

REASSESSING THE SOPHISTICATED INSURED EXCEPTION

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Contra-insurer rules of construction, such as contra proferentem and the reasonable expectations doctrine, can be and sometimes are displaced when the insured is commercially sophisticated or, e.g., represented by counsel or a broker. In recent years, such displacement has become something of a trend, and insurers have attempted to extend the situations in which, they argue, savvy business or other sophisticated entities should be held to the insurance contract as written. Thus, they say that the notice-prejudice rule need not and should not be applied when a sophisticated insured has failed to meet a policy notice provision, and that sophisticated insureds can and should be deemed to have waived statutory requirements imposed on insurers in certain circumstances.

The author argues that contra-insurer rules of construction advance a valid public policy goal and should be retained, notwithstanding the wealth, size, power, or acumen of the insured. In some limited circumstances, however, sophistication of the insured should be considered. If the insurance contract is really a product of joint drafting, or if factual inquiry is necessary to assess the intent of the parties, then the insured's sophistication can be considered.

I. INTRODUCTION

The canons of insurance contract construction traditionally have favored the insured. Chief among these rules are contra proferentem and the reasonable expectations doctrine. Pro-insured canons of contract interpretation law have been justified on a variety of grounds, including the adhesive quality of the insurance product, the parties' relative bargaining power, the

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relation of trust, the parties' asymmetric access to information, the unique nature of insurance, and the quasi-public nature of the insurance industry.¹

A few decades ago, insurers began to contest the wholesale application of *contra proferentem* by arguing that in certain instances it defied common sense or fairness. Insurers argued that sophisticated insureds did not need protective contract interpretation rules to level the playing field, and that the justifications for applying *contra proferentem* were unfair to insurers when the parties' bargaining power was equal.

Ten years ago, Professor Jeffrey Stempel assessed the nascent sophisticated insured exception.² He observed that "courts in the 1980s acted with increasing frequency in rejecting or modifying the ambiguity principle when the nondrafter was a sophisticated party or was sufficiently involved in the contract drafting process" and noted a "distinct line of cases" in this trend.³

The sophisticated insured exception to *contra proferentem* continues to percolate in insurance law, but the parameters of the exception are difficult to define.⁴ Some commentators suggest that because *contra proferentem* was intended to rectify the problems of unequal bargaining power, relative bargaining equality should justify its displacement.⁵ Other commentators caution that a wholesale abandonment of *contra proferentem* merely because an insured enjoys a measure of wealth and power ignores the unique reality of insurance marketing. These critics argue that rules of construction in favor of the insured should not be abandoned because, when it comes to insurers and insureds, equality is a fiction.⁶

A middle ground approach, proposed ten years ago by Professor Stempel, acknowledges that the sophisticated insured exception may be appropriate in a limited class of insurance contracts where extrinsic evidence compels rejection of the *contra-insurer* rules of construction. The factors Professor Stempel identified tend to show that the insurance contract was

1. See generally James M. Fischer, *Why Are Insurance Contracts Subject to Special Rules of Interpretation?: Text Versus Context*, 24 ARIZ. ST. L.J. 995 (1992).

2. Jeffrey Stempel, *Reassessing the "Sophisticated" Policyholder Defense in Insurance Coverage Litigation*, 42 DRAKE L. REV. 807 (1993).

3. *Id.* at 832. Professor Stempel also noted an increasing reticence to employ the exception. *Id.* at 848. This reticence continues.

4. While it is often characterized as the "sophisticated insured defense," it is more aptly identified as an exception to the rule of *contra proferentem*, rather than a defense.

5. See Michael G. Patrizio, *Fables of Construction: The Sophisticated Policyholder Defense*, 79 ILL. B.J. 234 (1991) (commenting that "courts have begun to recognize that a large commercial policyholder, which has equal bargaining power with an insurer, should not have traditional rules of contract construction applied in its favor").

6. Eugene R. Anderson & James J. Fournier, *Why Courts Enforce Insurance Policyholders' Objectively Reasonable Expectations of Insurance Coverage*, 5 CONN. INS. L.J. 335, 369-71 (1998) (discussing the "fallacy" of the sophisticated policyholder and noting that even so-called manuscript policies derive from standard forms promulgated by insurers.)

the product of actual bargaining between relative equals with adequate representation, experience, and knowledge sufficient to justify rejecting contra-insurer rules of construction.

This article explores the maturing sophisticated insured exception and its varied applications. Recent cases suggest that courts recognizing the exception have largely opted for Professor Stempel's functional approach. Courts in recent years have adhered to contra-insurer rules of construction to resolve ambiguities in most insurance contract disputes regardless of the insured's sophistication or wealth, but have rejected such rules where the insured, its broker, or its attorney actually negotiated or drafted the insurance contract. Many courts examine the drafting and negotiating history to discern whether real bargaining over the disputed terms occurred before abandoning traditional rules of construction.

Recently, insurers have advanced yet other situations where consideration of the insured's sophistication may be appropriate to negate pro-insured rules. They argue that when judging the reasonableness of an insured's conduct during the performance of the insurance obligations, sophisticated insureds should be held to a standard of reasonableness that comports with their knowledge and experience. Savvy business entities thus would be less readily excused by ignorance of insurance practices. For example, when an insured fails to strictly comply with an insurance policy's notice provisions, the modern trend is to excuse the insured where the late notice has not prejudiced the insurer, to ameliorate the harshness of forfeiture. However, insurers recently have argued that sophisticated insureds should not be excused for their deficiencies because they should be diligent about insurance matters in their business practices. Insurers also have argued that sophisticated insureds should be able to waive statutory rights, even when insurers do not strictly comply with formal statutory waiver requirements.

To be sure, the sophistication of parties to contracts has always been an appropriate consideration in contract law. For example, the Uniform Commercial Code allows usage of trade both to supply terms and to interpret terms in an agreement between parties who should be knowledgeable of such customary usage.⁷ Thus, parties with a sophisticated knowledge of their trade are chargeable with such knowledge whereas consumers and parties not in the trade will not be held to such knowledge.⁸ Furthermore,

7. U.C.C. § 1-205(2) (1989) ("usage of trade is any practice or method of dealing having such regularity of observance in place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question").

8. Under U.C.C. § 1-205(3) (1989), parties are subject to usage of trade "in the vocation or trade in which they are engaged or of which they are or should be aware." See 2 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 7.13, at 312-13 (2d ed. 1998) (discussing burden of proof in charging one with trade usage).

the sophisticated knowledge of the parties is relevant in contract interpretation generally: "language that is ambiguous to an unsophisticated party may not be ambiguous to a sophisticated commercial entity."⁹ In addition, in balancing public policy and unconscionability with freedom of contract, courts often indulge the right of sophisticated parties to make a bad bargain or relinquish valuable rights with less judicial protection than is often afforded to ordinary consumers.¹⁰

Thus, in some ways, the sophisticated insured exception is unremarkable, and merely an offshoot of traditional principles of contract construction. However, there are fundamental differences between contracts generally and contracts of insurance.¹¹ Thus, just as *contra proferentem* and reasonable expectations, both with clear roots in contract law, have been transformed with regard to insurance contracts, so too has application and consideration of sophistication been adapted to the unique realm of insurance.

This article examines the justifications for holding sophisticated and unsophisticated insureds to differing standards and assesses the sophisticated insured exception in its current variety of contexts. Part II explores *contra-insurer* rules of insurance contract interpretation and describes an increasingly principled rejection of those rules for certain sophisticated insureds. This article posits that in the interests of equality among insureds, predictability of standardized language, and consistency of judicial outcomes, whenever standardized insurance language is used, regardless of who offered it, that language should be interpreted using traditional pro-insured rules of construction. To do otherwise would allow insurers opportunistically to seize an advantage based on the insured's status and allow unpredictable and inconsistent interpretations of standard language.

Part III identifies still other instances where insurers have made some inroads in urging courts to consider the insured's sophistication, such as to avoid the notice-prejudice rule and to avoid unfavorable application of waiver and estoppel. This article concludes that a "sophisticated insured exception" is not necessary, but instead the insured's sophistication is a relevant factual consideration in certain contexts.

Part IV points out that considering an insured's sophistication without principle unfairly and irrationally penalizes commercial insureds and yields inconsistent and unpredictable results. Such consideration allows the insurer opportunistically to seize an advantage merely because of the in-

9. *Purcell Tire & Rubber Co., Inc. v. Executive Beechcraft, Inc.*, 59 S.W.3d 505, 510 (Mo. 2001) (en banc).

10. See, e.g., *id.* at 508-09 (noting that sophisticated parties may, among other things, contractually limit remedies and waive jury trials, and holding that they may disclaim tort liability when provisions are clear and unambiguous).

11. See generally Fischer, *supra* note 1, at 1001 (arguing that the imbalance in information best justifies pro-insured bias in judicial decisions).

sured's status. When the dispute involves a standardized agreement, or a statute or judicial rule of general application, then the status of the insured should not matter. Carving out exceptions in these instances raises problems of inequality, inconsistency, and unpredictability among the insured public and is therefore undesirable.

Considering the insured's sophistication is appropriate, however, when it helps to resolve factual questions and does not raise issues of inequality, inconsistency, or unpredictability. Thus, in the context of nonstandardized insurance terms negotiated and mutually drafted by parties with equal bargaining power, the insured's sophistication may be useful to determine what the parties meant by their choice of words. Where the court's task is to understand the meaning of particular conduct, understanding who the parties are may be useful and illuminating. When sophistication is considered in this context, it does not favor one party over another, but merely protects the parties' objective intent.

II. INTERPRETING INSURANCE CONTRACTS

A. *Rules of Contract Construction in the Insurance Context*

The canons of insurance contract interpretation have roots in contract law, but are not precisely the same.¹² Professor Jerry notes, "Although the notion that an insurance contract should be interpreted by reference to the principles that govern the interpretation of any contract is alive and well, it is also clear that many decisions cannot be explained cogently by reference to ordinary principles of contract interpretation."¹³ Professor Fischer further explains:

The special rules governing insurance contract interpretation build on general rules applicable to all contracts. . . . The rules of insurance contract interpretation are, however, more than simple extensions of the basic rules of contract. The insurance rules often have a significant twist that distinguishes them from the general rules of contract interpretation.¹⁴

12. See generally Fischer, *supra* note 1.

13. ROBERT H. JERRY II, UNDERSTANDING INSURANCE LAW § 25A[c], at 176 (3d ed. 2002).

14. Fischer, *supra* note 1, at 1002–04. Professor Fischer gives the following examples of "special" rules:

For example, to the general rule that the contract should be construed as a whole and the court should attempt to give meaning and effect to all words and phrases of the contract, we add the insurance rule that "where two interpretations equally fair may be made, that which affords the greatest measure of protection to the insured will prevail." Similarly, where the general rule provides that the contract should not be construed in the abstract and parts of the contract should not be considered in isolation from the remainder of the contract, the insurance rule provides that a specific provision, such as an endorsement, will control over a general provision. Although the rule facially parallels a similar basic contract rule that specific provisions govern general provisions, in insurance law the rule is a one-way ratchet. Specific terms that expand coverage control over general terms, but specific

Interpretation rules, as they apply to insurance cases, are more protective of insureds generally.¹⁵ Applying canons of construction to favor the insured is justified on a number of grounds, including, among others, the parties' unequal bargaining power, the insurer's relationship of trust to the insured, the standardized and adhesion nature of the insurance policy, the complexity of the contract, public policy considerations including the desirability of favoring coverage, and the imbalance in information between the parties.¹⁶

There are instances where these liberal canons of construction are inapt. For example, the rationale behind favoring the insured's interpretation of the insurance policy is less compelling when construing legislatively mandated provisions, as courts and commentators generally recognize.¹⁷ Moreover, in disputes between cedents and reinsurers, some jurisdictions assume that they enjoy equality of information and therefore do not need protective rules.¹⁸

Two enduring rules of insurance contract interpretation are *contra proferentem* and its more modern and less predictable offspring, the reasonable expectations doctrine.¹⁹ *Contra proferentem* requires courts to interpret ambiguous contract terms against the drafter.²⁰ In contract law, it is typically invoked as a tiebreaker when resort to extrinsic evidence and other canons of construction fails to yield an answer.²¹ *Contra proferentem* "is

terms that restrict coverage do not control over general terms that provide for expanded coverage.

Id. at 1003 (footnotes omitted).

15. *Id.*

16. *See id.*

17. In *Terra Indus., Inc. v. Commonwealth Ins. Co. of Am.*, 981 F. Supp. 581, 590-92 (N.D. Iowa 1997), the court rejected *contra proferentem* in interpreting a mandated proof of loss provision in a property insurance contract, noting "one might say that in such circumstances, the policy is one of 'adhesion' as to both the insurer and the insured." *Id.* at 591 (emphasis in original). In fact, the court attempts to discern legislative, rather than the party's, intent when interpreting legislatively mandated provisions. *Id.* at 591 nn.4-5 (collecting cases). *See also* LEE R. RUSS, 2 COUCH ON INSURANCE § 22.22 n. 11, 11.1 (2003); JEFFREY STEMPEL, LAW OF INSURANCE CONTRACT DISPUTES § 4.08[e], at 4-82-83 (noting split of authority).

18. *See, e.g.,* Commercial Union Ins. Co. v. Swiss Reins. Am. Corp., No. Civ.A. 00-12267-DPW, 2003 WL 1786863, at *9 (D. Mass. Mar. 31, 2003). However, "[t]he applicability of the *contra proferentem* doctrine to reinsurance contracts is subject to debate among U.S. courts." Vincent J. Vitkovsky, et al., *International Insurance and Reinsurance Developments*, 34 INT'L L. 473, 481 (2000) (comparing *Zenith Ins. Co. v. Employers Ins. of Wausau*, 141 F.3d 300, 304-05 (7th Cir. 1998) (*contra proferentem* is applicable under Wisconsin law) with *Unigard Sec. Ins. Co. v. N. River Ins. Co.*, 4 F.3d 1049, 1065 (2d Cir. 1993) (*contra proferentem* is not applicable under New York law)).

19. *See generally* Fischer, *supra* note 1; Peter Nash Swisher, *Judicial Interpretations of Insurance Contract Disputes: Toward a Realistic Middle Ground Approach*, 57 OHIO ST. L.J. 543 (1996).

20. *See generally* FARNSWORTH, *supra* note 8, § 7.11, at 287-88.

21. *See, e.g.,* Eastern Air Lines, Inc. v. Ins. Co. of Pennsylvania, No. 96 CIV. 7113(MGC), 2001 WL 1111514, at *5 (S.D.N.Y. Sept. 21, 2001) (noting that "each party has submitted extrinsic evidence to support its interpretation of the Insurance Contract, creating an issue of fact that precludes application of *contra proferentem* at the summary judgment stage").

not applicable if the language is unambiguous and it is often denigrated as a rule of 'last resort.'²² However, often in insurance law contra proferentem is not employed merely as a tiebreaker, but also as a rule of substantive insurance law.²³

The reasonable expectations doctrine is also rooted in contract law. In its most benign form, courts simply attempt to find the parties' intent and to give effect to their mutually held objectively reasonable expectations, and afford no systematic advantage to either party.²⁴ In a more powerful form, with regard to standardized contracts, it is used unilaterally, to favor a consumer's reasonable expectations of standardized agreements.²⁵ However, in the insurance contract, a "super form" of reasonable expectations, as articulated by Professor Robert E. Keeton in 1970, has developed in some jurisdictions.²⁶ The adoption of this super form has hardly been uni-

22. FARNSWORTH, *supra* note 8, § 7.11, at 290 (citing cases employing contra proferentem as a tiebreaker after consideration of extrinsic evidence and after other aids to construction).

23. Professor Stempel explains that the liberalization of the admissibility of extrinsic evidence has lessened the importance of contra proferentem in contract law generally. He views employing it as a "tie breaker" in insurance disputes after extrinsic evidence is considered the "better approach." However, he also notes that courts look to extrinsic evidence less frequently in insurance cases and thus contra proferentem "retain[s] central importance" in insurance disputes. He complains that courts sometimes turn first to contra proferentem without considering elucidating extrinsic evidence. STEMPEL, *supra* note 17, § 4.11(b), at 4-181-82.

24. See, e.g., *Standard Magnesium Corp. v. United States*, 241 F.2d 677 (10th Cir. 1957) (interpreting estimates in contract according to reasonable expectations of the parties); *Eskin v. Acheson Mfg. Co.*, 236 F.2d 135, 137 (3d Cir. 1956) (interpreting agency agreement, under Pennsylvania or New Jersey law, according to the reasonable expectations of the parties); *Huger v. Dampskisaktieselskabet Int'l*, 170 F. Supp. 601, 610 (S.D. Cal. 1959) (interpreting stevedoring contract in accord with reasonable expectations); *Mitchell v. Adams*, 129 F. Supp. 377, 388 (M.D. Ga. 1955) (employment contract interpreted in view of reasonable expectations of employer and employees); *Chandler v. Roach*, 319 P.2d 776, 780 (Cal. Ct. App. 1958) (implied in fact contract between author and television producer contains promise to fulfill the reasonable expectations of the author); *Producers Pipe & Supply Co. v. James*, 332 P.2d 958, 961 (Okla. 1958) (interpreting provision in lease according to the reasonable expectations of lessor); *Tuttle v. W.T. Grant Co.*, 171 N.Y.S.2d 954, (N.Y. Super. 1958) (allowing evidence of the parties' reasonable expectations of lease provisions), *rev'd*, 159 N.E.2d 202 (N.Y. 1959); *Bakenhus v. Seattle*, 296 P.2d 536 (Wash. 1956) (en banc) (interpreting employment contract's pension plan according to reasonable expectations of the employee).

25. The roots of the insurance form of reasonable expectations are contained in *Restatement (Second) of Contracts* § 211 (1981). It provides that parties to standardized agreements accept the terms of a standardized agreement, except "[w]here 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." *RESTATEMENT (SECOND) OF CONTRACTS* § 211 (3). In commentary, it explains, "Although customers typically adhere to standardized agreements and are bound to them without even appearing to know the standard terms in detail, they are not bound to unknown terms which are beyond the range of reasonable expectation." *Id.* § 211 cmt. f.

26. The reasonable expectations doctrine, as it is known today, derived from two seminal articles by Professor Keeton. Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961 (1970); Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions: Part Two*, 83 HARV. L. REV. 1281 (1970). Numerous scholars discuss the

versal or uniform.²⁷ In its “strong” or broadest form, the reasonable expectations doctrine allows courts to honor the reasonable expectations of insureds even when those expectations are at variance with the policy language.²⁸ In its weaker form, some courts invoke it merely as an aid to resolve ambiguities or when the contract is unconscionable or contains hidden, technical, or obscure provisions or when waiver, estoppel, misrepresentation, or other public policy considerations are apparent.²⁹

While insurers may perceive *contra proferentem* and the reasonable expectations doctrine as a display of judicial bias, insureds view these doctrines as merely leveling an unequal playing field. Indisputably, they are powerful litigation tools that favor insureds. Thus, it is hardly a surprise that insurers should advance arguments such as the sophisticated insured exception to avoid these rules in litigation. How many insureds will fit within the exception is therefore a fertile legal question.

B. *The Sophisticated Insured Exception to Contra-Insurer Canons of Construction*

In the past few decades, insurers have, with mixed success, mounted an attack on wholesale application of these *contra-insurer* doctrines, at least in some cases. Insurers argue that when insureds are sophisticated, application of *contra proferentem* is not justified because there is no inequality between the parties to justify invoking these insured-protective doctrines. However, a precise definition of “sophisticated” is elusive. In one early and influential case, a court refused to invoke *contra proferentem*, explaining:

development of the doctrine, and the varied approaches that courts have taken to it. See generally JERRY, *supra* note 13, § 25D[b], at 184; Symposium, *The Insurance Law Doctrine of Reasonable Expectations After Three Decades*, 5 CONN. INS. L.J. 1 (1998); Robert H. Jerry II, *Insurance, Contract, and the Doctrine of Reasonable Expectations*, 5 CONN. INS. L.J. 21 (1998).

27. Ostrager and Newman tally six states that have rejected the reasonable expectations doctrine and forty-two that have recognized some variation of it. See 1 BARRY R. OSTRAGER & THOMAS R. NEWMAN, *INSURANCE COVERAGE DISPUTES*, § 1.03 [b], at 20–32 (11th ed. 2002). The variations in the doctrine have been noted and thoroughly discussed by many scholars. See, e.g., Peter Nash Swisher, *A Realistic Consensus Approach to the Insurance Law Doctrine of Reasonable Expectations*, 35 TORT & INS. L.J. 729 (2000) (exploring judicial responses and proposing a middle-ground approach); Jeffrey W. Stempel, *Unmet Expectations: Undue Restriction of the Reasonable Expectations Approach and the Misleading Mythology of Judicial Role*, 5 CONN. INS. L.J. 181, 191 (1998) (describing judicial approaches and noting both liberal and narrow approaches among the majority of states that have purported to have adopted the doctrine). Professor Henderson identified a variety of forms and conducted a careful inventory of state approaches in 1990. See Roger C. Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L.J. 823 (1990).

28. See generally Swisher, *supra* note 19. See, e.g., *Priority Finishing Corp. v. Hartford Steam Boiler Inspection and Ins. Co.*, No. CV 940544055S, 1998 WL 731081 (Conn. Super. Oct. 6, 1998) (commenting that the reasonable expectations doctrine considers the expectations of the “objectively reasonable insured” . . . “irrespective of whether the contract language itself is ambiguous”).

29. Swisher, *supra* note 19; JERRY, *supra* note 13, at § 25D[b], at 186–87; Stempel, *supra* note 2, at 827–28.

We do not feel compelled to apply, or, indeed, justified in applying the general rule that an insurance policy is construed against the insurer in the commercial insurance field when the insured is not an innocent but a corporation of immense size, carrying insurance with annual premiums in six figures, managed by sophisticated business men, and represented by counsel on the same professional level as the counsel for insurers. In substance the authorship of the policy is attributable to both parties alike. Significantly, the policy in question is not the usual printed form but is what is known as a "manuscript" policy, containing some standard printed clauses but confected especially for Olin. It is true, of course, as the trial judge observed, "scriveners of insurance policies are acutely aware of the meaning and effect of the language". We comment: So too, are counsel for large companies carrying fleet insurance with annual premiums in six figures. There is no purpose in following a legal platitude that has no realistic application to a contract confected by a large corporation and a large insurance company each advised by competent counsel and informed experts.³⁰

Thus, even in this early sophisticated insured case, sophistication was a shorthand expression to identify insureds with wealth, bargaining power, knowledge, and legal or broker representation, which enjoyed meaningful participation in negotiations and drafting the policy.³¹

Commentators writing from a pro-insurer perspective favor eliminating contra-insurer rules broadly and applying neutral contract construction rules to commercial insureds, in recognition that they have the bargaining power and ability to actively participate in the insurance contracting process:

[T]he general rule requiring construction of an insurance policy against the insurer should have no application in the context of business insurance policies that have been negotiated by parties with substantially equal bargaining power. . . . [T]he contra-insurer rule of construction developed as a judicial response to the unequal bargaining power of the average personal insurance consumer in relation to his insurer, particularly in cases involving 'standard form' personal insurance policies drafted by the insurer and marketed to insureds on a 'take it or leave it' basis. . . . [B]usiness insureds, by contrast, have considerable sophistication and bargaining power, and . . . business insurance policies are typically negotiated (and often drafted) on behalf of the business by corporate risk managers, independent insurance brokers and/or attorneys. . . .³²

30. *Eagle Leasing Corp. v. Hartford Fire Ins. Co.*, 540 F.2d 1257, 1261 (5th Cir. 1976) (footnote and citation omitted).

31. See *Northwest Airlines, Inc. v. Globe Indem. Co.*, 225 N.W.2d 831, 837 n.2 (Minn. 1975) (applying rule of strict construction against the corporate insurer because the "policy at issue was a printed form supplied by [the insurer]" and not a product of "arm's-length negotiations").

32. Barry R. Ostrager & David W. Ichel, *The Role of Bargaining Power Evidence in the Construction of the Business Insurance Policy: An Update*, 18 FORUM 577 (1983). Others also favor liberal application of the sophisticated insured exception, when large corporations rely on their own brokers or legal departments to procure insurance. See Patrizio, *supra* note 5.

Under this broader approach, courts consider factors such as “the size and insurance sophistication of the insured, its representation by brokers or counsel in the placement, negotiation and drafting of the policy in question or the degree of its involvement in the administration of the policy” to determine when to reject *contra proferentem*.

On the other hand, commentators writing from the insured’s perspective respond that in procuring insurance, the concept of a sophisticated policyholder is fabrication.³³ They assert, among other things, that being a large corporate insured does not necessarily equate with sophisticated knowledge about insurance. Furthermore, regardless of the insured’s wealth or size, most insurance contracts are nevertheless standardized and unnegotiated. They further claim that even manuscript policies that purport to be customized and negotiated policies are in reality nothing more than cut and pasted versions of standard forms.³⁴ Pro-insurer commentators also assert that departing from the entrenched rules of *contra proferentem* and reasonable expectations unfairly gives sophisticated insureds less insurance than other insureds by singling their terms out for a different and unfavorable interpretation.³⁵

In 1993, Professor Stempel surveyed cases and examined the circumstances that led courts to employ the so-called sophisticated insured exception to avoid *contra-insurer* rules of contract interpretation.³⁶ He noted variations in whether and how the courts applied the developing doctrine, commenting on its mixed reception and varied formulations.³⁷

33. Anderson & Fournier, *supra* note 6, at 369. They are not alone in their objection to the sophisticated insured exception. Heintz and Danforth also believe:

The notion that the meaning of standard-form policy language should vary depending upon the sophistication of the policyholder is anathema to the doctrine of *contra proferentem*. The purpose of the doctrine is to shift the risk of ambiguity to the drafter because the drafter has the power to avoid ambiguity through the use of more precise language. The relative sophistication or bargaining strength of the parties is completely unrelated to this purpose when the critical language is developed by insurance industry organizations and is not changed for individual policyholders. Moreover, interpretation of the standard form CGL [comprehensive general liability] policy on a contract-by-contract basis, taking into account extrinsic evidence of each policyholder’s understanding of the language at the time of contracting, would undermine the very reason for having standard language. Such a contract specific approach would wreak havoc upon the insurance industry, which depends upon uniform application of the standard language regardless of the intent of individual policyholders and carriers.

John E. Heintz & Adrienne Danforth, *Construing Standard Policy Language for the “Sophisticated Insured,”* 516 PLI Litig. & Admin. Practice Course 311, 314–15, Handbook Series No. H4–5209 (1994). See also *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 175 n.14 (Cal. 1966) (In Bank) (explaining that in favoring policyholders’ expectations, even sophisticated insureds have no choice in standardized provisions) (citing Comment, *The Insurer’s Duty to Defend Under a Liability Insurance Policy*, 114 U. Pa. L. Rev., 734, 748 (1966)).

34. Anderson & Fournier, *supra* note 6, at 369–72.

35. STEMPER, *supra* note 17, §4.11(f), at 4–203.

36. See Stempel, *supra* note 2.

37. *Id.* at 848–49.

Professor Stempel then proposed a functional approach to its application and offered a list of factual considerations concerning the policyholder's status and involvement in negotiation and drafting to assist a court in determining a contract's meaning. He suggested that courts consider (1) the drafter's actual identity; (2) a broker's presence and activity; (3) an attorney's presence and activity; (4) the degree of negotiation and whether the policy was customized for the insured; (5) whether the term is ambiguous in light of the parties and the facts; (6) the parties' oral and written conduct during negotiation, finalization, and implementation; (7) the objectively reasonable expectations or reasonable reliance of the insured; (8) the presence of a genuine contractual relationship; (9) the presence of extrinsic evidence; and (10) the fundamental fairness to invoke *contra proferentem* against the insurer.³⁸ Professor Stempel argued that such a factual analysis would shed light on the meaning of a term more than a mere examination of the relative economic and bargaining strength of the parties.³⁹

In the decade since Professor Stempel's proposal, the sophisticated insured exception has matured, although it has not gained universal acceptance or much clarity.⁴⁰ It also has been invoked as an exception to the reasonable expectations doctrine.⁴¹ Courts have employed many of the

38. *Id.* at 849–55.

39. *Id.* at 855.

40. For example, New York law is unclear. *See* *Sea Ins. Co., Ltd. v. Westchester Fire Ins. Co.*, 51 F.3d 22 (2d Cir. 1995) (applying New York law and holding that *contra proferentem* applies even as to disputes between sophisticated insurers); *Gerling Am. Ins. Co. v. Steadfast Ins. Co.*, No. 00 Civ. 7907(HB), 2001 WL 936288 (S.D.N.Y. Aug. 17, 2001) (noting that *contra proferentem* applies even to disputes between insurers), *but cf.* *Morgan Stanley Group Inc. v. New England Ins. Co.*, 225 F.3d 270 (2d Cir. 2000) (noting that it is unclear under New York law whether sophisticated insureds who negotiate the contract lose the advantage of *contra proferentem*); *Eastern Air Lines, Inc. v. Ins. Co. of Pennsylvania*, No. 96 CIV. 7113(MGC), 2001 WL 1111514 (S.D.N.Y. Sept. 21, 2001) (noting that “[i]t is unsettled under New York law, however, whether [*contra proferentem*] applies when the insured is a sophisticated entity that negotiated the terms of the insurance contract”). Missouri law is similarly unclear. *See, e.g.*, *May Dep’t Stores Co. v. Fed. Ins. Co.*, 305 F.3d 597, 600 (7th Cir. 2002) (noting that several cases held that *contra proferentem* “was inapplicable when the insured is a sophisticated business rather than a hapless individual” but that later cases “have continued to invoke the doctrine in cases involving commercially sophisticated insureds”).

41. The sophisticated insured exception has also arisen similarly in the context of reasonable expectations, sometimes with a more favorable outcome for the insurer. *See, e.g.*, *Oritani Sav. & Loan Ass’n v. Fid. & Deposit Co. of Maryland*, 989 F.2d 635, 642–43 (3d Cir. 1993) (“We find that the average banking institution would not reasonably expect coverage recognized as unavailable by the banking industry. Indeed, New Jersey law proscribes us from straining to construe insurance policies to provide insurance coverage to sophisticated and powerful insureds who have significant bargaining power and expertise in drafting insurance contracts.”); *In re Reinforced Earth, Co.*, 925 F. Supp. 913 (D.P.R. 1996) (interpreting the scope of coverage under overlapping coverage with consideration of the fact that the insured was a large corporation represented by brokers); *Commercial Union Ins. Co. v. Swiss Reins. Am. Corp.*, No. Civ.A. 00–12267-DPW, 2003 WL 1786863, at *9 (D. Mass. Mar. 31, 2003) (reasonable expectations doctrine does not apply in a dispute between a primary insurer and a reinsurer where “both parties are sophisticated business enterprises familiar with the prac-

considerations Professor Stempel identified to allow a more narrow and principled application of the sophisticated insured exception against contra proferentem. Notably, the corporation's size and sophistication, or legal or broker representation alone, has generally not been sufficient to warrant abandoning contra proferentem, especially when a standard form insurance policy is in dispute,⁴² although sometimes cases seem to suggest that representation and corporate wealth are substantial factors in deciding when to discard contra proferentem.⁴³ However, in most recent cases, the

tices and forms of the reinsurance industry and are well-equipped to understand the scope of the coverage provided"); *Eljer Mfg., Inc. v. Liberty Mut. Ins. Co.*, 972 F.2d 805, 809–10 (7th Cir. 1992) ("Nor are literal interpretations, which assume that words or phrases are always used in their ordinary-language sense, regardless of context, the only plausible interpretations of contractual language, especially when the contract is between sophisticated business entities. We should at least ask what function 'physical injury' might have been intended to perform in a comprehensive general liability policy beyond just drawing a commonsensical, lay person's ordinary language distinction between physical injury and physical noninjury."); *Sphinx Int'l, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 226 F. Supp. 2d 1326, 1336 (M.D. Fla. 2002) ("[T]he Plaintiffs in this case were sophisticated insureds. They were quite able to read the insurance contract and see the exclusionary language.").

42. See, e.g., *Stone Container Corp. v. Hartford Steam Boiler Inspection & Ins. Co.*, 165 F.3d 1157, 1160 (7th Cir. 1999) ("the principle of 'contra proferentem' . . . which Illinois applies even where . . . the insured is a large and sophisticated firm, provided it didn't actually negotiate over the terms of coverage"); *Pittston Co. Ultramar Am. Ltd. v. Allianz Ins. Co.*, 124 F.3d 508 (3d Cir. 1997) ("the dispositive question is not merely whether the insured is a sophisticated corporate entity, but rather whether the insurance contract is negotiated, jointly drafted or drafted by the insured"); *New Castle County v. Hartford Accident and Indem. Co.*, 933 F.2d 1162 (3d Cir. 1991) (holding under Delaware law that the sophisticated insured exception is inapplicable where the insured did not participate in drafting or negotiation of standard insurance contract terms); *Alstrin v. St. Paul Mercury Ins. Co.*, 179 F. Supp. 2d 376, 390 (D. Del. 2002) ("While there certainly may be instances where applying the contra-insurer rule would be inappropriate, this is not such an instance. It is clear from the documentary record before the court that CTFG had no substantial role in drafting the National Union policy form, on which the four exclusions relied upon by National Union were standard boilerplate terms."); *St. Paul Fire and Marine Ins. Co. v. MetPath, Inc.*, 38 F. Supp. 2d 1087, 1092 (D. Minn. 1999) (noting that under New Jersey law, the sophisticated insured exception is only applicable where the "insurance contract is negotiated, jointly drafted or drafted by the insured" and that Minnesota law is unsettled if the exception is viable); *Employers Reins. Corp. v. Worthington Custom Plastics, Inc.*, 672 N.E.2d 734, 740 (Ohio Ct. App. 1996) (commenting that "plaintiff fails to cite any Ohio case which suggests that ambiguities contained in policy language should not be construed in favor of the insured when the insured is either a large corporation or a self-insured employer under the workers' compensation law"); *Chem. Leaman Tank Lines, Inc. v. Aetna Cas. and Sur. Co.*, 817 F. Supp. 1136, 1156 (D.N.J. 1993) (applying contra proferentem: "[t]his court . . . is convinced that the size or sophistication of the insured is irrelevant to the application of contra proferentem when the policy in dispute has been drafted solely by the carrier"); *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Rhone-Poulenc Basic Chems.*, C.A. No. 87C-SE-11, 1992 WL 22690, at *9 (Del. Super. Jan. 16, 1992) (applying contra proferentem in interpreting CGL policy: "[a]pplication of [contra proferentem] turns not on the size or sophistication of the insured, but rather on the fact that the policy language at issue is drafted by the insurer and is not negotiated").

43. See, e.g., *May Dep't Stores Co.*, 305 F.3d at 600 (commenting on Missouri law that construing contracts against the drafter is "inapplicable when the insured is a sophisticated business rather than a hapless individual"); *Eagle Leasing Corp. v. Hartford Fire Ins. Co.*,

primary factor that leads to rejecting contra-insurer construction rules is the drafting history of the contract language.⁴⁴ For some courts, the precise language in dispute must be actually negotiated—it is not enough that negotiation occurred generally about other provisions.⁴⁵ As one court com-

540 F.2d 1257, 1262 (5th Cir. 1976); *Koch Eng'g Co. v. Gibraltar Cas. Co., Inc.*, 878 F. Supp. 1286, 1288 (E.D. Mo. 1995), *aff'd*, 78 F.3d 1291 (8th Cir. 1996); First State Underwriters Agency of New England Reins. Corp. v. Travelers Ins. Co., 803 F.2d 1308 (N.J. 1986).

44. A number of cases reject contra proferentem based substantially upon drafting and negotiating history. See, e.g., *Newport Assocs. Dev. Co. v. Travelers Indem. Co. of Illinois*, 162 F.3d 789, 794 (3d Cir. 1998) (holding that where the policy was drafted by an independent broker hired by the insured, contra proferentem does not apply); *Pittston Co.*, 124 F.3d at 521 (rejecting application of contra proferentem where “broker prepared initial draft of the policies and negotiated the terms with the insurers”); *Northbrook Excess and Surplus Ins. Co. v. Procter & Gamble Co.*, 924 F.2d 633, 639 (7th Cir. 1991) (rejecting application of contra proferentem and noting that “[t]here was substantial evidence to support the conclusion that the final Commercial policy was profoundly more than a standard insurance policy; indeed, significant portions of the policy’s language [were] customized”); *Eastern Air Lines, Inc.*, 2001 WL 1111514, at *5 (noting that New York law is unclear and relying instead on extrinsic evidence, but commenting that the “considerations underlying the contra proferentem rule are absent” where insured’s “experienced insurance broker . . . negotiated the premium formula” in dispute); *Koch Eng'g Co.*, 878 F. Supp. at 1288 (contra proferentem does not apply where insured negotiated a “complex, twenty million dollar . . . manuscript policy”).

Other cases recognize the doctrine but nevertheless apply or approve application of contra proferentem based upon lack of participation in drafting language despite sophistication. See, e.g., *Morgan Stanley Group Inc.*, 225 F.3d at 279–80 (noting that it is unclear if New York recognizes a sophisticated insured exception where policy was standard form, but the insurer’s agent testified that the insurer “didn’t amend for anybody”); *Commercial Union Ins. Co. v. Walbrook Ins. Co., Ltd.*, 7 F.3d 1047, 1053 n.8 (1st Cir. 1993) (noting under Massachusetts law that the sophisticated insured exception has been invoked sparingly, and finding no evidence that the insured “participated in drafting the language at issue”); *New Castle County*, 933 F.2d at 1189 (under Delaware law contra proferentem applies even when “the insured is itself a corporate giant”: “The critical factor remains that the ambiguity was caused by language selected by the insurer.”); *Alstrin*, 179 F. Supp. 2d at 390 (insured “had no substantial role in drafting” the policy form); *In re Molten Metal Tech., Inc.*, 271 B.R. 711 (D. Mass. 2002) (contra proferentem applies where, although some terms were negotiated, the term in question was not); *CIGNA Ins. Co. v. Didimoi Prop. Holdings, N.V.*, 110 F. Supp. 2d 259 (D. Del. 2000) (holding that language is not ambiguous); *St. Paul Fire and Marine Ins. Co.*, 38 F. Supp. 2d at 1092 (contra proferentem applicable where there is no evidence that insured “negotiated or jointly drafted” the policy).

45. For example, in *In re Molten Metal Tech., Inc.*, 271 B.R. at 711, the court explained that under Massachusetts law, “Insurers must show not only that the party procuring the insurance coverage . . . was a sophisticated commercial entity and equal in bargaining power to the Insurers, but also that the specific language at issue was a result of bargaining between the Insurer and [the Insured].” *Id.* at 724. The court acknowledged that some modification of the disputed endorsement exclusion was negotiated, but “the crucial policy language” was not discussed or negotiated. *Id.* In *AIU Ins. Co. v. Superior Court*, 799 P.2d 1253 (Cal. 1990) (In Bank), although recognizing the concept, the California Supreme Court did not apply the sophisticated insured exception where the parties did not negotiate the policy, even though the policyholder’s subsidiary insurance company, had itself drafted similar language:

FMC unquestionably possesses both legal sophistication and substantial bargaining power. For this reason, the insurers contend, we should neither construe the policy language at issue in this case in the broad sense understood by laypersons (as opposed to a narrower technical sense) nor resolve ambiguities in favor of coverage. There is some force to these arguments, particularly in light of the fact that FMC itself operates a subsidiary that drafts

mented, "While it is frequently the case that insureds who draft or select policy language are large, sophisticated corporate insureds, the wealth and size of the insured is not relevant. Rather, the crucial inquiry in applying the doctrine of *contra proferentem* is who drafted or selected the policy language."⁴⁶

Although insurers often point to the use of a broker as a reason to reject *contra proferentem*, it does not of itself compel application of the sophisticated insured exception. Even experienced independent brokers may not understand the nature of complex or novel insurance products and may rely on the insurance company's expertise.⁴⁷ On the other hand, brokers may be liable for their negligence in procuring inadequate or inappropriate insurance as well as in failing to advise clients of their obligations under a policy.⁴⁸ Arguably, the ability to blame an intermediary might justify a more neutral approach to policy interpretation where the insured's agent plays an active role in procuring particular coverage.⁴⁹

CGL policies identical to those at issue in this case. In the absence of evidence that the parties, at the time they entered into the policies, intended the provisions at issue here to carry technical meanings and implemented this intention by specially crafting policy language, however, we see little reason to depart from ordinary principles of interpretation.

AIU Ins. Co., 799 P.2d at 1266. See also *Shell Oil Co. v. Winterhur Swiss Ins. Co.*, 15 Cal. Rptr. 2d 815, 829-20 (Ct. App. 1993).

46. *AIU Ins. Co.*, 799 P.2d at 1264 (rejecting the insured's interpretation of a policy provision concerning the authority of appraisers to determine the amount of loss).

47. For example, in *Priority Finishing Corp. v. Hartford Steam Boiler Inspection & Insurance Co.*, No. CV 940544055S, 1998 WL 731081 (Conn. Super. Ct. Oct. 6, 1998), the insured, Priority, sought to replace an all-risk commercial insurance policy. In particular, primary coverage for its customer's goods was a key objective. Priority hired an independent broker authorized to sell Hartford products and indicated that it desired to replace its existing policy with one with similar coverage. At the time, Hartford was marketing a new insurance product, which its own salesman represented to Priority's broker would cover customer goods. When smoke damaged the customer's stored goods, Hartford refused coverage and claimed that as to customer goods, Hartford's policy was an excess policy and not a primary policy. Interpreting the policy terms under Connecticut's reasonable expectations doctrine, the court considered the "objectively reasonable expectations" "of a policyholder having an ordinary degree of familiarity with the type of coverage involved." *Id.* at *10 and *11. The reasonable expectations doctrine also requires examination of the "methods and practice of marketing" and the insurer's representations. Even though the insureds used an experienced broker to procure the insurance, the court noted that Hartford "was pressing its salesmen to sell" the new product, and that its own salesmen admitted being ignorant and sold the policy "without knowing whether the coverage provided by the Unitech policy for the goods of others was primary or excess in nature." *Id.* at *14.

48. See, e.g., *Int'l Bhd. of Teamsters v. Willis Corroon Corp. of Maryland*, 802 A.2d 1050 (Md. 2002) (reversing summary judgment and explaining that a broker employed to obtain a policy covering certain risks may be liable in tort or contract for failing to obtain such coverage and failing to explain that the policy does not cover the risks sought to be covered); *Baseball Office of Comm'r v. Marsh & McLennan, Inc.*, 742 N.Y.S.2d 40 (App. Div. 2002).

49. In this regard, the World Trade Center (WTC) dispute is instructive. When the WTC collapsed on September 11, 2001, no insurance policy had actually been issued to the new WTC lessees, the Silverstein Properties. However, numerous insurers had issued binders

Two recent Third Circuit cases illustrate a judicious, factual approach like that suggested by Professor Stempel. In *Pittston Co. Ultramar America Ltd. v. Allianz Insurance Co.*,⁵⁰ the court considered whether, under New Jersey law, a policyholder's Comprehensive Marine Liability Package⁵¹ afforded coverage for environmental liability of an additional insured to a named insured.⁵² Beginning in 1954, Pittston operated an oil storage and transfer facility called Tankport. The property had been used as an oil refinery in the 1930s as well. In Pittston's operation, oil arrived by barge to a pier, and was then pumped from the barge through pipelines and stored in storage tanks on the land until transferred to trucks for land delivery to customers. The tanks on land were at or below the water table and leaks and spills over the years had caused extensive pollution issues. Pittston sold Tankport to Ultramar and agreed to indemnify Ultramar for contamination occurring during Pittston's ownership. Pittston had comprehensive general liability⁵³ policies in place. However, beginning in 1971, the CGL policies began excluding pollution coverage. In 1978, Pittston also purchased a series of CMLPs as well as CGL policies. Both Pittston and Ultramar tendered pollution cleanup cost claims to various insurers, and the litigation involved multiple issues, including the scope of coverage under the CGL policies and whether the known loss and loss in progress doctrines excluded coverage.⁵⁴

covering the property. After the terrorist attack, the issue arose whether the collapse of the towers constituted one or two occurrences under the per occurrence coverage provision. The binder correspondence reflected agreement on the WilProp form, which contained the following definition of occurrence:

"Occurrence" shall mean all losses or damages that are attributable directly or indirectly to one cause or to one series of similar causes. All such losses will be added together and the total amount of such losses will be treated as one occurrence irrespective of the period of time or area over which such losses occur.

SR Int'l Bus. Ins. Co. Ltd. v. World Trade Ctr. Props., LLC, 345 F.3d 154, 160 (2d Cir. 2003). The WilProp form, with this restrictive definition of occurrence, was a "manuscript form" created by Willis of New York, Silverstein's own independent broker. *Id.* at 173. Ironically, Travelers Insurance was to be the lead underwriter, and a Travelers policy would most likely have become the form of the policy eventually issued. The Travelers policy did not contain a definition of occurrence at all. *See id.* at 180. Thus, Silverstein's own broker offered a provision less favorable and more restrictive in scope than the insurers would have and Silverstein found itself fighting its broker's own form. The court affirmed the lower court and held that the WilProp form was unambiguous and that the attacks on the twin towers were "one series of similar causes" and thus a single occurrence. *Id.* It also ruled that the Travelers form, to which Travelers bound itself, was ambiguous because it lacked a definition of occurrence. *Id.* at 182. In interpreting the WilProp form, the court did not invoke *contra proferentem* against either party. It relied on the plain meaning rule. *Id.* at 180.

50. 124 F.3d 508 (3d Cir. 1997).

51. Hereinafter CMLP.

52. *Pittston*, 124 F.3d at 519.

53. Hereinafter CGL.

54. *Pittston*, 124 F.3d at 515.

Whether the CMLP covered land-based pollution raised the sophisticated insured exception issue. Pittston's marine policy in question was divided into a general terms and conditions section and a section that provided specific insuring agreements. The specific insuring agreements provided insurance for marine risks rather than for land-based operations. Pittston argued that a broad provision within the General Policy Terms and Conditions and Insuring Agreements granted freestanding coverage for the pollution claim regardless of the limited scope of the specific insuring agreements within another part of the policy.⁵⁵ The insured argued that a general provision providing coverage for "any loss, damage liability and/or expense arising out of, or in consequence of . . . discharge, emissions, spillage, or leakage upon or into the seas, waters, land or air, of oil petroleum products, chemicals or other substances of any kind or nature whatsoever" covered its liability for the contamination from the Tankport storage tanks.

The insurer, on the other hand, argued that the general provisions portion of the policy did not create insurance and that under the architecture of the policy, coverage existed only as to the named insuring agreements. Those insuring agreements covered traditional marine risks—charterer's liability, wharfinger's liability, cargo liability, and owned barges liability. Thus, the insurer argued, there was no insurance agreement for pollution caused by oil storage tanks on the land. The trial court concluded that there was no ambiguity and that the architecture of the policy form made clear that there was no land-based coverage.⁵⁶ The appellate court reversed on this issue, remanding for a determination as to whether the general terms and conditions section afforded stand-alone coverage for all types of pollution, including that occurring on the land.⁵⁷

Neither the trial nor the appellate court gave Pittston the advantage of *contra proferentem*.⁵⁸ Pittston had a high level of sophistication, representation by brokers, and substantial participation in crafting the policy. The evidence suggested that Pittston might have appreciated that the policy was ambiguous and that the insurer might not have intended to cover land pollution, but Pittston took its chances because it was unable to secure land pollution coverage elsewhere anyway.⁵⁹ Moreover, there was conflicting

55. *Id.* at 519–20.

56. *Id.* at 514–15.

57. *Id.* at 523.

58. See *Pittston Co. Ultramar Am. Ltd. v. Allianz Ins. Co.*, 905 F. Supp. 1279, 1320 (D.N.J. 1995) and *Pittston*, 124 F.3d at 520.

59. *Pittston*, 905 F. Supp. at 1323. For example, a contemporaneous memo by Pittston stated its understanding that the CMLP provided broad coverage, but cautioned to keep this fact confidential, noting, "As we were trying to put this program together, several large brokerage houses indicated such pollution coverage was simply unavailable and that higher limits for the rest of the marine program were obtainable but only at exorbitantly high prices." *Id.*

expert testimony regarding how the two-part policy structure should function together in a marine package policy.⁶⁰ That structure allowed Pittston to add new types of coverage in part two, while retaining the general terms in part one.⁶¹ There also was evidence of direct negotiations regarding known land pollution risks beyond the marine risks and the insurer's representations that coverage was refused.⁶²

The appellate court agreed with the insured that the scope of coverage under the policy terms was ambiguous. Still, though, the court did not resolve the case merely by invoking *contra proferentem*.⁶³ Instead, the court remanded for trial as to the policy's meaning.⁶⁴ It acknowledged that New Jersey law requires any ambiguities in an insurance contract to be resolved in favor of the insured.⁶⁵ However, the court explained, the rationale behind *contra proferentem* is premised on the adhesive nature of insurance, and *contra proferentem* is inapplicable when the contract is truly negotiated:

Read in conjunction, these cases indicate that the dispositive question is not merely whether the insured is a sophisticated corporate entity, but rather whether the insurance contract is negotiated, jointly drafted or drafted by the insured. In such instances, we conclude that the doctrine of *contra proferentem* should not be invoked to inure to the benefit of the insured.⁶⁶

The court then examined the drafting history and the broker's role during contract negotiations and concluded that *contra proferentem* was inapplicable:

Here, it is undisputed that Pittston hired an insurance broker, Sedgewick James of New York, to secure marine insurance. The broker testified in his deposition that he prepared the initial draft of the policies and negotiated the terms with the insurers. . . . As such, we conclude that the CMLP policies were not contracts of adhesion and are more properly treated as traditional, jointly-negotiated contracts. . . . Thus, Pittston, as a sophisticated insured who was heavily involved in the drafting and negotiating of the policies, cannot benefit from the general rule favoring coverage, and we will not apply it here.⁶⁷

The court commented on the memo's significance: "While this evidence may show Pittston's belief as to what coverage it had bought, or hoped to buy, it undercuts the claim that it had an actual meeting of the minds on the issue with its insurer and that any supposed misunderstanding on its part was reasonable." *Id.*

60. *Id.* at 1326.

61. *Id.* at 1321.

62. *Id.* at 1323–24.

63. *Pittston*, 124 F.3d at 520–21.

64. *Id.* at 523 (citations omitted).

65. *Id.* at 520.

66. *Id.*

67. *Id.* (citations omitted).

Thus, the factors that the court considered in discarding *contra proferentem* included (1) that the insured was a sophisticated entity; (2) that the contract was jointly negotiated; (3) that an independent broker represented the insured; and (4) that the insured's broker had a significant role in drafting the policy by contributing the initial policy draft.

Similarly, *Newport Associates Development Co. v. Travelers Indemnity Co. of Illinois*⁶⁸ is a case where factual inquiry into the negotiating process also justified application of the sophisticated insured exception. The insured hired an independent broker, Feinstein, to procure insurance for its marina operation. Feinstein took photographs of the marina and met with the insured's employees to discuss the scope of insurance desired.⁶⁹ Feinstein drafted scope of coverage language, which insured, among other things, "[s]lips, consisting of metal slips, walkways, ramps, pilings, power cables and other integral parts."⁷⁰ Feinstein testified that he intended to cover "everything in the water." Feinstein placed the insurance with Travelers, which incorporated the language verbatim in the policy it issued. When a breakwater about 120 feet from the pier was damaged, the insured sought coverage for the loss under the policy. Travelers denied the claim, asserting that the breakwater was not covered. The court refused to apply *contra proferentem*, examining Feinstein's role in depth:

Here, the insurance policy was drafted by an independent broker who was hired by Newport and acted in consultation with Newport employees. The drafted policy was then shopped to at least two different insurance companies. Newport selected Travelers after reviewing its proposed policy, and Travelers adopted the broker's policy language without any changes to the provisions at issue. Under these circumstances, we believe the contract was either drafted by Newport or jointly drafted, and the doctrine of *contra proferentem* does not operate in Newport's favor.⁷¹

After considering the extrinsic evidence, the court held that the language in dispute was not ambiguous.

On the other hand, a third case illustrates a troublesome application of the sophisticated insured exception with relatively less factual inquiry and where the disputed language derived from standard policies. In *Koch Engineering Co. v. Gibraltar Casualty Co.*,⁷² the insured, a manufacturer of a filtration system using innovative packing material, claimed that its liability policy covered damages sustained by Monsanto, its customer, following the

68. 162 F.3d 789 (3d Cir. 1998).

69. *Id.* at 794.

70. *Id.* at 791.

71. *Id.* at 794-95.

72. 878 F. Supp. 1286 (E.D. Mo. 1995), *aff'd*, 78 F.3d 1291 (8th Cir. 1996).

failure of Koch's product to perform as promised. Koch alleged that its liability to Monsanto constituted an occurrence under the policy, while the insurer claimed that a breach of contract was not an occurrence and that, additionally, coverage for the insured's product and work were exceptions to coverage under the policy. The policy in question defined an occurrence as "an accident, a happening, an event, or a continuous or repeated exposure to conditions which results . . . in Property Damage. . . ."⁷³

In interpreting the policy terms the lower court refused to apply *contra proferentem*. However, it gave no detail about the drafting or negotiation process:

As a preface to the discussion, the Court finds that the doctrine of *contra proferentem*, which construes the policy against the insurance company as the drafter of the contract, does not apply. In addition to the lack of ambiguity in the policy which would preclude the application of the doctrine, it does not apply to sophisticated contractors. In analyzing a dispute involving Missouri law, Judge Wisdom warned against the automatic adoption of the *contra proferentem* doctrine:

We do not feel compelled to apply, or, indeed, justified in applying the general rule . . . in the commercial insurance field when the insured is not an innocent but a corporation of immense size, carrying insurance with annual premiums in six figures, managed by sophisticated business men and represented by counsel on the same professional level as the counsel for insurers.

That analysis applies to the situation in this case. Koch negotiated a complex, twenty million dollar policy with the Defendants. In fact, in this case, the parties negotiated what they called a manuscript policy, the mere title of which indicates that it was not an adhesion, preprinted contract but a policy negotiated by two equal parties on a level playing field; therefore, Koch is not entitled to any special protection.⁷⁴

Thereafter, the court determined that there was no ambiguity, in essence making its prefatory rejection of *contra proferentem* mere dicta. The court simply looked to Missouri law to explain the meaning of an occurrence and relied on its conventional meaning, concluding that it did not encompass breach of contract claims.⁷⁵ The court further decided that even if the damage constituted an occurrence, coverage "would still be denied because the damages fall under the insured's work and insured's product exceptions within the policy."⁷⁶ The court may have correctly decided that the policy

73. *Koch Eng'g*, 78 F.3d at 1293.

74. *Koch Eng'g*, 878 F. Supp. at 1288 (quoting *Eagle Leasing Corp. v. Hartford Fire Ins. Co.*, 540 F.2d 1257, 1261 (5th Cir. 1976)). The appellate court affirmed. It did not make any reference to the sophisticated insured exception, but neither did it apply *contra proferentem*. *Koch Eng'g*, 78 F.3d at 1296.

75. *Koch Eng'g*, 878 F. Supp. at 1288-89.

76. *Id.* at 1289.

was not ambiguous, especially because Missouri law does not include breach of contract within its common definition of occurrence in CGL policies. However, the court's gratuitous rejection of the contra-insurer rules to interpret these standard terms based solely on the insured's representation during negotiations and the policy being a negotiated manuscript policy, without a more detailed inquiry, is unsettling. The case does not discuss any evidence that the terms "occurrence" or the "insured's product" were in fact negotiated, or were even negotiable, whether they were to have anything but a standard definition, who offered the terms, or who drafted the policy. "Occurrence" and "insured's product" are certainly common words in standardized policies and therefore probably came to be in the contract because of the standardized meaning that the parties ascribed to the words. That standardized language carried with it the expectation that it would be interpreted against insurers. Simply characterizing the policy as a so-called manuscript policy is an unconvincing justification. As many have noted, the characterization may merely mean that the insurer created a customized policy from a menu of standard terms drafted by it, rather than actually negotiated terms. Therefore, this label alone is unconvincing reason to abandon contra proferentem.⁷⁷

C. *A Principled and Narrow Approach*

As courts now recognize, the sophisticated insured exception to contra proferentem should have limited vitality.⁷⁸ Decisions increasingly examine the factors Professor Stempel outlined, including the drafting history, the equality of bargaining power, the representation, and the access to information of the parties. Courts also should allow the exception only when the disputed language, regardless of the insured's active participation in negotiations or sophistication, is not standardized language.

The sophisticated insured exception should not be applied when interpreting standardized agreements or standard provisions.⁷⁹ The fairness of applying contra proferentem whenever the language in question is standardized is apparent. By standardizing, insurers gain certain clear advantages including efficiency, predictability, and control over drafting.⁸⁰ Moreover, standardization allows insurers to rate and calculate their losses based

77. See Anderson & Fournier, *supra* note 6, at 369-72.

78. See, e.g., Commercial Union Ins. Co. v. Walbrook Ins. Co., Ltd., 7 F.3d 1047, 1053 (1st Cir. 1993) (under Massachusetts law, sophisticated insured exception is invoked "sparingly").

79. See, e.g., Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co., 52 Cal. Rptr. 2d 690, 697 (Ct. App. 1996) ("A policy should not be read as it might be analyzed by an attorney or an insurance expert. This is so even if the policyholder is a sophisticated insured.") (citations omitted).

80. See Swisher, *supra* note 27, at 759 (discussing the advantages of standardized insurance contracts).

on experience with the same provisions; it allows the insurer to expect "more consistent or predictable judicial decisionmaking . . . thereby 'reducing coverage litigation,' " it "reduces public confusion," and it "facilitate[s] claims handling because claims disposition is made more uniform at less cost."⁸¹ Regardless of which party offers the standardized language, it was initially drafted by the insurance industry with the assumption that it would be interpreted against the insurer. If the insurer does not desire the words to mean exactly what the words mean in other cases litigating those same standardized terms, it should say that here the words are unique and are not meant to carry a standardized meaning. Otherwise, it would be unfair to allow the insurer to capitalize on its customer's sophistication and to claim an advantage that it never sought when it adopted the standard language. Rejecting *contra proferentem* with regard to sophisticated insureds means that the sophisticated insured obtains a different and inferior policy to layperson insureds when, by accepting standardized language, such was not the expectation of either party.

The decision not to individualize the interpretation of standardized agreements or standardized clauses properly elevates these *contra-insurer* interpretation rules in standardized language cases beyond mere canons of construction and recognizes them as substantive. The *contra proferentem* rule determines what the contract means, without regard to what the parties might have thought or intended, and so is not merely interpretative.⁸²

The argument against applying a sophisticated insured exception, with regard to standardized forms, finds support in the *Restatement (Second) of Contracts* § 211, which covers how to interpret standardized agreements. Section 211 advises courts interpreting standardized agreements to "seek to effectuate the reasonable expectations of the average member of the public who accepts it" even though "[t]he result may be to give the advantage of a restrictive reading to some sophisticated customers who con-

81. STEMPER, *supra* note 17, § 4.06[c] (citing Laurence A. Silverman & Michael J. Lane, *Rules of Construction in Insurance Policies, in INSURANCE, EXCESS, AND REINSURANCE COVERAGE DISPUTES* 1989, at 19–19 (Barry R. Ostrager & Thomas R. Newman eds. 1989)). See also David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529 (1971) (noting increasing use of standardized contracts and advantages and disadvantages); Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 630–32 (1943) (noting industry advantages in using standardized contracts, including avoiding and controlling "juridical risks").

82. See Mark C. Rahdert, *Reasonable Expectations Reconsidered*, 17 CONN. L. REV. 323, 328 (1986) (noting that when *contra proferentem* is elevated from a tiebreaker rule it is transformed to one of substantive insurance law); Henderson, *supra* note 27, at 826–28 (noting that in its stronger form, the reasonable expectations doctrine is not a mere canon of construction but one of substantive insurance law). The idea that *contra proferentem* is not a mere aid in the construction of ambiguous terms, but a substantive rule of insurance law, is not unlike the concept of the parol evidence rule, which is regarded not merely as an evidentiary rule but as substantive contract law. See FARNSWORTH, *supra* note 8, § 7.2, at 213–14.

tracted with knowledge of an ambiguity or dispute.”⁸³ It acknowledges the advantages of using standard forms, including predictability, reduced transaction costs, and mass marketing advantages that inure to the drafter. However, section 211 also recognizes disadvantages to the nondrafting party, including the risk that the drafter inserts unfair provisions, the lack of meaningful assent to specific terms, and the loss of bargaining and control over the transaction.⁸⁴ On balance, in the case of standardized agreements, the *Restatement* favors uniformity in interpretation to achieve equality of treatment.⁸⁵

Insurers expect and desire equality of treatment from standardized language as well. The industry depends on certainty and predictability to set premiums and predict losses. Standardization protects against uncertainty and allows insurers to predict future losses and to collect data to set premiums.

Uniformity of policy language is a critical element of this loss prediction process because it ensures that carriers will experience the same covered losses under the same set of circumstances. If each carrier’s losses were derived from different policy language, the statistics collected by the ratings 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 ratings bureaus.⁸⁶

On the other hand, when policy language at issue is individualized and mutually drafted by parties with equal bargaining power and knowledge,

83. The *Restatement* justifies equal treatment because parties expect equal treatment with all others who enter into a standard contract:

e. Equality of treatment. One who assents to standard contract terms normally assumes that others are doing likewise and that all who do so are on an equal footing. In the case of a public utility, that assumption is fortified by statutory and common law limitations on discrimination among customers; a term prescribed by statute or regulation in the case of an insurance policy also carries an assurance of equal treatment. Apart from government regulation, courts in construing and applying a standardized contract seek to effectuate the reasonable expectations of the average member of the public who accepts it. The result may be to give the advantage of a restrictive reading to some sophisticated customers who contracted with knowledge of an ambiguity or dispute.

Illustration:

4. A, an insurance company, issues an insurance policy to B covering injuries “by accidental means.” A clause in the policy excludes “disability or other loss resulting from or contributed to by any disease or ailment.” B believes himself to be in good health, but has a latent Parkinson’s disease. Later an accidental blow activates the disease into a disabling condition. B is covered by the policy without regard to his knowledge or understanding of the quoted language at the time of contracting.

RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. e, illus. 4 (1981).

84. *Id.* § 211 cmts. a–c.

85. *Id.* § 211 cmt. e.

86. Heintz & Danforth, *supra* note 33, at 318–19. These authors comment that “interpretation of the standard form CGL policy on a contract-by-contract basis, taking into account extrinsic evidence of each policyholder’s understanding of the language at the time of contracting, would undermine the very reason for having standard language.” *Id.* at 314.

then contra proferentem has less appeal or justification. The factual inquiry, therefore, also should include consideration of whether the disputed language is a standard provision. If the term is standard, regardless of who offered it, contra proferentem should apply to favor the insured. However, where the provision in dispute is not a standard provision, inequality, the desirability of predictability, and the risks of differing decisions do not arise. Moreover, in the case of mutually negotiated nonstandardized provisions, the parties would not expect the interpretation to be weighted against either one. Parties with equal bargaining power with representation and access to information do not need contra proferentem to ameliorate overreaching and unfairness.⁸⁷

Considering how the standardization caveat would apply in the three cases recounted above shows how it further narrows Professor Stempel's functional approach. *Newport* and *Pittston* both applied a careful, functional approach. Moreover, each case raises sufficiently factual issues so as not to pose consistency, predictability, and equality problems.

Newport offers a strong justification for abandoning contra proferentem because the descriptive language in question (that is, does the description "[s]lips, consisting of metal slips, walkways, ramps, pilings, power cables and other integral parts" cover a breakwater 120 feet away?) was unique to this dispute and was not standardized. The intended meaning was individualized between sophisticated parties. Moreover, there is no risk that this outcome will result in unequal treatment because the language is unique; for the same reason, there is little or no risk of inconsistency and unpredictability.

Pittston also supports abandoning contra proferentem, especially because the evidence suggests that the placement of the ambiguous pollution clause was negotiable and could have been moved.⁸⁸ However, if the placement

87. California follows this narrow approach, which considers legal sophistication, equality of bargaining power, and actual negotiation, but also requires joint drafting of the provision in dispute and language that is not standardized:

The insurers have submitted evidence (specifically, an internal FMC memorandum stating that the policies were written "on a line-per-line basis through continuing negotiation with the insurance carrier") that FMC individually negotiated the policies in question. This evidence does not, however, shed light on the meaning to be ascribed to the coverage provisions at issue here. These provisions, as we have noted above, are adopted verbatim from standard form policies used throughout the country. For this reason, even if the policies were "negotiated" in a broad sense, this fact has little bearing on construction of the specific policy language in question here.

AIU Ins. Co. v. Superior Court, 799 P.2d 1253, 1266 n.9 (Cal. 1990). See also *Berres v. Artifex, Ltd.*, 21 F. Supp. 2d 909, 913 (E.D. Wis. 1998); *Shell Oil Co. v. Winterhur Swiss Ins. Co.*, 15 Cal. Rptr. 2d 815, 829 (Ct. App. 1993) (emphasis added).

88. *Pittston Co. Ultramar Am. Ltd. v. Allianz Ins. Co.*, 905 F. Supp. 1279, 1324 (D.N.J. 1995) (noting that when Ultramar took over the operations, it insisted on reorganizing the sections of the CMLP insurance).

of the pollution provision within the general terms section was not unique, but followed the structure of marine policies generally, the outcome in *Pittston* should be consistent in how it interprets the two sections of a marine policy. Providing a nonstandardized interpretation to a standardized structure would give an advantage to the insurer in litigation that was probably not contemplated. Therefore, assuming that either the language or the structure of the policy was common to marine policies and not unique to this particular insurance contract,⁸⁹ how the general provisions and the insuring agreements fit together should comport to the standard meaning and structure common to marine liability policies, because the insurer and the insured likely intended that. That meaning and structure should be interpreted by means of *contra proferentem*, for the sake of uniformity, predictability, and equality.

Finally, *Koch Engineering* is a case where the sophisticated insured exception is not appropriate because the words "occurrence" and "insured's product" are standard terms. Notably, the court actually looked to other Missouri cases to define "occurrence" and "insured's product" and held that the terms were unambiguous in this instance. But by rejecting *contra proferentem*, the court ran the risk that these standard terms would not have the same meaning in cases between sophisticated insureds and insurers. This raises equality, consistency, and predictability problems and would allow the insurer to capture an unbargained-for advantage by departing from the meaning of the terms that the parties likely ascribed by virtue of their standardization.

III. OTHER CONTEXTS CONSIDERING THE INSURED'S SOPHISTICATION

Professor Stempel presciently recognized that there could be other situations in which to appropriately consider the insured's sophistication, aside from contract interpretation: "Although focusing on the ambiguity principle, judicial acceptance of the notion that contract doctrine varies somewhat according to the nature of the parties and the facts of the transaction should affect other contract rules in addition to *contra proferentem*—for example waiver, estoppel, and reasonable expectations."⁹⁰

Insurance companies are increasingly inviting courts to consider the sophistication of insureds in other contexts to level the playing field. They

89. There is no reason to assume that the policies in question were particularly unique or that the insureds intended the policies to expand or narrow coverage beyond the ordinary expectations of purchasers of marine policies. Notably, in addition to the marine policies, the insureds had CGL policies in place as well, but those excluded pollution coverage. *Pittston Co. Ultramar Am. Ltd. v. Allianz Ins. Co.*, 124 F.3d 508, 514 (3d Cir. 1997).

90. Stempel, *supra* note 2, at 832.

have argued that courts should consider the sophistication of the insured in a variety of estoppel and waiver contexts, in deciding whether to apply the notice-prejudice rule in delayed and defective notice or tender cases, and in deciding whether to excuse an insurer's own failure to strictly comply with statutory provisions. In these instances, the insured's sophistication is considered in determining the reasonableness of the insured's conduct or intent, or in weighing the harm of the insurer's conduct in light of the insured's ability to protect itself.

A. Heightened Duties to Read, Understand, and Object to Policy Terms

Even sophisticated, experienced insureds represented by brokers may invoke the reasonable expectations doctrine in estoppel situations,⁹¹ although there is more doubt whether that doctrine has a clear rationale in the context of interpreting provisions between equal parties.⁹²

*Reliance Insurance Co. v. Moessner*⁹³ presents a careful consideration of the insured's sophistication under the reasonable expectations doctrine in an estoppel context. The issue was whether a CGL policy's total pollution exclusion⁹⁴ endorsement in a renewal policy was applicable to a claim based upon the insured's liability to an injured customer overcome by carbon monoxide from the insured's product. The insured argued that the pollution exclusion applied only to environmental catastrophes, and was not intended to exclude bodily injury claims caused by a poisonous emission from the insured's product. The court disagreed that the policy language was ambiguous, stating that the TPE in the renewal policy "unambiguously bars coverage for the claims."⁹⁵

Under the reasonable expectations doctrine, however, the court reversed and remanded for trial even though the insured was sophisticated and the policy was unambiguous. Under Pennsylvania law, "even the most clearly written exclusion will not bind the insured where the insurer or its agent has created in the insured a reasonable expectation of coverage."⁹⁶ Moreover, "[w]here an individual applies and prepays for specific coverage, the insurer may not unilaterally change the coverage provided without an af-

91. See, e.g., *Priority Finishing Corp. v. Hartford Steam Boiler Inspection & Ins. Co.*, No. CV 940544055S, 1998 WL 731081 (Conn. Super. Ct. Oct. 6, 1998) (applying reasonable expectations doctrine to favor the insured's expectations where insurer's salesman assured independent broker that the policy provided certain coverages).

92. *Madden v. Kaiser Found. Hosps.*, 131 Cal. Rptr. 882 (1976) (In Bank) (holding that a health plan negotiated between the State of California and Kaiser Foundation is not a contract of adhesion and reasonable expectations doctrine was inapplicable because plan was the "product of negotiation between two parties . . . possessing parity of bargaining strength").

93. 121 F.3d 895 (3d Cir. 1997).

94. Hereinafter TPE.

95. *Moessner*, 121 F.3d at 902.

96. *Id.* at 903.

firmative showing that the insured was notified of, and understood, the change, regardless of whether the insured read the policy.⁹⁷ To discern the insured's reasonable expectations, the court examined the manner in which the original and replacement insurance policies were procured. For example, the renewal policy contained the unambiguous exclusion, whereas the original policy did not. The original policy was procured after VE, the insured, hired a brokerage firm to acquire insurance. VE specifically requested that its broker acquire insurance with coverage for losses arising from the use of its "vaporator" and informed the broker that the vaporator emitted carbon monoxide as a by-product of normal operation. The broker conveyed that information to the underwriter at Reliance, the insurer, and the original policy, which would have covered the loss, was issued.⁹⁸ According to the court, at the time of renewal, Reliance "unilaterally inserted the TPE endorsement into VE's renewal policy and never brought that change to VE's attention."⁹⁹

The court determined that the reasonable expectations doctrine could apply, despite the lack of ambiguity, based on estoppel.¹⁰⁰ The court next considered whether status as a sophisticated insured represented by an experienced broker precluded application of the reasonable expectations doctrine. The court concluded that it did not. "While sophisticated insureds may ex-

97. *Id.* at 904.

98. *Id.* at 906.

99. *Id.* at 906. In *Twelve Knotts Ltd. P'ship v. Fireman's Fund Ins. Co.*, 589 A.2d 105 (Md. 1991), the court considered an insured's failure to object to policy provisions that did not conform to the contract as orally agreed, affirming Maryland's rule that an insured has a duty to read and understand its policy and that "[i]f the terms of the policy are inconsistent with his desires, he is required to notify the insurer of the inconsistency and of his refusal to accept the condition." *Twelve Knotts Ltd. P'ship*, 589 A.2d at 113. In explaining the reasonableness of the rule in that case, the court reasoned that "[a]ppellant is a sophisticated business entity having had previous experience purchasing insurance. The offending provision is clear and unambiguous." *Twelve Knotts Ltd. P'ship*, 589 A.2d at 113. The court then held that by neglecting to object until the end of the policy year, the insured was deemed to have accepted the nonconforming provision. *Twelve Knotts Ltd. P'ship*, 589 A.2d at 114.

100. *Moessner*, 121 F.3d at 903. Although the court held that the exclusion was not ambiguous, detrimental reliance or equitable estoppel arguably justifies the court's willingness to invoke reasonable expectations. It relied on earlier precedent: "[W]here an individual applies and prepays for specific insurance coverage, the insurer may not unilaterally change the coverage provided without an affirmative showing that the insured was notified of, and understood, the change, regardless of whether the insured read the policy." *Id.* at 904 (citing *Bensalem Township v. Int'l Surplus Lines Ins. Co.*, 38 F.3d 1303, 1311 (3d Cir. 1994)). See also *TJS Brokerage & Co., Inc. v. Hartford Cas. Ins. Co.*, No. 2755 Dec. Term 1995, 2000 WL 1060645, at **20-21 n.8 (Pa. C.P. Apr. 24, 2000) (declining to reach whether sophisticated insured is entitled to reasonable expectations doctrine, but holding that despite clear policy language, where the insurer creates an expectation of coverage, the reasonable expectations of an insured will be honored unless insurer makes an affirmative showing that insured was informed and understood limitations of coverage): *Cf. Swisher*, *supra* note 19, at 603 ("based on the acts and representations made by the insurer or its agents, the legal doctrines of waiver, estoppel, election, and reformation of contract are also available to the insured and should be liberally construed to validate the insured's reasonable expectations of coverage").

exercise more bargaining power vis-à-vis the insurers, and therefore be in less need of protection from the courts than other insureds, the rationale of the reasonable expectations doctrine is still applicable when the insurer unilaterally alters the insurance coverage requested by the insured.”¹⁰¹

The court added a proviso, however.

[W]hile we predict that Pennsylvania will not make the status of the insured determinative of the applicability of the reasonable expectations doctrine, we also believe that it would deem the insured’s status to be a factor to be considered when resolving whether the insured acted reasonably in expecting a given claim to be covered.¹⁰²

The court then identified factors both tending to show that the insured did reasonably expect coverage as well as tending to suggest that it did not. Evidence tending to negate an expectation of coverage included the broker’s and the insured’s general familiarity with TPE provisions as well as their notice of the changes based on the endorsement on the renewal, which clearly and boldly stated that it contained changes, that the policy was reviewed and unobjected to when it was received (albeit three months after coverage commenced), and that the premium was drastically reduced. As to the insured’s failure to object to the policy terms after the policy was issued, the court stated, “We thus believe that Pennsylvania would hold that the duty [of the insurer to inform the insured of changes at variance with the coverage requested] is presumptive, but can be set aside when a sophisticated insured is given constructive notice of a change at a time when it can negotiate an alteration in the policy.”¹⁰³

This decision represents a good example of how sophistication should be considered. Sophisticated insureds should not lose traditional safeguards of insurance law and the law should not indulge two sets of rules based on the status of insureds. However, a party’s sophistication should be considered to explain the intent of its conduct. Considering the insured’s sophistication in this context is entirely appropriate because the question is whether this insured had constructive notice of the policy provisions at a time when the insured could still reject the terms. That question is necessarily factual, and can only be answered by examining the insured’s conduct. Here, considering the insured’s status helps give contextual meaning to the insured’s conduct. Moreover, considering the insured’s sophistication in this context will not make for inconsistent decisions because notice is necessarily a factual question.

101. *Moessner*, 121 F.3d at 905.

102. *Id.* at 906.

103. *Id.* at 908.

B. Defective Tender or Notice

Generally, insureds must give notice and tender claims to insurers as conditions of coverage.¹⁰⁴ Often compliance with the prescribed manner and time of notice and tender is a condition of coverage.¹⁰⁵ Not infrequently, insureds fail to conform precisely to such policy provisions because of an oversight or ignorance. Some jurisdictions continue to hold that the unexcused failure to abide by notice and tender provisions can result in forfeiture of coverage.¹⁰⁶ However, to ameliorate the harshness of forfeiture, the modern trend has been to excuse defective tender or notice unless the insurer has been prejudiced by the delay or defect.¹⁰⁷ Thus, some jurisdictions require the insured to show the absence of prejudice to the insurer, since prejudice is otherwise presumed.¹⁰⁸ Others require the insurer to affirmatively show that it was prejudiced.¹⁰⁹ Still others consider prejudice as one factor in determining if the delay or defect was excusable or reasonable.¹¹⁰

104. "The traditional approach is grounded upon a strict contractual interpretation of insurance policies under which delayed notice was viewed as constituting a breach of contract, making the issue of insurer prejudice immaterial." *Clementi v. Nationwide Mut. Fire Ins. Co.*, 16 P.3d 223, 226, 232 (Colo. 2001) (en banc) (overruling traditional approach and holding that "once it has been established that an insured has unreasonably provided delayed notice to an insurer, an insurer may only deny benefits if it can prove by a preponderance of the evidence that it was prejudiced by the delay").

105. See generally Charles C. Marvel, Annotation, *Modern Status of Rules Requiring Liability Insurer to Show Prejudice to Escape Liability Because of Insured's Failure or Delay in Giving Notice of Accident or Claim, or in Forwarding Suit Papers*, 32 A.L.R.4th 141 (1984 & Supp. 2002).

106. See *id.* at 146-52 (collecting cases). See also *Clementi*, 16 P.3d at 223 (collecting cases and commenting that "[f]ew courts today strictly adhere to the traditional approach which allowed for no consideration of insurer prejudice in determining whether benefits should be denied due to noncompliance with an insurance policy's notice requirements").

107. See RESTATEMENT (SECOND) OF CONTRACTS § 229 (1981). See also *Ferrando v. Auto-Owners Mut. Ins. Co.*, 781 N.E.2d 927, 946 (Ohio 2002) ("Furthermore, the rule requiring an inquiry into prejudice is the accepted rule in a significant majority of states, and this rule also appears sound when applied in cases involving breach of a consent-to-settle or other subrogation-related provision; a clear majority of states also require an inquiry into prejudice in those cases. The reasons relied on by a majority of states, detailed above, to impose a prejudice requirement in such cases are compelling."); *Alcazar v. Hayes*, 982 S.W.2d 845, 852-53, 856 (Tenn. 1998) ("resolving to join the modern trend" and overruling traditional rule and establishing a rebuttable presumption rule).

108. See, e.g., *U.S. Fire Ins. Co. v. Vanderbilt Univ.*, 267 F.3d 465 (6th Cir. 2001) (under Tennessee law prejudice is rebuttably presumed by failure to provide timely notice); *Ferrando v. Auto-Owners Mut. Ins. Co.*, 781 N.E.2d 927 (Ohio 2002); *Aetna Cas. & Sur. Co. v. Murphy*, 538 A.2d 219 (Conn. 1988).

109. See *Marvel*, *supra* note 105, at 152-67 (collecting cases). See also *Alcazar*, 982 S.W.2d at 854 ("A clear plurality of states hold that once it is demonstrated that the insured breached the notice provision, the burden of proof is allocated to the insurer to prove that it has been prejudiced by the breach.")

110. See *Amerisure Ins. Co. v. Laserage Tech. Corp.*, 2 F. Supp. 2d 296, 305 (W.D.N.Y. 1998) (under Illinois law); *Am. Country Ins. Co. v. Bruhn*, 682 N.E.2d 366, 370 (Ill. App. Ct. 1997); *Koski v. Allstate Ins. Co.*, 572 N.W.2d 636, 639 (Mich. 1998). See also *Clementi*, 16 P.3d at 223 ("[w]e find this approach problematic because we believe that insurer prejudice is not relevant to the reasonableness of the insured's delayed notice, and thus should not be considered as a

Whatever the formulation of the notice-prejudice rule, insurers recently have argued that sophisticated insureds should not be excused. One rationale insurers offer is that sophisticated insureds should be expected to act professionally and reasonably by giving proper and timely notice and suffer the consequences of their lapses.¹¹¹ As one court explained,

we do assume that a corporation . . . is presumed to have more sophistication in managing its affairs than the average consumer, and thus should be able to recognize and adhere to notice provisions in its contracts of insurance that require it to contact its carriers "as soon as practicable" in the event of an "occurrence" and "immediately" when "claim is made or suit is brought."¹¹²

Similarly, when notice must be given reasonably, some jurisdictions consider the insured's sophistication to assess reasonableness.¹¹³

Not all courts find a distinction based upon the insured's sophistication compelling in the area of notice or defective tender.¹¹⁴ These courts reject

factor"); *Alcazar*, 982 S.W.2d at 855 (collecting cases and calling the factor approach "analytically flawed" because prejudice to the insurer is not a factor in assessing the insured's excusable conduct and the approach could lead to confusion that is detrimental to the insured).

111. See, e.g., *Fed. Deposit Ins. Corp. v. Ins. Co. of N. Am.*, 105 F.3d 778 (1st Cir. 1997) (concluding that under Massachusetts law, notice-prejudice rule is inapplicable to a fidelity bond issued to a sophisticated financial institution). Cf. *Erie Ins. Exch. v. Virgin Islands Enters., Inc.*, 264 F. Supp. 2d 261 (D.V.I. 2003) (holding that an insurance company is a sophisticated insured and its pre-tender expenses were not recoverable from a car rental company co-defendant); *Am. Mut. Liab. Ins. Co. v. Beatrice Cos., Inc.*, 924 F. Supp. 861 (N.D. Ill. 1996) (noting that "at least between sophisticated parties," pre-tender defense costs are not subject to a notice-prejudice rule).

112. *Avco Corp. v. Aetna Cas. & Sur. Co.*, 679 A.2d 323, 329-30 (R.I. 1996).

113. See *Amerisure Ins. Co.*, 2 F. Supp. 2d at 296 (under Illinois law, noting that insured, a corporation with over 100 employees and annual sales over \$10 million was "sophisticated with regard to commerce and insurance"); *Am. Country Ins. Co.*, 682 N.E.2d at 370 (explaining that factors in assessing reasonableness of notice include prejudice to the insurer, "the sophistication of the insured regarding insurance policies," "the insured's awareness that an occurrence as defined under the terms of the policy has taken place," and "the insured's diligence in ascertaining whether policy coverage is available"). Still other jurisdictions have limited the application of the notice-prejudice rule in the commercial insurance context. See, e.g., *Liberty Mut. Ins. Co. v. Gibbs*, 773 F.2d 15 (1st Cir. 1985); *Cheschi v. Boston Edison Co.*, 654 N.E.2d 48, 53 (Mass. App. Ct. 1995).

114. *Carrington Estate Planning Servs. v. Reliance Standard Life Ins. Co.*, 289 F.3d 644 (9th Cir. 2002) (noting that the notice-prejudice rule applies regardless of the insured's sophistication); *Trustees of the Univ. of Pa. v. Lexington Ins. Co.*, 815 F.2d 890, 898 (3d Cir. 1987) (extending notice-prejudice rule to policies between sophisticated parties); *Federated Mut. Ins. Co. v. State Farm Mut. Auto. Ins. Co.*, 668 N.E.2d 627, 633 (Ill. App. Ct. 1996) (rejecting policy's written tender requirement and holding "that an insurer's duty to defend claims potentially falling within the terms of a policy is triggered by actual notice of a lawsuit, regardless of whether the insured is sophisticated or unsophisticated—provided the insured has not selected one insurer to provide an exclusive defense and there is no prejudice to the insurer"). See also *British Ins. Co. of Cayman v. