the “Ifs” of life. Some of these commercials tell consumers to “call on MetLife’s expertise.” MetLife tries to portray a caring tone, focusing on how they can make consumer’s choices easier, and occasionally referencing their size, 70 million insured, or their long history of insuring consumers. The use of Snoopy,<sup>73</sup> and of animation in general, coupled with the focus on “your family’s dreams” creates a warm fuzzy approach to insurance.

MetLife does have one line of ads that seek to inform consumers or at least inform them of a way to educate themselves. These ads illustrate MetLife’s “Simplifier” tools, applications that allow consumers to compare different types of insurance and, theoretically, make the best insurance choices for their individual situation. Finding these tools on the MetLife website is not easy, however. There is one tool for employee benefits and one for life insurance.<sup>74</sup> MetLife also has an ad that guarantees “full replacement cost” of homes and cars. This ad stands out because it conveys important substantive information about MetLife’s policies.

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<sup>72</sup> All of MetLife’s advertisements are available at <http://metlife.feedroom.com/>. This includes many advertisements aimed at non-English speakers, some of which have a different feel. For example, the majority of the English language advertisements feature animation, while the Spanish advertisements feature a live-action familial setting.

<sup>73</sup> Snoopy is a character in the late Charles Schultz’ Peanuts comic strip. The comic is available at: <http://comics.com/peanuts>

<sup>74</sup> See [http://www.metlife.com/individual/employee-benefits/employee-benefits-tool/index.html?MCAT\[66\]=x](http://www.metlife.com/individual/employee-benefits/employee-benefits-tool/index.html?MCAT[66]=x) (employee benefits) and [http://www.metlife.com/individual/insurance/term-life-disability/index.html?MCAT\[63\]=x&WT.ac=Pro1\\_TermDisIFDiv\\_5-15721\\_T3619-IN-individual&oc\\_id=Pro1\\_TermDisIFDiv\\_5-15721\\_T3619-IN-individual#term-life-disability-basics](http://www.metlife.com/individual/insurance/term-life-disability/index.html?MCAT[63]=x&WT.ac=Pro1_TermDisIFDiv_5-15721_T3619-IN-individual&oc_id=Pro1_TermDisIFDiv_5-15721_T3619-IN-individual#term-life-disability-basics) (life insurance).

New York Life's commercials are positive but substance-free.<sup>75</sup> Mass Mutual commercials close with the note that Mass Mutual is "owned by its policyholders" which seems to suggest that Mass Mutual is more focused on its customers than other companies. The rest of the ad content is unhelpful to consumers, however.<sup>76</sup> Allstate takes a dual approach. First, it emphasizes the low cost of its insurance, stating that you can save between \$300 and \$500 a year over its competitors.<sup>77</sup> Second, it runs a more fearful series of ads that illustrate how much harm you face, such as the "1 in 8" chance of crashing a car.

In short, a consumer looking to learn about insurance and insurers should turn off the television. A distinction should be drawn between swaying consumers and educating them. "You can trust us," "We deliver," and "We care about your problems," are not educational statements unless they are followed by evidence, such as the percentage of current

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<sup>75</sup> See <http://www.youtube.com/watch?v=KZEW3AUyqg> and <http://www.youtube.com/watch?v=9JXTtffkGGY>, for example. New York Life does not keep advertisements on their website. One ad focuses on what life insurance can do for small children because "life insurance is the only one gift guarantees a lifetime of firsts." New York Life also notes the long history the company has, noting that their "values never change," and they only serve "the interest of our customers," always finishing with the tag line, "the company you keep," suggesting that once you chose New York Life, you never have to shop for insurance again.

<sup>76</sup> See <http://www.massmutual.com/aboutmassmutual/saa/advertising>, (Mass Mutual website, which also shows its print ads). Mass Mutual focuses on uncertainty in life, with one commercial that explains how a couple's child keeps returning, first from camp, later from college and Europe, and that they are not "renting out his room," since he may in fact return to live with them after his honeymoon. Mass Mutual's ads all focus on the idea that consumers "can't predict, but you can prepare" for the future. Other Mass Mutual ads focus on the "signs of a good decision," such as an entrepreneur that moves his office from an office with an imposing view over a major city to his home, so he can be closer to his children, and a commercial where a fishing boat, after leaving its dock, turns back around in the face of an impending storm, cutting short the fishing trip but potentially saving the lives of those on board. Both commercials close with the idea that a "good decision" when it comes to the world of personal finance is choosing Mass Mutual.

<sup>77</sup> The series includes some lighthearted commercials, such as the "Bergwood" commercials that focus on a football-crazed fan, and his hijinks. Bergwood has his own YouTube channel (<http://www.youtube.com/user/bergwoood>) and website at [bergwood.net](http://bergwood.net). All of the recent Bergwood videos are available on his YouTube channel.

buyers who endorse the claim. A seller moves beyond persuasion to education when it perceives the buyer will both (a) learn from the lesson and (b) change buying behavior.

The ultimate question is to what extent insurers attempt to attract additional market share by action, in addition to image. If it is right that policyholders are ill-equipped to judge action, in the absence of intelligible promises, tinkering with image may be the wiser course. If an individual insurer has limited effect on the reputation of the industry as a whole, and also has a hard time affecting consumers' perceptions of it as separate from the entire industry, there is limited reputational pressure on the insurer's actions. The rub is that reputation *should* be the battleground between two competitors who offer nearly interchangeable contracts.<sup>78</sup>

#### *Other Educational Sources*

Insurers do not have a monopoly on educational insurance information, of course. Perhaps consumers can simply rely on data and ratings provided by a neutral third party, an insurance version of *Consumer Reports*.<sup>79</sup> Indeed, *Consumer Reports* does provide some homeowners insurance reporting.<sup>80</sup> There does not appear to be any information about the percentage of consumers who use these reports;

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<sup>78</sup> Lucian A. Bebchuk and Richard A. Posner have argued that where reputational pressures apply to sellers but not to buyers, one-sided contracts that favor the seller are defense mechanism that do not necessarily "imply that the transaction will be one-sided, but only that the seller will have discretion with respect to how to treat the consumer." Lucian A. Bebchuk & Richard A. Posner, *One-sided Contracts in Competitive Consumer Markets*, 104 MICH. L. J. 827, 827 (2006). Reputation effects do not apply to consumer policyholders but given the lack of strong reputational effects on insurance sellers, we cannot confidently assume that one-sided insurance clauses are merely a defense against opportunistic consumers.

<sup>79</sup> *Consumer Reports* does provide a video entitled "Homeowners Insurance: Beware of loopholes in your homeowners insurance. Make sure you have the coverage you need.", available at <http://www.consumerreports.org/cro/video-hub/money/other-money/home-insurance-/14037629001/1280500155/>.

