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## *Contra Proferentem*: The Allure of Ambiguous Boilerplate

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# CONTRA PROFERENTEM: THE ALLURE OF AMBIGUOUS BOILERPLATE

Michelle E. Boardman\*

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## INTRODUCTION

Bad boilerplate can shake one's faith in evolution; not only does it not die away, it multiplies. The puzzle is why. Much of boilerplate is ambiguous or incomprehensible. This alienates consumers and is increasingly punished by courts construing the language against the drafter. There must, therefore, be some hidden allure to ambiguous boilerplate. The popular theory is trickery: drafters lure consumers in with promising language that comes to nothing in court. But this trick would require consumers to do three things they do not do—read the language, understand it, and take comfort in it.

There is a hidden allure to ambiguous boilerplate, but the trick lies in the courts, not the consumer. The trick is a private conversation between drafters and courts; excused from the table is the consumer, who could have no fair duty to understand, and so has no duty to read. With the consumer out of the room, edits and additions to boilerplate are targeted to courts alone. The new language does not need to make sense to a layman. It does not even need to make sense standing alone; a judge will read the language in the context of precedent, with the aid of briefing.

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\* Assistant Professor, George Mason University School of Law. —Ed. Thanks to David Bernstein, Lloyd Cohen, Ross Davies, Bruce Kobayashi, Kimberly Moore, Nicholas Quinn Rosenkranz, Omri Ben-Shahar, Eugene Volokh, and the participants of this symposium for their insights. I am grateful to the George Mason Law and Economics Center for generous support.

Boilerplate, used widely, repeatedly, applied uniformly to all, is like a broad statute,<sup>1</sup> or the First Amendment.<sup>2</sup> An innocent first reader is not on notice that the true meaning of the words is found in the case law. Drafters do not use this language to trick consumers, however, because they no longer care what consumers think of the language. Drafters value boilerplate because *courts* know what it means.

This Article evaluates the continued abstruseness of boilerplate language despite incentives, judicial and otherwise, for clarity. Several rules and patterns of judicial interpretation aim for clarity, but perversely result in continuity. The linguistic community dwindles to the court and the drafter alone, cutting out the nondrafter, reader, or consumer. This drives drafters deeper and deeper into the arms of existing case law as a primary means of selecting clauses. The danger is that while some consumers may not read the contract, none will read the case law in which any particular turn of phrase is embedded. Precedents speak to the drafter, not to the reader.

The problem is in fullest bloom in the insurance context. Insurers will cling for decades to language that courts continually declare ambiguous and construe against the insurer. Why, in the face of this history, insurers have chosen not to clarify the language, or to stop using it, courts “cannot conceive of an answer.”<sup>3</sup> What the court does not realize is that it has fired its last shot, and the insurer knows it.

Any discussion of insurance law is by necessity a discussion of contract law. Some of the discoveries and conclusions of this piece apply equally well to ordinary contract law, or even serve as a warning about the future of consumer contract law. History suggests that where the subspecialty of insurance doctrine leads, ordinary contract doctrine may follow. Far from being the dull cousin of the contract family, insurance is the odd but brilliant prodigy. The law of insurance often deviates from basic contract law at precisely the point where insurance contracts typify the modern consumer contract—boilerplate clauses, little negotiation, written in legalese, and received by the consumer only after the contract has begun.

Insurance is of course more than just the ultimate consumer contract because insurance contracts have their own qualities. Nonetheless, if courts view consumer contracts as disreputable, they view insurance contracts as downright seedy. The result is that insurance law is often the crucible in which new legal approaches to protecting the consumer are formed; more aggressive applications of existing doctrine may arise in the insurance context and return with new vigor when applied to other consumer contracts.<sup>4</sup>

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1. See, e.g., Sherman Act, 15 U.S.C. § 1 (2000).

2. “Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof . . .” U.S. CONST. amend. I.

3. *New Castle County, Del. v. Nat’l Union Fire Ins. Co. of Pittsburgh*, 243 F.3d 744, 755 (3d Cir. 2001).

4. The Arizona Supreme Court describes one such example:

Artificial results derived from application of ordinary rules of contract construction to insurance policies have made courts struggle to find some method of reaching a sensible resolution

Courts try to improve the language of insurance policies, as a parent tries to improve a child's behavior, both by punishment and by encouragement. The frustration of courts in this endeavor suggests that they realize their efforts are being wasted. As stated by one court in 1970, and repeated by the Supreme Court of South Carolina in 1997:

Ambiguity and incomprehensibility seem to be the favorite tools of the insurance trade in drafting policies. Most are a virtually impenetrable thicket of incomprehensible verbosity. It seems that insurers generally are attempting to convince the customer when selling the policy that everything is covered and convince the court when a claim is made that nothing is covered.<sup>5</sup>

Given how rarely insurance policy language is read, even by sophisticated commercial policyholders, who mostly rely on a broker's description, it seems unlikely that policy language is meant to convince would-be policyholders of broad coverage. In fact, one would expect that an attempt to lure in new policyholders with truly incomprehensible language would fail. Evidence supports the proposition advanced here, that the insurers' audience from start to finish is the courts, a practice that leaves policyholders by the wayside, and one that courts unwittingly encourage.

The first perverse incentive is one courts cannot control, but it underlies the other three: the sheer act of having interpreted a clause in a way that allows for predictable application in the future adds value to that clause. With insurance, the value is great enough that this generally makes it more likely, not less, that drafters will retain poor language. With ordinary commercial contracts, the value of certainty will sometimes outweigh a less than ideal clause content, and sometimes not. But where drafters—such as insurers—care more that a clause have a *fixed* meaning than a *particular* meaning, path dependence can preclude otherwise desirable improvements in the language.

Second, many courts have come to conclude that nondrafters cannot be required to read their contracts. If insurance language is unredeemable, for example, courts should simply protect the "reasonable expectations" of policyholders as to the scope of their coverage—confusing contrary policy

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within the conceptual bounds of treating standardized, formal contracts as if they were traditional "agreements," reached by bargaining between the parties. This difficult task is often accomplished by the use of various constructs which enable courts to reach a desired result by giving lip service to traditional contract rules. One of the most prominent of these methods is the well recognized principle of resolving ambiguities against the insurer [otherwise known as *contra proferentem*].

Damer Motor Sales, Inc. v. Universal Underwriters Ins. Co., 682 P.2d 388, 394 (Ariz. 1984) (en banc).

5. S.C. Ins. Co. v. Fid. & Guar. Ins. Underwriters, Inc., 489 S.E.2d 200, 206 (S.C. 1997) (citing *Universal Underwriters Ins. Co. v. Travelers Ins. Co.*, 451 S.W.2d 616, 622–23 (Ky. Ct. App. 1970)) (attempting to navigate the application of other insurance clauses in order to determine how much is owed by each insurer). The South Carolina court also notes that while courts turn "confidently to tried and true principles of contract law," they turn in vain, for judges have "failed utterly to anticipate the linguistic excesses to which the insurance industry would resort in order to avoid paying claims." *Id.* at 210–11.

language notwithstanding.<sup>6</sup> The carrot of the “reasonable expectations” doctrine is that if insurers write clearly, the policyholder’s contrary expectations will not be considered “reasonable.” The message sent by courts is a mixed one, however. A state supreme court, for example, dismissed evidence of clearly contrary policy language due to the absence of proof that the policyholder had knowledge of the language.<sup>7</sup> In other words, if the insurer could not prove the policyholder had read the language, the language could not control the policyholder. As more courts flirt with this approach in the ordinary contract realm, its potential effect deepens.

Third, courts are trapping themselves in a sticky combination of *contra proferentem*, a consensus approach to finding ambiguity, and what will be called here the adverse possession of language. *Contra proferentem* is meant to give drafters an incentive to draft cleanly, by construing ambiguous language against the drafter, in favor of coverage. In first determining whether the language is ambiguous, “some courts hold that a difference of opinion among courts of various jurisdictions *establishes conclusively* that a particular clause is ambiguous, while others hold that it merely constitutes evidence of ambiguity.”<sup>8</sup> These latter courts view a split among other jurisdictions as “a factor to be considered in determining the existence of ambiguity.”<sup>9</sup> As more courts adopt this approach of follow the leader, national drafters can more easily anticipate how the language will be interpreted, even in jurisdictions where the clause has not yet been litigated. The value of the clause thus goes up, not down.<sup>10</sup>

6. ROBERT E. KEETON & ALAN I. WIDISS, *INSURANCE LAW* § 6.3 (1988).

7. *C&J Fertilizer, Inc. v. Allied Mut. Ins. Co.*, 227 N.W.2d 169, 176 (Iowa 1975) (en banc).

8. *Hartford Accident. & Indem. Co. v. Dana Corp.*, 690 N.E.2d 285, 295 (Ind. App. 1997) (emphasis added) (citation omitted) (“We conclude that the division of authority on this issue is instructive and is evidence that more than one reasonable interpretation . . . is possible.”) This concept was confirmed in *Travelers Indemnity Co. v. Summit Corp. of America*, 715 N.E.2d 926, 938 (Ind. App. 1999) and *American Home Assurance Co. v. Allen*, 814 N.E.2d 662, 668 n.4 (Ind. App. 2004), in which the court noted: “Even if we were to find that the terms ‘related’ and ‘interrelated’ had the same meaning, we observe that division of authority on an issue is instructive and is evidence that more than one reasonable interpretation of a term is possible.” *Id.* (emphasis added); see also *Damer Motor Sales, Inc. v. Universal Underwriters Ins. Co.*, 682 P.2d 388, 394 (Ariz. 1984) (en banc).

9. *Sullins v. Allstate Ins. Co.*, 667 A.2d 617, 624 (Md. 1995) (“[I]f other judges have held alternative interpretations of the same language to be reasonable, that certainly lends some credence to the proposition that the language is ambiguous and must be resolved against the drafter.”); see also *Lefrak Org., Inc. v. Chubb Custom Ins. Co.*, 942 F. Supp. 949, 957 (S.D.N.Y. 1996) (“[T]he range and variety of judicial opinions bolsters the conclusion that the pollution exclusion . . . is ambiguous.”), quoted approvingly by *Peace v. Nw. Nat’l Ins. Co.*, 596 N.W.2d 429, 454 (Wis. 1999); *Fight Against Coercive Tactics Network, Inc. v. Coregis Ins. Co.*, 926 F. Supp. 1426, 1433 (D. Colo. 1996) (“That different courts have arrived at conflicting interpretations of similar clauses in other policies is indicative of the Policy’s ambiguity.”); *Aetna Cas. & Sur. Co. v. DeBruicker*, 838 F. Supp. 215, 221 (E.D. Pa. 1993) (“The fact that courts differ on the meaning of a particular term in a particular context is evidence that the term is indeed ambiguous.”).

10. As always, this is not true for clauses where the adverse interpretation is one the insurer cannot bear actuarially. For one such example, the insurance industry’s response to the risk of terrorism coverage, see Michelle E. Boardman, *Known Unknowns: The Illusion of Terrorism Insurance*, 93 GEO. L.J. 783 (2005).

The problem is compounded by the more than legitimate position courts take when organizations, including insurers, continue to use language that causes years of confusion and costly litigation; at some point the “hostile, open, and notorious” use of such difficult language causes it to be “adversely possessed” by the courts.<sup>11</sup> In short, the user is on notice that courts will construe the language against him. Even those jurisdictions that have not yet ruled on the language, and so do not independently find the language ambiguous, will join other courts in construing the language in favor of the nondrafter. The result, yet again, is that the language has a settled meaning—not necessarily found in a natural reading of the clause—that is retained, just where the evidence demands redrafting.<sup>12</sup>

This Article first examines how the drafting process creates a feedback loop that makes existing language more valuable over time. The network effects and path dependency of shared language are more forceful in insurance than ordinary contract drafting, yet this Article is the first contribution to the subject. Next, the bulk of the Article establishes and analyzes three ways in which courts counterintuitively reinforce the retention of unclear language through the application of interpretative principles. Finally, while the discussion of these perverse incentives is novel, the Conclusion considers some rather obvious solutions.

## I. THE BIRTH OF BOILERPLATE

The infiltration of lawyers in commercial contract drafting, at least in the United States, has led to more than language recycled by a single entity, it has led to communal boilerplate—fixed language that is common to an industry, or across industries.<sup>13</sup> The more widely boilerplate spreads, the more it comes to resemble a public statute instead of a private agreement. This, in turn, leads to the common law of common boilerplate.

Corbin drew a distinction between the interpretation and the construction of contracts.<sup>14</sup> An interpretation of contractual language seeks to find the parties’ meaning. A construction of the language determines the legally binding meaning, which could bear a number of different relations to the

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11. BLACK’S LAW DICTIONARY 59 (8th ed. 2004) (“adverse possession”); see also 2 C.J.S. *Adverse Possession* § 29 (2003). The analogy is inverted because it is the drafter openly and notoriously using the language, but the courts that come to claim possession of it. Purists can base the adverse possession claim in the courts’ hostile, open, and notorious interpretation of the language.

12. There is a fifth twist, not examined here, that distorts insurance drafting. In a parallel to statutory interpretation, courts turn on occasion to the drafting and regulatory history of insurance clauses. This history includes internal ISO documents, published bulletins, and representations to state insurance commissioners about the scope and meaning of new clauses. This history is only used if it adds to or changes a court’s interpretation, that is, only if it provides meaning not readily accessible in the clause itself. The private conversation between courts and insurers continues.

13. Farnsworth defines “boilerplate” as “standard clauses lifted from other agreements on file or in form books.” E. ALLAN FARNSWORTH, *CONTRACTS* § 7.1, at 426 (3d ed. 1999).

14. See 3 ARTHUR LINTON CORBIN, *CORBIN ON CONTRACTS* § 534 (1960); see also Arthur L. Corbin, *Conditions in the Law of Contract*, 28 YALE L.J. 739, 740–41 (1919).

interpretation. With boilerplate, there is very little, if any, interpretation; all that is left to the court is construction.

Construing boilerplate rather than interpreting it is sensible. First, given that only one party—the drafter—may have read the language before signing, or even before litigation, a court is unlikely to find an actual joint meaning. Second, boilerplate clauses seem to make up a disproportionate percentage of those clauses courts are unwilling to enforce, even if, or perhaps because, their meaning is clear. This is of course one of the main paths by which construction will diverge from interpretation. Third, similar or identical boilerplate language may have already been interpreted by the court at hand or by other courts. In other words, the legal meaning of boilerplate—its construction—may already be known, making any foray into its subjective interpretation less desirable.

Moreover, the accumulative process by which boilerplate comes to be boilerplate, discussed in detail below, often leads to language a layman will not understand. At this point, many courts will lose all interest in the project of interpretation, if defined as seeking the meaning the parties ascribe to the language. And who can blame them? The nondrafter either will have ascribed no meaning to the inchoate language or will have been misled or confused by it. Given that a court cannot simply refuse to address the case in the absence of meaningful interpretation, it is left with construction.

Once it is accepted that boilerplate is not necessarily the will of the parties, interpretation can be given up in exchange for other values. *Contra proferentem*<sup>15</sup> attempts to value fairness and future clarity, and, in the insurance context, the “reasonable expectations” of the policyholder. It has therefore been written of *contra proferentem* that while “it can scarcely be said to be designed to ascertain the meanings attached by the parties,” at least the “rule may encourage care in the drafting of contracts.”<sup>16</sup> This Article suggests otherwise.

The value of uniform interpretation for the same clause across parties mimics the application of statutory law. Under the Restatement (Second) of Contracts § 211(2), “standardized agreements” are “interpreted wherever reasonable as treating alike all those similarly situated, without regard to their knowledge or understanding of the standard terms of the writing.”<sup>17</sup> This rule “subordinates the meaning that an individual party may have attached to the contract language to the goal of equality of treatment for parties that are similarly situated.”<sup>18</sup> In other words, the language is treated

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15. *Contra proferentem* as a concept comes first from noninsurance contract law and is described in varying ways. The Supreme Court, applying it in a construction case, referred to “the general maxim that a contract should be construed most strongly against the drafter.” *United States v. Seckinger*, 397 U.S. 203, 210 (1970). As early as 1923, the Court had applied the rule in the insurance context. *Mut. Life Ins. Co. of N.Y. v. Huml Packing Co.*, 263 U.S. 167, 174 (1923) (“The rule is settled that in case of ambiguity that construction of the policy will be adopted which is most favorable to the insured.”); see also *infra* note 64.

16. FARNSWORTH, *supra* note 13, § 7.11, at 474.

17. RESTATEMENT (SECOND) OF CONTRACTS § 211(2) (1981).

18. FARNSWORTH, *supra* note 13, § 7.11, at 474.

not as a private agreement, but as a public statute, with one meaning applied to all.<sup>19</sup>

This approach to the unfortunate aspects of boilerplate can be self-perpetuating. Boilerplate that has repeatedly been construed by courts will take on a set, common meaning, but one that may not be easily understood by reading the language itself.<sup>20</sup> As with judicial interpretation of broad statutes (“Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.”),<sup>21</sup> or constitutional provisions (“Congress shall make no law . . . abridging the freedom of speech.”),<sup>22</sup> the meaning ascribed to the language by an innocent first reader will differ markedly from the meaning the language is given in court, the meaning upon which drafters rely.<sup>23</sup> With contract clauses, as with such statutes, an outside reader may have an illusion of understanding, but only knowledge of the subsequent case law and regulatory actions can reveal what the language means in the eyes of the law.

For the first nondrafter or consumer before the court, the application of *contra proferentem* is a boon, assuming that the drafter’s interpretation was rejected by the court in part to protect the consumer. But if the court’s construction of the language is *acceptable to the drafter*, it will be used in the future, to the disadvantage of consumers two through two million, who will not understand the language or who will be misled by it into not seeking relief a court would grant. In short, the language takes on a private meaning, not between the two parties to the contract, but between the courts and the sophisticated drafter.

Of all contracts, the insurance policy is the poster child for the downsides of boilerplate. Yet the doctrine and interpretive approaches applied to insurance are more strict or more consistently applied versions of those applied to other contracts. The assumption has been that courts are stricter with insurance contracts *because* insurers are incorrigibly bad drafters. It is worth asking if there is not some reverse causation; insurers have become the drafters they are under this stricter interpretive regime.

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19. See, e.g., *Carroll v. Littleford*, 170 S.E.2d 402, 405 (Ga. 1966) (“[T]he construction placed . . . upon similar contracts will control.”).

20. Boilerplate language that has a meaning apparent to drafter and nondrafter alike, and that a court is willing to enforce, does not concern us here.

21. E.g., Sherman Act, 15 U.S.C. § 1 (2000).

22. E.g., U.S. CONST. amend. I.

23. Drafters do not have to be in litigation to rely on the courts’ interpretation, of course. The initial payment offer and later negotiating positions are based on the actor’s perception of what would happen if the parties *were* to litigate.



## II. THE FEEDBACK LOOP IN POLICY DRAFTING

Positive network effects can flow from common or boilerplate clauses in any contract.<sup>24</sup> Widespread, shared contract language is more likely to have taken on a lay meaning,<sup>25</sup> and to have been previously interpreted, perhaps definitively, by courts.<sup>26</sup> If courts have fleshed out the application of language, a drafter can be confident about its future application. The value of contract language can therefore increase as the number of others adopting the language increases.

Interestingly, this is not a “true” or traditional network effect.<sup>27</sup> The value of a network effect in contract language may be one that, once achieved, is permanent, and no longer rests on the number of other users. By contrast, in order for the phone line running into your house to be valuable, there must be others on the network; the fact that others were *once* on the network is of less use than an eight-track player. Moreover, in this traditional network effect, the value of the network increases with the addition of each new member, assuming the absence of network overload. The added value of a network of contracts with the same clause may increase with each new member, but only up to a certain point, after which additional members neither add nor detract from the value.<sup>28</sup>

This imprecise fit between true network effects and the synergy or gestalt effects<sup>29</sup> of widespread contract language may explain the limited network analysis in the contract literature.<sup>30</sup> It cannot explain the inattention in the insurance context, however, where both true network and gestalt effects are strong. The combined strength of the effects is more than additive, it is mutually reinforcing.

24. This point is not new, of course. See Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (Or “The Economics of Boilerplate”)*, 83 VA. L. REV. 713 (1997); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995). The near absence of a discussion of network effects in the insurance contract is startling, however. One of the best early articles about network effects in the law does at least briefly mention insurance. Mark A. Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CAL. L. REV. 479, 587 (1998).

25. The lay meaning may not conform to the meaning given by courts, of course, which is a severe problem addressed below.

26. See Russell Korobkin, *Inertia and Preference in Contract Negotiation: The Psychological Power of Default Rules and Form Terms*, 51 VAND. L. REV. 1583, 1594–95 (1998).

27. See generally Lemley & McGowan, *supra* note 24; S.J. Liebowitz & Stephen E. Margolis, *Network Externality: An Uncommon Tragedy*, J. ECON. PERSP., Spring 1994, at 133, 135; Larry E. Ribstein & Bruce H. Kobayashi, *Choice of Form and Network Externalities*, 43 WM. & MARY L. REV. 79, 110 (2001); Howard A. Shelanski & J. Gregory Sidak, *Antitrust Divestiture in Network Industries*, 68 U. CHI. L. REV. 1, 5 (2001).

28. With traditional network effects, the counterpart to this point is sometimes referred to as critical mass: the point at which the value of joining the network exceeds the cost because of the positive externalities generated by those already on the network.

29. These effects are “gestalt” in the sense that the whole is greater than the sum of its parts.

30. For an excellent exception, see Claire A. Hill, *Why Contracts Are Written in “Legalese”*, 77 CHI.-KENT L. REV. 59 (2001).

A brief primer on insurance drafting: The primary organization in charge of the drafting process is the Insurance Services Office, or ISO.<sup>31</sup> ISO copyrights standard policy forms and sells access to them. In addition to drafting, ISO submits proposed language to state insurance commissioners and works with the commissioners, sometimes collectively, until the language is approved for use.<sup>32</sup> As loss data on the language comes back, and as courts interpret the language, ISO may start the cycle again with redrafting.<sup>33</sup> The result, says ISO, is that consumers “benefit from the clarity that the standard coverage language achieves.”<sup>34</sup>

It should be questioned both whether language does indeed evolve from less to more clear and who benefits from the language changes that are made. ISO boasts that it “monitors changes in the insurance industry and in the law,” and then “drafts language necessary to address new laws, court interpretations of coverage forms, or changed market conditions.”<sup>35</sup> But redrafts often carry the baggage of their past with them, so that for the *cognoscenti*, the language has contextualized meaning. This richer meaning is a form of greater clarity for courts and for insurers, but not necessarily for policyholders.

Courts and academics are overlooking the fundamental ways in which insurance drafting differs from ordinary contract drafting, even sophisticated commercial drafting. The structure of collective drafting and data pooling creates network effects and path dependence. The system is inherently self-reinforcing, but the strength of the reinforcement depends on the value of known language relative to the value of redrafted language. Doctrines of

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31. ISO formed in 1971 through the merger of similar entities for stock insurance companies (the National Bureau of Casualty Underwriters, later the Insurance Rating Bureau) and mutual insurance companies (the Mutual Insurance Rating Bureau), both of which had been drafting policy language for the entire industry since the early 1940s. ISO bills itself as “the property/casualty insurance industry’s leading supplier of statistical, actuarial, underwriting, and claims data.” ISO Home Page, <http://www.iso.com> (last visited Jan. 8, 2006). ISO should not be confused with ISO, the International Organization for Standardization. See Int’l Org. for Standardization Home Page, <http://www.iso.org> (last visited Jan. 8, 2006).

32. The role of insurance commissioners is significant:

States have the principal regulatory authority over the primary insurance companies [and e]ach state has an insurance official who has two primary areas of responsibility: (1) monitoring and overseeing the financial solvency of the insurers, and (2) examining insurers’ rates and market practices. The National Association of Insurance Commissioners (NAIC), through its advisory recommendations, plays a key role in state regulators’ efforts to coordinate and strengthen their oversight of the insurance industry.

PAYING THE PRICE: THE STATUS AND ROLE OF INSURANCE AGAINST NATURAL DISASTERS IN THE UNITED STATES 9 (Howard Kunreuther & Richard J. Roth, Sr. eds., 1998) (citation omitted).

33. Standardized policies do include “manuscript” terms, terms that are drafted for a particular policy. Even here, however, any given manuscript term is likely based on a common form of that term. The existence of a manuscript term may indicate more individualized bargaining over that particular term, such that negotiation history might prove useful, but it does not necessarily make interpretation of the term any less “public” than standard ISO terms.

34. INS. SERVS. OFFICE, INC., ISO: ENHANCING COMPETITION IN THE WORLD’S INSURANCE MARKETS (1999), reprinted in KENNETH S. ABRAHAM, INSURANCE LAW AND REGULATION 33 (3d ed. 2000).

35. ABRAHAM, *supra* note 34, at 34.

interpretation that increase the value of known language or increase the risk of new language strengthen the loop.

In the ordinary contract setting, Kahan and Klausner reserve the term “network benefits” for those externalities that are dependent upon an existing network but not a past network, and use “learning benefits” for those externalities that are dependent upon the past common use but not a future one.<sup>36</sup> Learning benefits in ordinary contracts can stem from language that has become familiar through use, whether or not the language continues to be popular.<sup>37</sup> Just so in insurance, but the learning carries more weight in two ways.

First, whether wisdom or paranoia, insurers assume that new language will be systematically construed against their interests. The value of “learning,” therefore, is higher relative to the dim alternative for insurers. Second, insurers are learning on two fronts. In addition to the language taking on a shared industry meaning, it takes on judicial meaning, and then actuarial meaning.

Note that the network value of judicial knowledge is separate from that of actuarial knowledge. There is a value to many insurers being on the same “language network,” in that the language will more quickly be interpreted by each jurisdiction, and without most insurers having to engage in litigation. As with statutes, but unlike many contracts, a court’s interpretation of policy language holds for all those “governed” by the language. “The interpretation of policy terms is generalized beyond the claims of a single insured to the entire market for that policy.”<sup>38</sup> This is a direct network effect until the terms are well settled, and then it becomes a learning benefit, in that others do not need to continue using the language going forward.

The value of actuarial data, by contrast, includes an ongoing network effect, which would be lost if others dropped off the chain. The size, scope, and frequency of losses change over time; without the ability to continually pool loss data with others hooked into the same network, past actuarial data loses its value. Insurers find themselves locked into existing language because they must stay in the feedback loop to retain that value. Without the collective endeavor, the rating services (i.e., price setting) of ISO become useless.

Of course, the collective gain from pooling loss data can be had with new language. The value of new language is enhanced by the network benefit of collecting actuarial data, even if the learning benefit of court interpretation has yet to be reached. However, until the language has been interpreted, the actuarial data will have limited value; the question is not simply how many fires there are in a year, for example, but how many are

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36. Kahan & Klausner, *supra* note 24, at 718.

37. Of course, there may be some level of “maintenance” use that is required to sustain the learning benefit.

38. John Randolph Prince, III, *Where No Minds Meet: Insurance Policy Interpretation and the Use of Drafting History*, 18 VT. L. REV. 409, 413 (1994).

covered and to what amount—information that comes only from the interaction of fire facts with courts' interpretation of fire language.<sup>39</sup>

As a result, insurers will retain language that is unclear to policyholders as long as it has become clear to courts, even if the courts' interpretation differs from the insurer's original meaning. For example, consider a policy that covers a policyholder's "property damage," defined as "physical injury to tangible property . . . or loss of use of tangible property that is not physically injured."<sup>40</sup> When the policyholder's computers crash, destroying valuable electronic data, is there coverage?<sup>41</sup> Courts are currently struggling with whether electronically stored data is tangible property and whether the loss of data is property damage.<sup>42</sup>

Although large sums of money are at stake in the initial decisions, prospectively the answer doesn't much matter. Either computer files are property, in which case insurers can include the risk in the premium, or files aren't property, in which case insurers will exclude the risk from the premium. Similarly, although with more difficulty, if electronic data is "tangible property" according to case law, insurers can rewrite the definition of "property" or explicitly exclude electronic data from coverage, perhaps selling separate electronic coverage. Once the language has been given meaning by the courts, even if it continues to confuse policyholders, the insurer's path is set.

It should be noted that although insurers may be indifferent, something *is* lost when restricted coverage is interpreted more expansively. In extreme cases, insurers will find the expanded coverage untenable and drop the area of coverage altogether. Policyholders might prefer a world in which they can choose between buying ordinary property coverage, or, for more money, adding electronic property coverage. If, on the other hand, policyholders always *assume* that electronic data will be covered, courts may be right that these expectations can be met only by preventing insurers from selling the lesser coverage.

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39. On the other hand, it might be that insurers experience a strong learning benefit from judicial and actuarial experience, but not the usual benefit of a shared understanding between the contracting parties themselves. If this Article is correct that insurers either choose or are trained to ignore the policyholder when drafting, then shared understanding between the two contracting parties is unlikely and insignificant.

40. Catherine L. Rivard & Michael A. Rossi, *Expert Commentary: Is Computer Data "Tangible Property" or Subject to "Physical Loss or Damage"?*—Part 1, INT'L RISK MGMT INST., Aug. 2001, <http://www.irmi.com/irmicom/expert/articles/2001/rossi08.aspx> (describing the standard Commercial General Liability policy definition of "property damage").

41. For a thorough analysis of the options under different policies and clauses, see Robert H. Jerry, II & Michele L. Mekel, *Cybercoverage for Cyber-Risks: An Overview of Insurers' Responses to the Perils of E-Commerce*, 8 CONN. INS. L.J. 7 (2001).

42. For two of the best opinions on each side, compare *Am. Online, Inc. v. St. Paul Mercury Ins. Co.*, 347 F.3d 89 (4th Cir. 2003) (under Virginia law, computer data not covered because not tangible property), with *Centennial Ins. Co. v. Applied Health Care Sys., Inc.*, 710 F.2d 1288 (7th Cir. 1983) (under California law, insurer had a duty to defend a computer hardware and software policyholder for loss of computer data).

With or without this loss of choice, there are thus several types of path dependence to the interpretation of a boilerplate clause.<sup>43</sup> Once the meaning of a clause has been clarified, enlarged, and applied by a court, its value increases, at least for the drafter. The drafter can communicate, to courts, if not to policyholders,<sup>44</sup> in one clause what it has taken a court paragraphs—or perhaps an entire opinion—to say. Goetz and Scott have described this, in the ordinary contract context, as the “quasi-Darwinian evolutionary process” that clauses must undergo in order to “become mature conventions whose risks and performance characteristics are known.”<sup>45</sup>

Of course, knowing precisely how courts will interpret a clause can regularly lead to rejecting it. On the other hand, the replacement for a dropped clause might not be a newly minted one, but an alteration to the original. The alteration may be crafted in direct response to court opinions, again leaving the nondrafter out of the loop.

This type of “increasing returns” path dependence has not been applied to the insurance context, where it has real purchase; the force of path dependence cuts deeper ruts with insurance than ordinary contracts because of the feedback loop of actuarial data. Not only does past language become clearer over time in the insurer’s eyes, but the cost of each clause becomes increasingly clear as actuarial data is collected and pooled. Changing language, even in an effort to decrease coverage, could be more costly.<sup>46</sup> Insurance drafting thus creates more than a set path: it creates a Möbius strip of language reinforcement. Insurers can check out anytime they like, but they can never leave.<sup>47</sup>

As traditional path dependence teaches, the cost of shifting paths once the journey has begun may be prohibitive unless the value of the alternative path is higher than the collective switching cost. Insurers may be engaging

43. See Oona A. Hathaway, *Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System*, 86 IOWA L. REV. 601 (2001).

44. These differences are analogical to private and state-supplied contractual terms. See Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261 (1985).

45. *Id.* at 278. According to Goetz and Scott:

A . . . critically important benefit of standardized formulations is the reliability that results from the process of ‘recognition.’ A term is recognized when it is identified through adjudication or statutory interpretation and blessed with an official meaning. Informal or ‘unofficial’ customary terms may be well-tested and clearly communicative between parties to the transaction and nonetheless be subject to the prospect of misinterpretation by the state.

*Id.* at 288.

46. Even if insurers could write so clearly that policyholders and insurers had a shared understanding of the language, an omniscient court could not remove the risk of interpreting the language in new, unexpected contexts. New circumstances arise that neither party anticipated but that existing policy language might cover. No amount of careful drafting can answer these questions in advance, although redrafting as facts gradually change could. For example, why did insurers not write language anticipating the loss of computer data by the 1980s, if not much earlier? This Article provides a partial answer.

47. With apologies to THE EAGLES, *Hotel California*, on HOTEL CALIFORNIA (Elektra/Asylum Records 1976).

in status quo bias here, but that can be saved for later.<sup>48</sup> Even without such bias, it would be accurate for insurers to realize that there are large costs incurred in organizing the industry through groups like ISO, reaching agreement on new language, implementing the language in future policies, and educating policyholders about the change. Abandoning the value of a known interpretation should be added to these costs.

### III. PERVERSE INCENTIVES

The pitfalls of communal drafting are most dramatic with insurance-specific examples, although much of the analysis holds true in a less striking form for all boilerplate. Courts seemingly fail to see how their directives interact with the structure of the insurance-drafting process in particular and the choice of boilerplate in general. As a result, courts either fail to see the weakness of interpretive incentives, or they actively provide incentives to retain murky language. Three of these missteps are identified and explored here.

#### A. *An Interpreted Clause Is a Good Clause*

As the path-dependency discussion reveals, an interpreted clause is a valuable, predictable clause. With a settled contract term in the hand, even well-drafted new language is in the bush, because “the change itself weakens the relevance of the existing stock of dispute-resolving conventions that the traditional language invoked.”<sup>49</sup> Ordinary contract drafters thus become attached to clauses that both parties can agree upon and that consistently convey the intended meaning to the court.

With insurance, however, *every* settled clause has value.<sup>50</sup> First, a clause that confuses or misleads policyholders can still serve an insurer’s purpose if courts understand it. This is possible because a side effect of collective drafting is the lack of competition on policy language. As a former president of the National Association of Insurance Commissioners, or NAIC, testified,<sup>51</sup> standard clauses are

very carefully drawn by the best people in the industry and widely disseminated and understood and expected and desired and needed by the insurance industry to mean the same thing regardless of who issues it, regardless of whom he issues it to or where the claim arises or what the

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48. See Adam J. Hirsch, *Evolutionary Theories of Common Law Efficiency: Reasons for (Cognitive) Skepticism*, 32 FLA. ST. U. L. REV. 425, 429–30 (2005).

49. Goetz & Scott, *supra* note 44, at 301.

50. Well, almost every clause has value; those that require an insurer to provide coverage for a risk it deems uninsurable will be removed from future policies. A war exclusion that removed from coverage the losses of war, for example, would be changed or removed if courts consistently read it to require terrorism coverage. See Boardman, *supra* note 10.

51. The NAIC is first and foremost the national group for the state insurance commissioners—the people responsible for regulating insurance in each state. Its connections with the industry are both incestuous and adversarial.

claim is, or when the claim arises and who asserts. *The language means the same thing.*<sup>52</sup>

If the language is the same, and is given the same meaning for all comers by courts, there may be competition about which clauses are in each policy but not about the wording of those clauses. As a result, insurers don't have to compete by making clauses more accessible to policyholders—but only so long as all insurers use the same clause.

The industry's position is that, “[w]ith most insurers offering policies based on standard ISO language, insurance consumers can readily compare their options, based on price, coverage, service. By contrast, if standardized coverages did not exist, consumers would face an unintelligible array of different insurance forms.”<sup>53</sup> This proposition needs to be tested empirically. In lines such as life insurance, insurers do not need to pool loss data because the data is straightforward and available without collaboration. Clauses and policies still tend to converge on similar language, and perhaps it is easier for policyholders to compare both price and substance where one basic risk is insured.<sup>54</sup>

Whether insurers are right about policyholders' preferences for price competition over substance competition, collective drafting makes some forms of insurance possible.

If each carrier's loss experience were derived from different policy language, the statistics collected by the rating bureaus could never serve as the basis for loss prediction and rate-setting. Similarly, if individual carriers applied standard-form language differently, their loss experience data would be useless to the rating bureaus.<sup>55</sup>

At the heart of this ability to pool individual insurer's data is the courts' willingness to grant standard policy language the universal power of a statute.

A final way in which insurance drafting calcifies around a court's interpretation, any interpretation, is the insurers' willingness to accept an adverse interpretation, changing premiums in lieu of changing the language. This is unlikely to be the case in ordinary contract drafting; if a term is consistently misinterpreted by courts, drafters will stop using the clause. But as with “property damage” to “electronic data,” insurers may prefer a court's known interpretation to the insurer's original intended meaning.

Given network effects, path dependence taking the actuarial loop, and the customary preference of insurers for certainty over substance, what's a

52. *In re Asbestos Ins. Coverage Case*, Jud. Council Coord. Proceeding No. 1072 (Cal. Super.) (testimony of Richard E. Stewart, referring to Commercial General Liability policies), reprinted in John E. Heintz & Adrienne Danforth, *Construing Standard Policy Language for the “Sophisticated Insured”*, 516 PLI/LIT 311, 317 (1994) (emphasis added).

53. ABRAHAM, *supra* note 34, at 33.

54. In addition to insuring against the risk that an income-earner will die young, life insurance policies commonly include an investment component. Investment options differ more widely but still allow for competition on both price and substance.

55. Heintz & Danforth, *supra* note 52, at 318.

court to do? Unlike the next two contributions to calcified language, courts may be innocent parties in this debacle. The industry places great value, efficiently and not, on language that has been reliably interpreted by courts. The two obvious “fixes” are for courts to begin interpreting erratically or to refuse to interpret deficient language at all. Neither is tenable. Next best, understanding the self-reinforcing nature of insurance drafting might help relieve courts of the resentment that insurers willfully ignore their directives; in fact, insurers seem to deaf to all others.

### B. *Drafters Will Write Only to Those Who Read*

The reasonable expectations doctrine belittles the role of the written contract, thereby encouraging drafters to ignore it. In some courts, the focus on reasonable expectations began as a *limitation* on the power of *contra proferentem*.<sup>56</sup> If a term were ambiguous—open to more than one reasonable interpretation—courts would follow the proconsumer interpretation, but only if the result were within the consumer’s reasonable expectation of the clause. In a strong minority of jurisdictions, this has been inverted in the insurance context; the reasonable expectations of the policyholder, as formed by life, can trump what would be a reasonable expectation formed from the policy language.

One given purpose of the reasonable expectations doctrine is to create “incentives for insurers to clarify language.”<sup>57</sup> If only the language could be made clear enough, the contrary expectations of a policyholder would be deemed unreasonable. But in some jurisdictions the doctrine “applies to *all* insurance contracts” because “insurance policies are weighted with such a prolixity of complex verbiage that they would not be understood” and, if read, would present “an inexplicable riddle, a mere flood of darkness and confusion.”<sup>58</sup> Here, the incentive fails because of the unrebuttable presumption

56. The doctrine was first fully crafted by Robert E. Keeton in his seminal article, Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961 (1970). Keeton recognized an existing judicial behavior and molded it into a single coherent theory, but the behavior he observed was not uniform at the time and has not become uniform since. Twenty six years later, there are too many articles addressing the doctrine in the insurance context to cite. See Kenneth S. Abraham, *Judge-Made Law and Judge-Made Insurance: Honoring the Reasonable Expectations of the Insured*, 67 VA. L. REV. 1151 (1981); Roger C. Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L.J. 823 (1990); Peter Nash Swisher, *A Realistic Consensus Approach to the Insurance Law Doctrine of Reasonable Expectations*, 35 TORT & INS. L.J. 729 (2000); and the Fall 1998 issue of the Connecticut Insurance Law Journal.

57. John L. Romaker & Virgil B. Prieto, *Expectations Lost: Bank of the West v. Superior Court Places the Fox in Charge of the Henhouse*, 29 CAL. W. L. REV. 83, 103 (1992) (citing Keeton, *supra* note 56, at 968).

58. *Storms v. U.S. Fid. & Guar. Co.*, 388 A.2d 578, 579–80 (N.H. 1978) (quoting *De Lancey v. Ins. Co.*, 52 N.H. 581, 588 (1873)) (emphasis added) (citations omitted). Indeed, the court seems to think insurance scholars are engaged in a form of extreme scholarship. In its view, because insurers are afraid:

that, notwithstanding these discouraging circumstances, some extremely eccentric person might attempt to examine and understand the meaning of the involved and intricate net in



that insurance language is unreadable; once the application of the doctrine is divorced entirely from the policy language, the insurer has no incentive to make it clear, as no level of clarity would help.

For courts that take this position, the “duty to read” either does not arise or is a weak one.<sup>59</sup> This is so for one or several reasons: the policyholder does not receive the actual language until after the policy has been issued,<sup>60</sup> the insurer knows the policyholder does not read the policy when he receives it and therefore cannot rely on his having read it,<sup>61</sup> or the policyholder could not, or does not, understand the language in those rare cases where it is read. In this last case, courts are unwilling to charge policyholders with a “duty to understand” the policy because it is not their fault that the policy is incomprehensible, and if there is no duty to understand the written words, it would be silly to enforce a duty to read.

In its more extreme form, the doctrine allows courts to refuse to enforce policy language that is out of keeping with the policyholder’s “reasonable expectations” of what the policy would cover, even if reading the policy would be sufficient to disabuse the policyholder of his expectation. As one state supreme court explained, “[i]f a policy is so constructed that a reasonable man in the position of the insured would not *attempt* to read it, the insured’s reasonable expectations will not be delimited by the policy language, regardless of the clarity of one particular phrase among the Augean stable of print.”<sup>62</sup> In this scenario, insurers will aim to make policy language clear to the judge who will interpret it, not to the policyholder who is excused from reading it.<sup>63</sup>

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which he was to be entangled, it was printed in such small type, and in lines so long and crowded, that the perusal of it was made physically difficult, painful, and injurious.

*Id.* at 580 (quoting *De Lancey*, 52 N.H. at 588).

59. *C&J Fertilizer, Inc. v. Allied Mut. Ins. Co.*, 227 N.W.2d 169, 176 (Iowa 1975) (en banc) (“Nor can it be asserted the above doctrine [the reasonable expectations rule] does not apply here because plaintiff knew the policy contained the provision now complained of and [the plaintiff] cannot be heard to say it reasonably expected what it knew was not there. A search of the record discloses no such knowledge.”).

60. The policyholder commonly has a right to reject the contract for a brief period after receiving the policy.

61. *See, e.g., Estrin Constr. Co., Inc. v. Aetna Cas. & Sur. Co.*, 612 S.W.2d 413 (Mo. Ct. App. 1981). “In a contract of adhesion,” including the insurance policy under discussion, “the terms are imposed by the proponent of the form: they are not expected to be read and even if read, the adherent has choice only to conform.” *Id.* at 419 (citing CORBIN, *supra* note 14, § 559); *see also* 7 SAMUEL WILLISTON & WALTER H.E. JAEGER, A TREATISE ON THE LAW OF CONTRACTS § 906B (3d ed. 1963).

62. *Storms*, 388 A.2d at 580 (emphasis added) (finding that no policyholder could have a reasonable expectation of coverage after a policy had lapsed); *cf. Titan Holdings Syndicate, Inc. v. City of Keene*, 898 F.2d 265, 270–72 (1st Cir. 1990) (applying New Hampshire law).

63. In such cases, the courts seem concerned only with the representations of the insurer. But the policyholder makes representations too: that he understands the nature of the coverage being purchased. If the policyholder’s expectations are wildly out of sync with the actuarial underpinnings of what the policy will pay out and what the policy must first take in by premium, perhaps the policyholder should be estopped from insisting on his view of coverage. Should IBM, for example, not be charged with having read its policy?

C. Contra Proferentem: *Ambiguity by Consensus*  
and the Adverse Possession of Language

The doctrine of *contra proferentem* has an appealing principal rationale.<sup>64</sup> As the party in control of the drafting process, “it is incumbent upon the dominant party to make terms clear.”<sup>65</sup> If the drafter fails in its charge, ambiguous language will be construed against the drafter, in keeping with the reader’s reasonable expectations.<sup>66</sup> This provides the drafter an incentive to improve the language and is only fair to the reader, who cannot affect standard-form language. In short, from power comes responsibility: “Convoluted or confusing terms are the problem of the insurer . . . not the insured . . . .”<sup>67</sup>

Nicely turned out, but not true. Today, the ambiguity problem may be caused by the drafter, but it belongs to the consumer. The consumer is saddled with the same confusing language time and again, despite the drafter’s court-appointed duty. Courts—seemingly unaware of the private nature of their conversation with drafters, insurers in particular—are at wits’ end. The Third Circuit was recently exasperated by a clause that “is widely used in insurance policies and has been the subject of heated litigation throughout the entire country *over the past thirty years*.”<sup>68</sup> The relevant clause reads: “‘Personal injury’ means injury, other than ‘bodily injury,’ arising out of . . .

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In some jurisdictions, courts have decided that in order to maintain a uniform interpretation of identical policy language, the interpretation for sophisticated policyholders must match that for unsophisticated ones. Therefore, if an unsophisticated policyholder appears before a court first, the language in that jurisdiction will, for all, be based on the nonreading reasonable expectations. It would seem that insurers have an incentive to take their sophisticated policyholders to court first, in order to lock in a language-based interpretation, and exclude an expectations-based interpretation.

64. *Contra proferentem* is a basic contract law principle, described in varying ways. *See, e.g.*, 11 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 32:12, at 476–81 (4th ed. 1993 & Supp. 2005) (“Indeed, any contract of adhesion, a contract entered without any meaningful negotiation by a party with inferior bargaining power, is particularly susceptible to the rule that ambiguities will be construed against the drafter.”); RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981) (“In choosing among the reasonable meanings of a promise or agreement or a term thereof, that meaning is generally preferred which operates against the party who supplies the words or from whom a writing otherwise proceeds.”); UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS art. 4.6 (1994) (“If contract terms supplied by one party are unclear, an interpretation against that party is preferred.”); *see also* 17A AM. JUR. 2D *Contracts* § 342 (2004) (“An instrument uncertain as to its terms is to be most strongly construed against the party thereto who causes such uncertainty to exist, especially if he or she is the party who drew the contract or selected its language.”). C.J.S. expands on the case of selecting language drafted by a third party:

The language of a contract will be construed most strictly or strongly against the party responsible for its use, whether that party or his or her representative chose the language or prepared the contract. A party is responsible for language used by his or her attorney in drafting a contract [as well].

17A C.J.S. *Contracts* § 337 (2003).

65. *Penn Mut. Life Ins. Co. v. Oglesby*, 695 A.2d 1146, 1150 (Del. 1997).

66. In insurance, the role of the policyholder’s reasonable expectations varies with the jurisdiction. *See* Mark C. Rahdert, *Reasonable Expectations Revisited*, 5 CONN. INS. L.J. 107 (1998).

67. *Penn Mut. Life*, 695 A.2d at 1150.

68. *New Castle County, Del. v. Nat’l Union Fire Ins. Co. of Pittsburgh, Pa.*, 243 F.3d 744, 747 (3d Cir. 2001) (emphasis added).

[t]he wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling or premises that a person occupies by or on behalf of its owner, landlord or lessor.”<sup>69</sup>

As potential ambiguities spring to mind, bear in mind that in order to apply *contra proferentem*, the language must be ambiguous “as applied” to the factual case at hand. Here, the policyholder was a Delaware county that had quashed the plans of a developer, who then promptly sued for the taking of property without due process of law and for equal protection violations.<sup>70</sup> The county claimed that the insurer should provide coverage.

The policyholder’s first winning position was that “invasion of the right of private occupancy of a room, dwelling or premises” was ambiguous enough to allow a reasonable interpretation encompassing rezoning and building permit denial. The court’s conclusion that the language was ambiguous is supportable; the conclusion that the language was ambiguous as applied is not.

### 1. *Ambiguous by Consensus*

To support its conclusion, the Third Circuit relied on the fact that other courts had found the language ambiguous.<sup>71</sup> Some courts explicitly state that insurers should be held to the interpretation most favorable to the policyholder where there are known splits because the insurer has failed in its job of rewriting language it knows causes confusion.<sup>72</sup> Other courts hold more simply that such splits are *evidence* of ambiguity and resolve the ambiguity against the insurer.<sup>73</sup>

A minority of courts has found “invasion of private right” ambiguous, a majority has found it unambiguously excludes regulatory decisions, and none has found it unambiguously includes regulatory decisions. From this, the Third Circuit, among others, concluded that the language must be ambiguous. In an earlier case, the Third Circuit had held that “[t]he mere fact that several . . . courts have ruled in favor of a construction denying coverage, and several others have reached directly contrary conclusions, viewing

69. *Id.* at 756–57 n.1 (Scirica, J., dissenting) (quoting insurance policy).

70. *Id.* at 747–48.

71. *Id.* at 754–56.

72. See 2 GEORGE J. COUCH ET AL., COUCH CYCLOPEDIA OF INSURANCE LAW § 15:83 (2d rev. ed. 1984); see also *Little v. MGIC Indem. Corp.*, 836 F.2d 789, 796 (3d Cir. 1987) (“[T]hat different courts have arrived at conflicting interpretations of the policy is strongly indicative of the policy’s essential ambiguity.”); *Travelers Indem. Co. v. Summit Corp. of Am.*, 715 N.E.2d 926, 938 (Ind. Ct. App. 1999) (“This disagreement among the courts further indicates the ambiguity of the personal injury provisions.”). One state supreme court has recognized that because it “follow[s] the rule of construction that where different jurisdictions reach different conclusions regarding the language of an insurance contract ‘ambiguity is established,’” it may be “justly criticized for accepting the inventions [of ambiguity] of other courts.” *Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co.*, 682 P.2d 388, 394 (Ariz. 1984) (en banc) (citation omitted).

73. See *New Castle County*, 243 F.3d at 756 (“A single phrase, which insurance companies have consistently refused to define, and that has generated literally hundreds of lawsuits, with widely varying results, cannot, under our application of commonsense, be termed unambiguous.”).

almost identical policy provisions, itself creates the *inescapable* conclusion that the provision in issue is susceptible to more than one interpretation,” and is therefore ambiguous.<sup>74</sup>

The perverse incentive of abdicating the ambiguity decision to other courts is apparent. It allows the ordinarily slow process of jurisdiction-by-jurisdiction interpretation to snowball, increasing the predictive power of the language in less time. Moreover, following other jurisdictions on the ambiguity question might interfere with efficient competition between the states.<sup>75</sup> State courts do not defer to the decisions of other state courts on the theory that, well, hell, they’ve already done the work.

Finally, this follow-the-leader approach leads to awkward results once a jurisdiction has already ruled that particular language is not ambiguous, only to find a later split among the jurisdictions. Most courts will not reverse course because “conflicting interpretations from other jurisdictions do not create ambiguity where [the] courts have adopted a definitive interpretation under [that state’s] law.”<sup>76</sup> The somewhat random result is that whether a term is considered ambiguous or not in a given jurisdiction may turn on the order of decisions.

## 2. *The Adverse Possession of Language*

The second winning position for the “takings” policyholder was that insurers were on notice that the language was unacceptable. “Insurance companies have included the clause . . . for at least twenty years, and litigants have repeatedly disputed the meaning of the term ‘invasion of the right of private occupancy.’”<sup>77</sup> Moreover, after decades of litigation, while courts

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74. *Little*, 836 F.2d at 796 (quoting *Cohen v. Erie Indem. Co.*, 432 A.2d 596, 599 (Pa. Super. Ct. 1981) (emphasis added) (“[T]hat different courts have arrived at conflicting interpretations of the policy is strongly indicative of the policy’s essential ambiguity.”)). The Third Circuit reaffirmed this concept in *New Castle County*, 243 F.3d at 754. Since *Cohen*, however, the Pennsylvania Superior Court has, in turn, embraced and abandoned this approach. See, e.g., *Lower Paxton Twp. v. U.S. Fid. & Guar. Co.*, 557 A.2d 393, 400–01 n.4 (Pa. Super. Ct. 1989). There the court noted:

Surely we would be abdicating our judicial role were we to decide such [ambiguity] cases by the purely mechanical process of searching the nation’s courts to ascertain if there are conflicting decisions. . . . [W]hether other courts have reached varying conclusions regarding the meaning of a policy is only relevant where the various meanings ascribed are reasonable.

*Id.* The court then decided that the other courts “have ascribed an unreasonable meaning to an unambiguous provision.” *Id.* After this 1989 rejection of *Cohen*, a 1981 case, a panel of the court reverted in 1995, see *Gamble Farm Inn, Inc. v. Selective Ins. Co.*, 656 A.2d 142, 146 (Pa. Super. Ct. 1995) (“More important than the actual holdings by other courts is the fact that their decisions demonstrate the existence of an ambiguity in the crucial term . . .”), only to again reject the practice in 1996, see *Madison Constr. Co. v. Harleysville Mut. Ins. Co.*, 678 A.2d 802, 807 n.6 (Pa. Super. Ct. 1996) (“Rather than relying on the fact that jurisdictions are split over construing the provisions or that one jurisdictional line of reasoning is better than another, courts must remember to invoke the basic tenet of contract law and look to the writing itself first, before otherwise deciding a policy is ambiguous.”).

75. See Todd J. Zywicki, *The Rise and Fall of Efficiency in the Common Law: A Supply-Side Analysis*, 97 Nw. U. L. Rev. 1551 (2003).

76. E.g., *Beretta, U.S.A., Corp. v. Fed. Ins. Co.*, 117 F. Supp. 2d 489, 495 (D. Md. 2000).

77. *New Castle County*, 243 F.3d at 755 (quoting lower court disposition).

have still not settled on a common meaning, insurers know that a decent percentage will find the language ambiguous. Given this, courts take the position that ongoing use of such open and notoriously difficult language will be declared “adversely possessed” by the courts; its meaning may once have belonged to the drafter, but now it is as the courts say.<sup>78</sup>

As to why, in the face of this history, insurers had chosen not to clarify the language, or to stop using it, the court admitted that it “cannot conceive of an answer.”<sup>79</sup> What the court does not realize is that it has fired its last shot, and the insurer knows it. The threat of construing language against the insurer is mainly in the surprise; the insurer collected premium  $X$  but finds it owes coverage  $X + Y$ . The next year the insurer collects premium  $X + Y$ , or some calculation thereof, discounting (perhaps) for those policyholders who won’t seek  $Y$  coverage from  $X$  language.<sup>80</sup> One would think that this calculation would become complicated where one-third of the states choose  $X$ , one-third choose  $X + Y$ , and one-third has yet to rule. Courts are not the only ones stymied that insurers retain the language despite this morass, but consider the insurer’s options.

In two-thirds of the jurisdictions, the language has a settled valuable meaning:  $X$  in one-third,  $X + Y$  in one-third. In the remaining one-third, insurers can guess that more than half will take the jurisdictional split as proof of ambiguity and find  $X + Y$  coverage. A settled meaning can therefore be expected in five-sixths of the jurisdictions. In any event, the insurer knows the exact application of the clause (for the disputed facts) in the great majority of jurisdictions; why would it redraft the language now?

We might suspect that insurers would object to the untidy patchwork of interpretations. To get uniform results, the insurer has two options. First, it could introduce new language in every jurisdiction, but this opens it up to a whole new round of the game, without the current interpretation—security found in over two-thirds of cases. Second, it could introduce new language in the  $X + Y$  jurisdictions only, aiming to return to the category of  $X$  coverage. This choice only makes sense if uniform coverage from varied language is better than varied coverage from uniform language.

Of course, this analysis leaves out a central incentive for insurers—the cost of litigation. Under the current regime, the insurer can handle claims and settlements in at least two-thirds of cases (assuming equal distribution of cases across jurisdictions) without much need for litigation, at least not language-based litigation. The insurer knows how courts will interpret the language without going to court again, and the policyholder, even if confused about the language beforehand, can discover its meaning after the loss. If new language is introduced, however, even relatively clear language,

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78. See *supra* note 11.

79. *New Castle County*, 243 F.3d at 755.

80. See *infra* text accompanying note 87, discussing unsophisticated or ill-advised policyholders who do not know to seek coverage because the policy language does not reveal that courts have found coverage.

it likely will be litigated in every jurisdiction until a settled meaning is found. This insurers do not want to do.

Finally, some argue that *contra proferentem* should apply equally to unsophisticated and sophisticated parties, in order to maintain a uniform interpretation of the same policy language.<sup>81</sup> As the Supreme Court of Washington reasoned:

This standard form policy has been issued to big and small businesses throughout the state. Therefore it would be incongruous for the court to apply different rules of construction based on the policyholder because once the court construes the standard form coverage clause as a matter of law, the court's construction will bind policyholders throughout the state regardless of the size of their business.<sup>82</sup>

This seems to mean that even if a policyholder could show good reason why it understood the language at hand to have a different meaning, and the specific insurer either shared that meaning at the time (contrary, let us assume, to the drafters and the current precedent) or had reason to know of the policyholder's understanding yet did nothing to fix it, the court should refrain from enforcing the parties' joint intent.

This may be one of the strangest aspects of the statutory nature of boilerplate clauses; as with legislation, but unlike most contracts, a court's interpretation of policy language holds for all those "governed" by the language. The industry seems to recognize the statutory nature of insurance clause interpretation:

Court interpretations of standard coverage forms further assure consistent treatment of claimants. Once a court determines the meaning of a word, phrase, or clause in a standard coverage form, that interpretation has *far more meaning and scope* than if every insurer's policy form used different wording for the same idea.<sup>83</sup>

What has escaped notice, and therefore scrutiny, is the fact that this additional meaning is semi-private—the result of an ongoing conversation between insurers and courts—of which policyholders may be unaware. Of course, the meaning is public in that judicial opinions are public, but the public nature of Supreme Court opinions has not brought constitutional understanding to the streets.

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81. See, e.g., Heintz & Danforth, *supra* note 52, at 314–15.

82. Boeing Co. v. Aetna Cas. & Sur. Co., 784 P.2d 507, 514 (Wash. 1990) (en banc); see also Diamond Shamrock Chems. Co. v. Aetna Cas. & Sur. Co., 609 A.2d 440, 461 (N.J. Super. Ct. App. Div. 1992) ("The use of standard policy provisions is founded upon the premise that collaboration among casualty insurers is necessary to calculate and maintain reasonable rates. . . . It would seem that the benefits of this standardization would be lost if standard form language were given different meanings for different insureds based upon individual degrees of sophistication and bargaining power:").

83. ABRAHAM, *supra* note 34, at 33–34 (emphasis added).

## CONCLUSION: ENDING THE PRIVATE CONVERSATION

The ongoing debate about the potential efficiency of the common law raises a structurally similar question here.<sup>84</sup> Two agents are candidates for evolution in this context, with two potential spheres of efficiency. First, we might expect that over time the courts will develop increasingly efficient rules for the interpretation and application of boilerplate contracts, including insurance contracts. Without taking a position on the general trend, this Article reveals that courts are retaining various inefficient interpretive rules, the goals of which (language alteration) are counter to the incentive created (language perpetuation).

Second, we might hope that as the courts' interpretation of contracts evolves, so would the contracts themselves. If the rules effectively blocked the benefits of misleading language, drafters would draft more direct language. If the rules effectively punished drafters for sloppy language, they would allow less of it to pass once, and none of it to pass twice. Poor language avoided is hard to show, and there are examples of helpful redrafts, but contracts do not seem to be swept along in the inexorable march toward clarity, brevity, and efficiency.

There is a difference between missing the basket and making a foul: the lack of efficient evolution in interpretive rules is a missed opportunity, but more, the intentional pursuit of efficiency by courts has resulted in actively perverse incentives in the drafting of policies.

The first outcome no doubt has many causes, but to the extent courts defer to one another's ambiguity rulings, competitive evolutionary pressures are relieved. The second outcome—perverse incentives to retain poor language—stems from the communal structure of boilerplate evolution, and the collaborative structure of the insurance market. This structure, while perhaps inevitable and perhaps desirable, limits competition on the policy front, shifting competition to price, package, and service.<sup>85</sup> The key, however, is knowing that the opinions should be read—knowing that a particular turn of phrase in a clause refers to the judicial interpretation of a prior clause. This *sotto voce* command to the courts can result in concealed meaning, or in language that Goetz and Scott call “encrusted.”<sup>86</sup>

Notice that if the incentive given to insurers is to retain language that has increased in certainty value by interpretation, courts seem to assume that

84. In chronological order, four highlights of the debate are: RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 320–28 (1st ed. 1972) (opening shot); WILLIAM M. LANDES & RICHARD A. POSNER, *THE ECONOMIC ANALYSIS OF TORT LAW* (1987) (driving the point home); Gillian K. Hadfield, *Bias in the Evolution of Legal Rules*, 80 *GEO. L.J.* 583 (1992) (counter point); and Zywicki, *supra* note 75 (game, set, match). The fact that the evolution of common law has inefficiencies makes the law and economics approach to contracts more, not less, useful. See Richard Craswell, *In That Case, What Is the Question? Economics and the Demands of Contract Theory*, 112 *YALE L.J.* 903 (2003).

85. ABRAHAM, *supra* note 34, at 33–38.

86. Goetz & Scott, *supra* note 44, at 289. Clauses are “encrust[ed]” by “an overlaying of legal jargon to the point that the intelligibility of the language deteriorates significantly. Such boilerplate weakens the communicative properties of preformulations, reducing their reliability as signals of what the parties really intend.” *Id.*

all future policyholders will be helped nonetheless. Those that go to court will, and perhaps that is all some courts can see. The remaining policyholders are harmed. Those who do not sue because they do not read the hidden text into the unclear or misleading calcified language are not aided by the fact that, had they sued, coverage would be found. Moreover, these policyholders pay the increased premium for the judicially interpreted clause but only demand coverage for the clause as written.<sup>87</sup> In short, the less sophisticated the policyholder, the greater the risk of harm—again, an outcome opposite courts' intentions.

This Article uncovers numerous difficulties but points to one fairly obvious solution: courts should be schooled in the nature of boilerplate creation, including insurance drafting, and be wary of creating perverse incentives to retain the very clauses they seek to change. As the trend in ordinary contract interpretation parallels more closely that already taken with insurance contracts, courts should be aware of the consequences.

Specifically, while the reasonable expectations doctrine has an established place, its application should not be completely divorced from contract language, or drafters will likewise divorce themselves from improving the language. Moreover, compulsive application of *contra proferentem* to clauses that are not ambiguous, but rather simply disputed, can also belittle the role of language; to give drafters (and particularly, insurers) an incentive to fix language, language must carry weight with the court.

As for insurers, one might wonder why the onus for change is not laid at their own feet. First, the thrust of this Article is that courts have one aim but unintentionally encourage another, often contrary, result. What is called for is a better understanding of the process, not a more illusive change in motivation or appeal to the altruistic side of insurers. Second, to the extent insurers already have a motivation to improve poor language, that motivation might be unleashed if courts were to stop raising unnecessary hurdles. Ending inartful overapplication of the reasonable expectation doctrine, for example, could have substantial effect.

Similarly, those who believe in the strong incentives of the market system should be skeptical about what seems to be a failure of individual insurers to grab the low-hanging fruit. Of course, again, this Article argues that insurers are constrained by their collective endeavor in a way evident in few other industries. In addition, it is not obvious that insurers aren't relatively content with the current system; the frustration of misconstrued language might be outweighed by the importance of predictable language. As long as insurers expect courts to systematically rule against them at every margin, insurers may value nothing so highly as the ability to nail courts down through precedent.

Conversations with industry insiders suggest that the "insurance crowd" has internal rules about the way in which policies should be written, and perhaps this prevents the kind of innovative policy writing market forces

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



might predict.<sup>88</sup> Insurers seem more comfortable with the old beat-up language they know than the innovative clear language that one might expect would bring a market edge. It may well be true that in insurance, as in other areas of life, “it is better for reputation to fail conventionally than to succeed unconventionally.”<sup>89</sup> In other words, an insurance executive may be able to keep her job and steadily advance, all the while endorsing ISO-drafted language that all other insurers are using, even if that language causes millions or billions of dollars in litigation. After all, it is industry standard to use ISO forms, not an individual decision for which the executive would be held accountable. On the other hand, proposing that your company depart from industry language brings high risk with undervalued reward.

It should be remembered, however, that there are real costs to breaking with the industry whole where the industry is otherwise cohesive. Whenever language is redrafted, removed, or newly introduced, the store of past actuarial data becomes either less relevant or useless. If all insurers embark on this new adventure together, not only can they pool the new actuarial data faster, but no one company will suffer relative to the others for the language’s failings.<sup>90</sup> If, however, an insurer strikes out on its own, this innovation brings the full cost of gathering actuarial data and the lonely danger of the language leading to unexpected liability.

The industry that drafts together, sticks together, not just for future drafting, but for the pooling of loss data that comes in on the first draft. From insurers, therefore, improvement will lie not in more individualized innovation, but in more industrywide redrafting. What should be discarded in the end is not the standardized policy supported by mass actuarial data, but those interpretive rules that create perverse incentives to retain weak language and create secret meaning.

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88. In *THE WISDOM OF CROWDS*, James Surowiecki attempts to explain the type of situation where competitors are all too cautious when they each have an incentive to buck the received wisdom. JAMES SUROWIECKI, *THE WISDOM OF CROWDS* (2004).

89. JOHN MAYNARD KEYNES, *THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY* 158 (1936), quoted in Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 *WASH. U. L.Q.* 347, 355–56 (1996).

90. This is an inexact generalization, of course. Some insurers will sell policies with the new language more broadly than others, thereby bearing more risk should the language implode. Similarly, based on their other risks and investments, insurers vary in their ability to take large losses.