<sup>80</sup> <http://www.consumerreports.org/cro/magazine-archive/september-2009/home-garden/homeowners-insurance/overview/homeowners-insurance-ov.htm>

one does have to subscribe to the magazine, either in print or online.

Although we do not know if consumers take advantage of the sources described here, the description is worth making. A survey of sources for consumer information on homeowners insurance online suggests that even if consumers were digging around, they would end up with little more than dirt.

State regulatory offices could be a good source of information. The Commonwealth of Virginia's site is indicative of other states'. The primary source is the website for the Virginia State Corporation Commission, Bureau of Insurance.<sup>81</sup> This site has detailed information on all insurance companies operating in Virginia, broken down by category of insurance. It provides information on each company's financial position, including assets and liabilities, premiums written and premiums earned. The problem with this website is its lack of analysis.

The financial forms are long and simply list the data without explaining its relevance or making any analytical comparisons between companies. This information would be useful to a very savvy purchaser of insurance, rather than to the average buyer. Notably, the website does have a page titled "Automobile and Homeowners Shopping Tips." However, this page contains only general advice about shopping around and some questions to ask an insurance agent. It does not offer specific advice for comparing insurance companies.

The remaining results of an online search relating to purchasing homeowners insurance fall into two major categories: (1) private insurance companies' websites and (2) short, simple internet sites containing general advice about purchasing insurance (similar to the tips found on the Virginia Bureau of Insurance site). If one digs through the advice sites, one can find suggestions for good analytical websites. The most user-friendly and insurance-oriented is A.M. Best.<sup>82</sup> Its Property/Casualty Center has industry news and announcements regarding ratings activity. Upon

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<sup>81</sup> Virginia State Corporation Commission, Bureau of Insurance, <http://www.scc.virginia.gov/division/boi/webpages/boihomepage.htm>.

<sup>82</sup> A.M. Best, Property/Casualty Center, <http://www3.ambest.com/pc/default.asp>.

registration, users can also access financial data and company ratings. Another helpful site is J.D. Power & Associates' annual ratings of homeowners insurance providers.<sup>83</sup> It ranks insurers according to customer satisfaction in a variety of categories, including pricing, filling claims, and contact with the insurer.

J.D. Power's three top rated homeowners insurance providers in the country are Amica Mutual, Auto Club of Southern California, and Cincinnati Insurance. Amica's website is user-friendly, with drop down menus that display what types of policies are available in each state. However, it does not offer anything beyond general statements and empty claims. Auto Club's website is slightly more comprehensive, breaking down its discussion of homeowners insurance by dwelling type.<sup>84</sup> However, it too is mostly a sales pitch, and it does not offer any type of sophisticated analysis. Similarly, Cincinnati Insurance offers brief descriptions of the various types of homeowners policies it carries, but like the other two insurers, its website serves mostly as a vehicle to get consumers to contact the insurance agents.<sup>85</sup>

There are several general watchdog organizations that focus at least in part on general homeowners insurance policies. ConsumerWatchdog.org has an Affordable Car and Home Insurance branch that offers detailed advice on purchasing homeowners insurance.<sup>86</sup> Although stationed in California, the group is dedicated to insurance reform throughout the country, and as a result, it offers some general advice for purchasers nationwide. However, this site is primarily designed as a vehicle for the group's political activism, rather than an analytical tool for consumers trying to size up various insurers.

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<sup>83</sup> J.D. Power and Associates, 2008 National Homeowners Insurance Study, <http://www.jdpower.com/homes/ratings/homeowners-insurance-company-ratings>.

<sup>84</sup> Auto Club of Southern California, Insurance Services, <http://www.aaa-calif.com/insurance/>.

<sup>85</sup> Cincinnati Financial Corporation, The Cincinnati Insurance Companies, <http://www.cinfin.com/>.

<sup>86</sup> ConsumerWatchdog.org, Affordable Car and Home Insurance, <http://www.consumerwatchdog.org/insurance>.

In short, the average consumer would have a difficult time finding useful information online regarding homeowners insurers. On a general nationwide level, the best consumer source seems to be A.M. Best, but only some of its information is freely available. Additionally, the insurers themselves offer little more than sales pitches.

## II. REWARDING PLAIN LANGUAGE

### A. TESTING THE LANGUAGE

Here again is the proposed tested language defense:

*If an insurer uses consumer research to test policy language before adopting it, the insurer can present the results of the research to rebut a finding of ambiguity.*

Consumer research is a robust field and it is outside the scope of this paper to suggest the best detailed approach to testing contract language. Still, a concise discussion is warranted. During the drafting stage, an insurer would present test consumers with several variations on a particular clause. To bring the defense in court, the insurer would show that the clause it chose, while not perfectly understood by all consumers, beat out the next best alternatives, drawn from a pool of initially reasonable candidates. This evidence would inform *but not control* the court's decision.

Existing consumer research techniques could be used to assess the readability and accuracy of contract language. If the Insurance Services Office continues<sup>87</sup> to be the collective drafter for many forms of insurance, the research would be conducted collectively, not by lone insurers. On the other hand, if the defense increases the value of competition over policy language, larger insurers may strike out from the pack.

For all types of research, insurers will have to decide who counts as a “likely voter”—who should be in the survey audience.<sup>88</sup> One option is to find out what the *nation* thinks, but courts may prefer or demand more a regional or state-focused approach in order to raise the tested language defense.

Focus groups or one-on-one interviews are the logical first step. Open-ended questions about how a consumer

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<sup>87</sup> [address the implications of the pending repeal of the McCarran-Ferguson Act]

<sup>88</sup> Fritz Scheuren, WHAT IS A SURVEY 17 (National Opinion Research Center 2004).

reads a clause and the ability to ask follow-up questions would reveal pitfalls and potential solutions. After redrafting to address the first pitfalls, round two may reveal new ones. This type of research is exploratory, allowing insurers to rework language, but it can also be used to make a final choice between clauses.

Focus groups can generate substantial “pre-testing” knowledge, both about how survey questions should be shaped and what respondents think of the questions, given a chance to think about them. A focus group is designed as a discussion, not a series of questions and answers. The knowledge generated cannot be relied upon statistically, since the sample size is small, and by design, biased.<sup>89</sup> Properly run, however, a focus group can lead to deep pre-test results.

Pre-testing covers a wide range of action, all intended to create a higher quality survey before the full-scale survey is released. Pre-testing typically falls into two categories—pre-field and field testing.<sup>90</sup> In addition to focus groups, a similar technique used is cognitive laboratory interviews.<sup>91</sup> In these, the interviewer can either “think through” the questionnaire with the survey respondent, or do an “exit interview,” asking questions after the survey is completed.<sup>92</sup> These interviews spot problems quickly. For example, if a particular question has a reoccurring problem, the question can be remedied before inclusion in a full-scale survey.<sup>93</sup> This correction can occur in as few as 15 cognitive interviews.<sup>94</sup> In addition, coding the behaviors of survey respondents can lead to better questions.<sup>95</sup> If a particular

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<sup>89</sup> Scheuren, *WHAT IS A SURVEY* at 37. Focus groups are designed to have similar people participate, but none of the participants should know one another.

<sup>90</sup> See, e.g., Ruth N. Bolton, *An Exploratory Investigation of Questionnaire Pretesting with Verbal Protocol Analysis*, vol. 18 *ADVANCES IN CONSUMER RESEARCH* 558-565 (Assoc. for Consumer Research 1991).

<sup>91</sup> *Id.*

<sup>92</sup> Scheuren at 46.

<sup>93</sup> *Id.*

<sup>94</sup> See Bolton, *An Exploratory Investigation of Questionnaire Pretesting with Verbal Protocol Analysis*, vol. 18 *ADVANCES IN CONSUMER RESEARCH* 560.

<sup>95</sup> Scheuren at 47.

question requires clarification repeatedly, coding this behavior detects systematic problems.<sup>96</sup>

The problem with using open-ended questions to select a clause, of course, is that the answers consumers give require some interpretation in order to yield meaningful collective results. Consider the conclusion, “85% of consumers understood the clause to exclude household mold coverage.” Unless the interviews have morphed into specific survey questions, this conclusion could be rephrased as “the researcher understood 85% of the consumers’ answers to mean they understood the clause to exclude mold damage.” The question asked can also influence the answer, both with interviews and with surveys. Interviews allow questions such as, “what does this sentence mean?,” which will result in as many answers as there are subjects. Narrower questions, such as, “does this sentence mean you will not be paid for mold damage?,” still have some effect on the answer. It focuses the test subject on the possibility that the sentence might do as the question asks and may suggest an answer. Results can still be useful, of course, as long as the limitations of the research are disclosed.

If the early qualitative research produces several good versions of a clause, the next stage can be more quantitative. Survey questions, with multiple choice and “yes/no” answers, will yield numerical results.<sup>97</sup> These remain open to different types of bias, including leading questions, just as with all consumer research.<sup>98</sup>

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<sup>96</sup> *Id.*

<sup>97</sup> Today, mail surveys are still the most common, due to their low cost. If a particular subset of the population is targeted, mail surveys can be particularly effective. These need not be the old mail-out, mail-in method either. Increasingly, the internet is used for these types of surveys. The other main type of survey is the interview survey, which can be done in-person or through the telephone. Experienced questionnaire designers tend to work backwards, drafting an outline of what the final report or paper will contain, allowing them to pinpoint the exact data they wish to find. In this case, the focus would be which use of language best conveys a point to consumers. See generally, Elizabeth Hirschman, *Scientific Style and the Conduct of Consumer Research*, vol. 12 *Journal of Consumer Research* 225(Sept. 1995).

<sup>98</sup> For example, a test subject could be asked to read a clause and answer, yes or no, whether they would be covered for flooding from a broken pipe. While a subject may check “no,” inside that “no” could be

Regardless of how well the final survey is designed, courts will regard warily the insurance industry's research expert. The key with redrafting language is for insurers' incentives to be aligned with consumers'. But the insurer's incentives change from drafting to final testing. At the redrafting stage, the insurer is not looking to slant the data but to find the best way to convey its meaning.<sup>99</sup>

It is *after* a best clause has been selected for use in a policy that there is an incentive to arrange survey questions to overstate the strength of the clause and to downplay any remaining ambiguity. Even if an insurer succeeds in overstating the percentage of people who understand a clause, it nonetheless has first redrafted using empirical guidance on consumer understanding. Under current legal incentives, insurers consider courts as their audience. The tested language defense brings consumers into the theater.

#### B. THE DEFENSE APPLIED TO CONTRA PROFERENTEM

*Contra proferentem*, "one of the most common grounds of the law," writes Francis Bacon, is the "rule[] that a man's deeds and his words shall be taken strongest against himself."<sup>100</sup> As applied in 1923 by the United States Supreme Court, the doctrine required "in case of ambiguity that construction of the [insurance] policy will be adopted

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the longer, "I hadn't thought about it the first time I read the sentence but, now that you mention it, no."

<sup>99</sup> An objection to this contention is that insurers benefit, sometimes, from ambiguous language. This must be true; language that puts consumers off from seeking payment or bringing suit, even if the insurer would lose in court, has some value. The value is complex because ambiguity carries heavy costs, both in litigation fees and lost suits. Where an insurer nonetheless values ambiguity over its costs, one would not expect the insurer to attempt the tested language defense. The objection, therefore, may hold that the defense's use will be limited but it does not foretell insurers using and gaming the defense at the drafting stage.

<sup>100</sup> 3 Francis Bacon, *The Elements of the Common Laws of England*, in *THE WORKS OF FRANCIS BACON* 225, 225 (1857). The doctrine "is a schoolmaster of wisdom and diligence in making men watchful of their own business." *Id.* Of course, it is likely that *contra proferentem* is less "common" today, compared with other "grounds of the law," than it was in Bacon's time.

which is most favorable to the insured.”<sup>101</sup> In other words, ambiguous terms are to be construed against the drafter.

Here, the drafter is the insurer and it is probably still true today that *contra proferentem* is “the most familiar expression in the reports of insurance cases.”<sup>102</sup> Currently, a court makes an ambiguity determination based on its own reading of the text and the policyholder’s claim that it reads the language in a particular way. The question is not whether the plaintiff found the language ambiguous but whether a reasonable person in the plaintiff’s position would. The consumer testing evidence speaks directly to this question.

The research would show, first, whether the language is indeed ambiguous to the relevant audience. Second, if the clause could not be made wholly unambiguous, the evidence will reveal whether the reading proposed by the policyholder in court is among the objective interpretations. The evidence also provides the court with shades of ambiguity.

Finally, evidence on the ambiguity front would save the doctrine in the eyes of some courts. The Arizona courts, for example, have “abandoned” the *contra proferentem* approach, believing that “a finding of ambiguity is the easy way out since it permits the court to create its own version of the contract and to find, or fail to find, ambiguity in order to justify an almost predetermined result.”<sup>103</sup> Research showing that consumers do or do not find language ambiguous is an antidote to concerns that courts are making it up as they go along.

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<sup>101</sup> *Mut. Life Ins. Co. of N.Y. v. Hurni Packing Co.*, 263 U.S. 167, 174 (1923).

<sup>102</sup> 2 G. Couch, R. Anderson, and M. Rhodes, *COUCH ON INSURANCE* 2D, § 15:74, at 334.

<sup>103</sup> *Ohio Cas. Ins. Co. v. Henderson*, 939 P.2d 1337, 1339 (Ariz. 1997) (citing *Darner Motor Sales v. Universal Underwriters Insurance Co.*, 682 P.2d 388 (1984)).

### *One Contra Proferentem Decision Tree*

1. Do consumers as a group find the language ambiguous?

No → the language is applied as written.

No, but the court finds it ambiguous as applied → go to 3.

Yes → go to 2.

2. Is the policyholder's reading one other consumers share?

Yes → the policyholder's reading is reasonable and can be enforced against the insurer.

No → The insurer has drafted and retained ambiguous language but the policyholder's reading is not a viable alternative.

The court can

- a. Punish the insurer by providing coverage anyway, which may or may not be as much coverage as the policyholder's reading provided.

- b. Construe the language against the insurer but in favor of the general consumers' reading, as opposed to the policyholder's.

3. The language is not ambiguous on its face but it is ambiguous as applied. Should the insurer bear responsibility for failing to foresee the ambiguous application?

No, because the risk is too new or emergent → C.P. may not apply

Yes, the application was foreseeable and the insurer failed to prevent the ambiguity → the court will punitively apply C.P.

This decision tree will have many more branches because consumer research will also reveal what *percentage* of consumers understood the chosen clause. State courts will have to develop a conception about what level triggers ambiguity and how to handle different types of results. For example, if 75% of consumers tested understood the clause to mean A and the remaining 25% understood the clause to mean B, how should a court address a plaintiff proposing reading B? If the insurer can show that efforts to get agreement above 75% were futile, perhaps the clause should

be allowed to stand, even in the face of 25% confusion. Some answers are proposed in the discussion of ambiguity and complexity, below.

Importantly, once done, the language research can cabin the sometimes imprecise effects of ambiguity. A clause that is legitimately open to more than one reading is not thereby open to all readings, particularly as applied to an individual context. Tested language can pare down the universe of options a court need consider.

A difficult question arises if 65% of consumers tested understood the clause to mean A and the remaining 35% understood the clause to mean B, but the plaintiff proposes meaning C. On the one hand, the insurer has willfully used language that confuses 35% of consumers, a choice that in most cases should be strongly discouraged and certainly not rewarded. On the other hand, if the consumer in court is proffering reading C, we can safely anticipate that to be the reading that provides coverage, and hence the reading that “punishes” the insurer. Yet the evidence suggests that reading C is unreasonable. Even if the facts are changed such that consumers fall out at 65% for A, 25% for B, and 10 % for C, that may suggest that C is a mistake, albeit not an idiosyncratic one.

The primary function of *contra proferentem* is to give the insurer an incentive to draft clean unambiguous language. I have argued elsewhere that this function often reverses itself in the insurance context.<sup>104</sup> Insurers draft as an industry and pool the resulting loss data. A clause that is backed by existing data has a known cost, even if that cost is higher than originally anticipated because courts have construed it against insurers. Drafting new language to respond to the widespread application of *contra proferentem* is expensive and risky; there is no guarantee that the revised language will be read as wished either. Wherever insurers prefer a known interpretation to a particular interpretation, *contra proferentem* serves to ensure that insurers will hold on to language that is ambiguous on the page but no longer ambiguous in court precedent.

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<sup>104</sup> Michelle Boardman, *Contra Proferentem: The Allure of Ambiguous Boilerplate*, 104 MICH. L. REV. 1105 (2006).

The effect on consumers is unfortunate. For the first consumer before the court, the application of *contra proferentem* is a boon. But if the court's interpretation of the language is acceptable to the industry, it will continue to be used, to the disadvantage of consumers two through two million, who will not understand the language or will be misled into not seeking relief a court would grant. Therefore, if the tested language defense can limit the overuse of *contra proferentem*, it may decrease the unintended reward courts give insurers for retaining poor language.

The second function of *contra proferentem* is to protect the policyholder from being harmed by an ambiguity of the drafter's own making. Flipped, it precludes the drafter from benefitting from an ambiguity of its own making. But it is a limitation of the evidence that it cannot completely track the abstract/as applied divide. A clause must be ambiguous as applied to the facts of the loss, rather than in the abstract.<sup>105</sup> Consider a scenario in which, despite the insurer's best research efforts, a clause is ambiguous *as applied* to a particular context. Assume the evidence shows that 90% of consumers understood the clause similarly but that the loss at hand is an unexpected context. Perhaps a court should still employ *contra proferentem* to protect the policyholder. While the court is not interested in punishing the insurer, it may hold that the risk of emergent ambiguities remains with the insurer. Moreover, there is less risk of the perverse effect described above; the insurer already has a strong incentive to retain the clause, which is understood in its main context by 90% of consumers.

Finally, there is a side benefit to allowing insurers to mount the tested language defense. The evidence will constrain insurers' ability to take procrustean litigation positions. An insurer should be considered locked-in to the basic meaning of language it chooses to use once it knows how a majority of consumers read the language. If a given research-tested interpretation goes against an insurer's interest in one case, we will not expect the insurer to raise the tested language defense in that case. However, if the evidence on the language's meaning has been considered by

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<sup>105</sup> Many insurance clauses are complex enough to be ambiguous in the abstract. On rare occasions, a court looking to construe a clause in a particular way will focus on the abstract ambiguity, where the language is not ambiguous as applied.

another court, and published in an opinion, the insurer's hands are tied. Note that this benefit is not limited to circumstances where the particular insurer has submitted the research evidence in the past. If the language is ISO-drafted, sold industry-wide, an insurer using that language is bound by the evidence of the original drafter.<sup>106</sup>

### C. THE DEFENSE APPLIED TO REASONABLE EXPECTATIONS

The doctrine of reasonable expectations was recognized, or created, depending on one's view, in 1970.<sup>107</sup> Its precise form varies with the jurisdiction but, as originally stated, it held:

The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations.<sup>108</sup>

In the many articles written on reasonable expectations since 1970, one central question has been how to handle

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<sup>106</sup> Courts have taken a similar position where ISO has made representations about the meaning of a clause to state regulators while seeking permission to use the language. See John R. Prince, III, *Where No Minds Meet: Insurance Policy Interpretation and the Use of Drafting History*, 18 Vt. L. Rev. 409, 436 (1994).

<sup>107</sup> Robert Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961 (1970). A few states reject the doctrine still. See *Wallace v. Balint*, 761 N.E.2d 598, 606 (Ohio 2002) ([T]here is not yet a majority on this court willing to accept the reasonable-expectations doctrine.); *Dakota, Minnesota & Eastern R.R. Corp. v. Heritage Mut. Ins. Co.*, 639 N.W.2d 513, 519 (S.D. 2002) (“[T]he doctrine of reasonable expectations has never been adopted by South Dakota; in fact, this Court has repeatedly declined to adopt the doctrine.”) (internal citations omitted).

<sup>108</sup> *Id.* at 967. The Restatement (Second) of Contracts § 211(3), “Standardized Agreements” reads: “Where the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement.” 2 Restatement of Law 2d, Contracts (1981). This formulation differs substantially from the variations on the doctrine courts follow. Although it is considered the Restatement's version of the reasonable expectations doctrine, section 211(3) is rarely mentioned or cited by courts in insurance cases.

language that would have negated expectations under more casual study.<sup>109</sup> Another has been whether ambiguous language is a prerequisite to application of the doctrine. There is also the question of whether the doctrine, as applied, truly seeks to enforce consumer expectations instead of consumer preferences.<sup>110</sup>

Happily, we can analyze the contribution of the tested language defense to the reasonable expectations doctrine without settling these debates. However else a court approaches the question, the court always asks what a reasonable person in the policyholder's shoes would have expected from the contract. Instead of speculating about what a reasonable person would have expected, or, worse, taking the plaintiff's post-loss litigation claims as proof of pre-loss expectation, consumer research can provide factual evidence.

The evidence would be used in two separate ways. First, the majority of courts do allow that if moderate "study" of the contract language would have deflated an expectation, that expectation is no longer "reasonable." In these courts, then, the consumer research evidence on what the average consumer believed a clause to mean would fit directly into the question.

Second, in some states it is "a precondition to reliance" on reasonable expectations "that an ordinary layperson would misunderstand the policy coverage."<sup>111</sup> Instead of speculating about what an ordinary layperson would or would not understand, courts could evaluate the evidence submitted under the tested language doctrine. Other states explicitly require that a policyholder's expectations be

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<sup>109</sup> See Roger C. Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L. J. 823 (1990); *Symposium, The Insurance Law Doctrine of Reasonable Expectations after Three Decades*, 5 CONN. INS. L. J. 1 (1998); James M. Fischer, *The Doctrine of Reasonable expectations Is Indispensible, If We Only Knew What For?*, 5 CONN. INS. L. J. 151 (1998).

<sup>110</sup> For an interesting discussion of the possible divergence, see Daphna Lewinsohn-Zamir, *Consumer Preferences, Citizen Preferences, and the Provision of Public Goods*, 108 YALE. L. J. 377 (1998).

<sup>111</sup> Susan Randall, *Freedom of Contract in Insurance*, 14:1 CONN. INS. L. J. 107 (2008), *citing Bituminous Cas. Corp. v. Sand Livestock Systems*, 728 N.W.2d 216, 220-21 (Iowa 2007), among others.

confirmed only if the policy language is ambiguous.<sup>112</sup> Here, the court would engage in the same ambiguity analysis required under *contra proferentem*.

Finally, there is a potential spillover benefit here. In the many cases where consumer research will remain unavailable, the tested language defense may still aid courts in making more accurate guesses about a consumer's "reasonable expectations." Several years of this type of evidence would school insurers and courts both in the types of reading mistakes consumers make and what level of language complexity can be understood by non-lawyers.

#### D AMBIGUITY AND COMPLEXITY

The third use of the tested language defense may be more controversial. The evidence should allow a court to decide if the insurer had done its best to make the language readable. This is not to pat the insurer on the back, but to determine if punishing the insurer for not doing better will have any positive effect.

Pinpointing where a clause falls on the ambiguity spectrum presents courts with a choice. Beyond a certain point, courts will want to "punish" the insurer for intentionally using an ambiguous clause. The decision turns on several factors. First, does the clause give policyholders false hope? Avoidable ambiguity is unwelcome but ambiguity that creates a lay impression of coverage while legalistically reducing coverage is unpalatable. Such a clause indicts the insurer's motive and doubly harms consumers. In this circumstance, a court may be willing to grant the policyholder's reading *even if* the evidence shows it is not one of the objective options.

When answering the "false hope" question, consumer testing evidence comes in at two points. First, it places the clause on the ambiguity spectrum. What percentage of consumers shares a common understanding of the clause? 90%? This may be the best real-world outcome. 75%?

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<sup>112</sup> See, e.g., *Merino v. Allstate Indem.*, (9th Cir. 2007) (applying California law); *Kolb v. Paul Revere Life Ins. Co.*, 355 F.3d 1132, 1136 (8th Cir. 2004) (applying Arkansas law); *Peck v. Pub. Serv. Mut. Ins.*, 363 F.Supp.2d 137, 145 (D. Conn. 2005).

Many courts may find this ambiguous but acceptable if the rest of the test is passed. 50%? Atrociously ambiguous.

Next, the evidence answers the “false hope” question directly; does a substantial portion of the lay public read the clause, not only to have a different meaning, but a more *attractive* meaning? Perhaps 20% read the clause inaccurately but not in a way that would, if read, lead them to either (a) purchase the policy or (b) refrain from seeking payment. Conversely, perhaps 20% misread the clause to increase coverage instead of decreasing it—a “false hope” clause.

A second question must be answered before a court decides to punish the insurer. Is the concept the provision attempts to convey complex enough that even the most artfully drafted clause will create consumer confusion? The ambiguity spectrum, coupled on occasion with evidence that consumer understanding of certain complex concepts hits a ceiling, may determine how a court treats “natural” and unavoidable complexity.

Consider three possible results from consumer testing of language and how courts might classify the results.

1. 90% of consumers understand the language as intended  
10% have random readings or claim no understanding  
This language is not ambiguous, as least as written. It may become ambiguous as applied to new or unusual facts.
2. 80% of consumers understand the language as intended, to mean “A”  
20% understand the language to mean “B” where “B” = “A + more coverage”  
States may differ on whether these percentages support a finding of ambiguity. The 20% who read “B” may have false hope. The court needs to know if reasonable attempts to remove that hope failed.
3. 65% of consumers understand the language as intended, to mean “A”  
25% understand the language to mean “B” where

“B” is not more attractive to consumers than “A”

10% have random readings or claim no understanding

This looks like classic ambiguity, although at least the insurer is not creating or benefiting from false hope.

But suppose in scenario 3 the insurer has submitted its alternate attempts to improve consumer understanding and proven that consumer understanding above 65% is not possible. The concept behind the provision is complex but has a strong basis in actuarial need. The complexity might even stem from an attempt to provide *more* coverage than a blanket exclusion; the insurer could simplify the language and improve the consumer numbers by providing no coverage at all, to policyholders’ detriment.

This is most likely in the infamous (among students of insurance) but common case of exceptions to exclusions.<sup>113</sup> The policy starts with a grant of coverage—physical damage to one’s home, say. The grant is limited by an exclusion of coverage—no payment for damage from mold, fungus, or wet rot.<sup>114</sup> Some coverage is granted back, however, by an *exception* to the exclusion—“we do insure for loss caused by mold, fungus or wet rot that is hidden within the walls or ceilings or beneath the floors or above the ceilings of a structure if such loss results from the accidental discharge or overflow of water or steam from within” various pipe systems.<sup>115</sup>

The exception expands the scope of coverage; it is therefore consumer friendly. To maintain a general exclusion on mold and rot, however, the exception is twice as long as this quotation and none of it less verbose. If a court decides that insurers must go whole hog in one direction or the other, for the sake of clarity, consumers will lose all mold coverage. Insurers have concluded that mold and toxic mold claims, which include both property damage and health

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<sup>113</sup> See, e.g., Thomas E. Chase, *All Risk Insurance, Exceptions to Exclusions: Burden of Proof?* N.Y. L. J. 6 (April 28, 2005).

<sup>114</sup> HO3-Special, HO 00 03 10 00, Section I Perils Insured Against, A. Coverage A—Dwelling and Coverage B—Other Structures, § A.2.c.(5). (ISO 1999).

<sup>115</sup> HO3-Special, HO 00 03 10 00, Section I Perils Insured Against, A. Coverage A—Dwelling and Coverage B—Other Structures, § A.2.c.(5). (ISO 1999).

problems, may be “the next asbestos”<sup>116</sup> In other words, enough to bankrupt individual insurers if exclusions fail.<sup>117</sup>

Courts are currently skeptical of insurer claims that language cannot be made clearer. If consumer research shows that some actuarially legitimate clauses are too complex to be made lay friendly, courts will have to decide how to weigh clarity and substance.

### III. ENJOYING PLAIN LANGUAGE

#### A. BENEFITTING FROM PLAIN LANGUAGE

It is commonly assumed that more accessible contract language is in the consumer’s interest, but this should not be taken for granted. In “*The Myth of the “Opportunity to Read” in Contract Law*,” Omri Ben-Shahar argues against giving consumers greater access to boilerplate contract language.<sup>118</sup> Efforts such as making the contract more readily available beforehand are useless and distract from valid reform, he argues. Instead, consumers “would benefit from mechanisms that accord them more meaningful information about the *product* (as opposed to the contract).”<sup>119</sup>

The problem in insurance, of course, is that the contract and the product coincide. The two are not easily distinguishable. While Ben-Shahar’s analysis is not meant to encompass insurance,<sup>120</sup> some points apply equally well; making the contract more accessible pre-purchase and more readable will not, by itself, tempt the majority to read.

On the other hand, there is more to be gained from reading an insurance policy at the time of purchase than,

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<sup>116</sup> See John T. Waldron III & Timothy P. Palmer, *Insurance Coverage for Mold and Fungi Claims: The Next Battleground?*, 38 TORT TRIAL & INS. PRAC. L.J. 49 (2002).

<sup>117</sup> See Thelma Jarman-Felstiner, *Mold is Gold: But Will it Be the Next Asbestos?*, 30 PEPP. L. REV. 529, 540-50 (2003).

<sup>118</sup> Omri Ben-Shahar, *The Myth of the “Opportunity to Read” in Contract Law* Chicago John M. Olin Law & Economics Working Paper No. 415 (July 2008).

<sup>119</sup> Ben-Shahar, *The Myth* at 6.

<sup>120</sup> In a brief discussion, Ben-Shahar places the reasonable expectations doctrine in insurance on one end of a spectrum, book-ended by the strict duty to read. *Id.* at 8.

say, the contract that comes with software or a bread maker. There is more room for modification to the agreement in insurance than with most goods—the level of coverage, additional coverage, and deductibles are all adjustable for a price. Ironically, there is more time to read the contract because it arrives after the purchase has been made (at which point it can be rejected or changed).

Most important, the argument advanced here is that there is value to being able to understand the insurance contract *after* the time for modifying the contract is long past. Scholars and policymakers have argued that accessible language in Contract 1 will allow the buyer to make a better decision about buying Product 1. In insurance, we should consider whether accessible language in Contract 1 will allow the buyer to make a better decision about buying Contract 2, Contract 3, and so on.

The exact value of readable contract language cannot be known in the absence of any. Nonetheless, the insurers' role in consumer misperception could be improved so that we do not have to speculate about how much consumers want to know; we can give them a chance to know more and see what happens. Understanding what was sold or what promise was made makes the market for a product possible. Under current language, policyholders are in the dark about many clauses. If language could be made readable, policyholders could more accurately:

- judge whether an insurer has breached
- share that judgment with the state insurance commissioner
- decide to switch insurers
- decide to purchase different coverage from the same insurer
- decide to act because a risk (flood) or an object (boat) is not covered
- decide to sue

These acts follow an internal and external education. The policyholder learns more about his own preferences, informing his next purchase. He learns about the quality of

his insurer, opening the insurer up to reputational pressures, the threat of which should improve the insurer's behavior. He can calculate more readily how to handle the results of the contract at hand, such as how hard to press for payment and whether to sue or file a state regulatory complaint.

There is also the hope of less and less expensive litigation. The more accurately a consumer can judge whether an insurer has breached, the more targeted consumer suits can be. Disappointed but not ill-treated consumers will sue less. Wronged consumers may sue more or more effectively press their claims without going to trial.

Once insurers know that policyholders can more accurately evaluate their behavior, two changes follow. First, the insurer should more readily pay legitimate claims, thereby decreasing the need for litigation. Second, the insurer and policyholder will be closer together in their joint understanding of the situation, making settlement more likely. Cases will still be brought, of course, but plain language does not benefit just the policyholder. The plainer the language, the less effort and time courts will expend to decide cases. Note again that none of these potential benefits require the policyholder to read one word of the insurance policy before purchasing it.

## B. SOME OBJECTIONS TO THE DEFENSE

### *Necessity*

One might question why we need a new doctrine or defense in order for insurers to start test driving their policy language. However disjointed the market for consumer insurance may be, surely the insurer who announced a plain language policy, proven to be "plain" by actual homeowners on the street, could attract some attention. This potential P.L. insurer has at least two serious hesitations. First, plain language may excite some buyers but the cost is starting afresh with the application of actuarial data to the new language, giving up a known quantity for a (perceived) high risk that courts will interpret the new language in unknown ways.<sup>121</sup> In other words, the cyclical reinforcement of

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<sup>121</sup> "Pricing insurance is difficult. Unlike most businesses, an insurance company can't set its prices based on known costs for production and

collective drafting and settled court interpretation exerts too much gravity.

Second, without the defense, insurers should be wary that their efforts at test driving will be used against them. The outcome of even the most carefully drafted and consumer tested language will not be that 98% of consumers come close to a single accurate understanding. The consumer research joke that one can find 10% of people who believe anything is funny because it's true.<sup>122</sup> What the research is more likely to show is a mix of reactions, with the best language garnering the most "votes" but still confusing some readers.

If "ambiguity" in the insurance context is defined to include any word, phrase, or clause that is given an alternative reading by, say, 15% or greater, then the research is better left undone because most will be declared ambiguous. The tested language defense seeks to provide insurers both with an incentive to employ plain language and with protection against a perverse reaction to consumer research.

#### *Giving an "A" for Effort*

A second objection to the tested language defense is that it gives insurers an "A" for Effort where a grade for outcome is more appropriate. Why should the insurer not bear the full risk of language being hard to decipher or being ambiguous as applied to a new scenario? One answer is that attempting to make the insurer bear the full risk has not improved consumers' lots; unclear language is retained, slightly modified, made longer and more obtuse, but not often removed. Rewarding effort, within limits, may be the only way to get the benefits of a plain language effort.

Nor does the tested language defense require courts to award an "A" for every effort. The defense would instruct a court to allow the insurer to present its consumer evidence

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distribution. Instead, an insurer needs to project the costs of future claims by examining historical data. The process is reliable only when the insurer uses a sufficient amount of accurate data." *Helping Insurers Price Their Products*, The Insurance Services Office, <http://www.iso.com/About-ISO/ISO-Services-for-Property-Casualty-Insurance/Helping-Insurers-Price-Their-Products.html>.

<sup>122</sup> Perhaps it is 10% of people who will *say* they believe something, such as that "Elvis is Alive." *JOURNAL OF CONSUMER RESEARCH*, Chicago.

and require the court to take seriously the possibility that the consumer-influenced language should not be found ambiguous or that the ramifications of ambiguity should be narrowed. In some cases, consumer research will change a court's reasoning without changing the case outcome.

For example, a court may start from the regulatory position that an insurer should provide a certain type of coverage because most policyholders purchasing that type of policy expect it. The court's honest position is not that insurers' should more clearly explain the exclusion; the court concludes that in the face of policyholders' abiding belief that a loss is covered, it *should* be covered. Rather than give insurers false hope, and start a new cycle of wasted litigation over new language, the court should come clean. Neither *contra proferentem* nor reasonable expectations explain the court's reasoning. The tested language defense could force judicial frankness by removing the easy out of ambiguity.

To the degree application of the tested language doctrine does reward insurers for effort, it is counter to the recent trend of analogizing consumer insurance policies to consumer products. The argument there is that, to the extent the policies are a contract, the contract content is unknowable to a consumer, and, to the extent the policy is a product, it is a consumer product, subject to judicial regulation for consumer protection.

It is an open question whether insurance policies are a contract, a description of the product sold, or a bit of both. Descriptively, the written policy is treated by courts as contributing to the contract between the parties but neither embodying the whole agreement (which is true of most contracts) nor being wholly included in the agreement. In addition, consumer insurance policies raise many of the same concerns that consumer products do, based on many of the same traits.

The analogy therefore is a rich one, deserving of exploration, but one danger will be considered here. It is a short step from categorizing an insurance policy as a consumer product to consciously treating insurance policies under a regime akin to products liability. This step is

already being advocated.<sup>123</sup> Product liability regimes differ by state but are generally strict liability once the product has been shown to be defective. The care taken in the product's creation by the maker is not a defense under strict liability. The tested language defense is therefore a step in the opposite direction from the growing "consumer insurance product" trend.

With a physical product, strict liability has much to recommend it.<sup>124</sup> It gives manufacturers an incentive to take care by requiring the maker to internalize the costs of loss from defective products. Of course, all products are imperfect and will fail on occasion even if made with best efforts or (lowering the precaution level) optimal efforts. When strict liability makes the manufacturer pay for a loss from an optimally created product, it allows the cost of loss to be spread across purchasers instead of falling disproportionately on the consumer who randomly experiences the loss from inevitable imperfection. At least in theory, the cost of these unavoidable losses will be added to the price of the product.

This is where the temptation to protect policyholders as just another set of consumers should be resisted. First, the initial loss is not caused by the "maker" – the insurer – it is caused by an outside risk, a falling tree or a kitchen fire. The party that has the best chance of avoiding or mitigating the loss is the consumer, not the insurer. Converse to the products liability scenario, the more an insurer pays for a loss, the more likely the loss is to happen. (Of course, people's misuse of a product can cause or exacerbate a loss, so there is moral hazard<sup>125</sup> in strict liability for products as well.<sup>126</sup>)

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<sup>123</sup> For the best defense to date, see Daniel Schwarcz, *A Products Liability Theory for the Judicial Regulation of Insurance Policies*, 48 WM. & MARY L. REV. 1389 (2006-07).

<sup>124</sup> Discuss W. Kip Viscusi, *Individual Rationality, Hazard Warnings, and the Foundations of Tort Law*, 8 RUTGERS L. REV. 625 (1996).]

<sup>125</sup> There is a moral hazard when the existence of insurance decreases the insured's incentive to avoid loss or harm. See Vol. 1 NEW APPLEMAN INSURANCE LAW PRACTICE GUIDE § 5.05[1] (L. Martinez, M. Meyerson, & D. Richmond, eds., 2008 ed.).

<sup>126</sup> Many jurisdictions require manufacturers to anticipate likely misuse of a product and to address the potential with improved design or warning. See Lars Noah, *The Imperative to Warn: Disentangling the*

Second, the risk spreading function the manufacturer provides by including the cost of non-negligent losses in the product price makes much less sense in insurance. This may be counterintuitive, given that risk spreading is the insurance function. Let us compare the two. By requiring a coffee pot manufacturer to pay the loss when a pot explodes, the law adds to the sale of the pot an insurance policy covering all pot-caused losses. Buyers pay for the policy, knowingly or not. Some buyers no doubt prefer a cheaper pot without the insurance. Other buyers may believe they prefer the cheaper, no-policy pot but are mistaken. Nonetheless, because we can combine the insurance with internalizing the maker's incentives, and because most buyers do not want to be bothered with the explicit choice between the pots, buyers as a whole may be better off with their forced insurance purchase.

Now consider homeowners insurance. We do not decrease the risk of loss by including the loss in coverage. In fact, as mentioned, at the margin we increase the risk of loss because the policyholder anticipating payment for the loss will take fewer precautions to avoid it. Because the risk (to a home) is external to the product being sold (the policy), if "strict liability" meant requiring the seller to pay for every loss, homeowners insurance policies would cover all damage to homes and their contents, by whatever cause, at an atrocious price. This forced sale of insurance would make buyers worse off, probably much worse off.

Most courts do not apply this form of strict liability. Even a court willing to find ambiguity around every page corner is unlikely to award coverage to the policyholder who burns down his own home. (On the other hand, what court will require the coffee pot manufacturer to compensate the buyer who pours gasoline into his pot and then lights a match?) But if "strict liability" means the insurer pays

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*"Right to Know" from the "Need to Know" About Consumer Product Hazards*, 11 YALE J. ON REG. 293 (1994) (discussing the overabundance of product warning label requirements imposed by Congress, federal regulators, and state legislatures); Howard Latin, *"Good" Warnings, Bad Products, and Cognitive Limitations*, 41 UCLA L. REV. 1193, 1201 (1994) ("The object of a good warning is to provide users with information about risk levels so that users can harmonize their use preferences with their safety preferences in an informed way, to provide users with information about safe and dangerous use so that they can choose optimal risk reduction strategies, or to provide both types of information").

whenever there is arguable ambiguity, the scope of coverage will still be dramatically increased. To the extent providing coverage becomes a stubborn default, resistant to all but the most robust rebuttal, courts are forcing future policyholders to purchase additional insurance.

The difference here is that the insurance is being added to the original insurance instead of to a product. This may give the impression that the policyholder is always better off. The buyer gets more of the product they wanted, what could be bad about that? Just as with the coffeepot, however, the court is requiring something of the seller but also of the buyer; it is another forced sale, which future prices will reflect.

The initial impulse to place the risk of all ambiguity on the insurer is sensible; insurers shift risk by definition and the insurer is in a better position to anticipate emerging risks and new ambiguities.<sup>127</sup> If placing the risk with insurers were costless to policyholders, or at least always cost justified, the impulse might be followed. In the end, however, it is not necessarily to policyholders' advantage to have the risk of every loss spread across the group and added to the price.

### *Structural Ambiguity*

It is not just the language of insurance policies that makes for difficult reading. The order of the language, the parachronistic structure of the policy, the intimate connection between clauses found in separate "sections" pages apart, sap the reader's will to continue, assuming sufficient fortitude to begin. A consumer who reads from page one and stops when he reaches a clause on point will often miss additional controlling clauses. Robert Jerry refers to this as "ambiguity of organization."<sup>128</sup> This form of

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<sup>127</sup> See W. Kip Viscusi, REFORMING PRODUCTS LIABILITY 64-66 (1991). Viscusi gives as the purpose of products liability law addressing "inadequate risk information," which is the "chief inadequacy of the market."

<sup>128</sup> Robert H. Jerry, II & Douglas R. Richmond, UNDERSTANDING INSURANCE LAW § 25A[a] & n. 316 (4th ed. 2007). Jerry adds ambiguity of organization to the Farnsworthian categories of imprecise language. See, e.g., E. Allan Farnsworth, "Meaning" in the Law of Contracts, 76 YALE L. J. 939 (1967).

ambiguity is more than inconsistent terms in the same contract.<sup>129</sup>

The tested language defense does not provide a direct incentive to fix structure. However, a court is likely to rebuff the defense if the interaction between two clear clauses is unclear. In some cases, therefore, improvements to structure may be required before an insurer can take advantage of the tested language defense. Improvements in structure theoretically could be tested using consumer research, although the time and attention required of test subjects would make the project unwieldy. A common sense structure, even chosen in the absence of consumer testing, would beat out a fossilized structure.

### *Overt Judicial Regulation*

Finally, it is worth considering if the clarity the tested language defense pursues is less desirable than a more subtle, more fictional understanding of how courts interpret contract language. If courts have a particular regulatory end in mind from which they will not be turned, for good or ill, the defense may undermine judicial credibility by leading courts to make incredible statements. Today, courts take positions on how a reasonable consumer would read language and whether it is ambiguous. When one party objects, we do not take it as evidence that the court is wrong; we expect the parties to disagree. And since insurance language is rarely clear in all applications, a court's conclusion that a certain clause is ambiguous, and therefore malleable, is difficult to reject out of hand.<sup>130</sup>

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<sup>129</sup> See E. Allan Farnsworth, "Meaning" in the Law of Contracts, 76 Yale L. J. at 956 ("Ambiguity in contracts may also result from inconsistent or conflicting language.").

<sup>130</sup> Many have concluded that excessive play in the joints of ambiguity has led courts to "fabricate ambiguities." Stephen J. Ware, *A Critique of the Reasonable Expectations Doctrine*, 56 U. CHI. L. REV. 1461, 1469 (1989). "The underinclusiveness of the ambiguity rule is even more problematic because it often leads judges to manufacture ambiguities. Although the ambiguity rule by its terms does not apply to inefficient, unambiguous provisions, judges sometimes--perhaps often--hold unambiguous terms to be ambiguous to avoid giving effect to provisions they perceive to be harsh." Michael B. Rappaport, *The Ambiguity Rule and Insurance Law: Why Insurance Contracts Should Not be Construed Against the Drafter*, 30 GEORGIA L. REV. 171, 224-25 (1995).

The tested language defense changes this. Evidence of consumer understanding renders a court's proposition testable and falsifiable. In a pair of Ukrainian short stories the narrator discovers that factories are making super-high-wattage bulbs in order to meet a government quota for more bulbs, measured in watts. When the new bulbs are installed, the residents in a communal apartment realize the squalor in which they live. We may find we prefer our old bulbs; spreading more light over judicial decision making may be depressing.<sup>131</sup>

On the other hand, it is difficult now to determine if a court honestly or strategically calls ambiguity. The answer is crucial to insurers who must decide whether a clause needs to be withdrawn or re-drawn. If courts find the clause so substantively objectionable that ambiguity will be found whenever possible, withdrawing the clause will save the hassle of repetitive revision and litigation.

#### CONCLUSION AND FUTURE QUESTION

Insurers speak to courts, not to policyholders. The current interpretive doctrines aimed at forcing insurers to speak clearly to consumers miss the mark; can one speak clearly to those to whom one isn't speaking at all? Even in the absence of court pressure, the market should reward insurers that offer comprehensible language to their policyholders. A glance at the most common homeowners policies reveals that this possible reward is apparently insufficient to overcome the benefits of retaining existing abstruse language.

This article seeks to break the cycle of insurer inattention to consumers and consumer inattention to

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<sup>131</sup> Ukrainian novelist Mikhail Zoshchenko wrote two adjoining stories on the danger of sharp clarity. *Available in* NERVOUS PEOPLE AND OTHER SATIRES (ed. Hugh McLean 1975). In "A Clever Little Trick" the narrator discovers that factories are making super-high-wattage bulbs in order to meet a government quota for more bulbs, measured in watts. In "Poverty" resident in a communal apartment realize the squalor in which they live after electric lights are installed. Thank you to Professor Julia Chadaga, specialist in twentieth-century Russian literature and culture, for helping me locate these stories outside of my memory.

insurers. It is an interactive problem – consumers don't read what insurers write and insurers don't write to consumers. Insurers and courts are locked in a repetitive waltz. Consumers are not even invited to the dance.

This article offers a new dance step; the proposed tested language defense states that although it is not possible to draft language that is perfectly unambiguous as applied, courts should accept evidence of consumer understanding as a defense to ambiguity. That evidence would inform, but not control, the courts' deliberations.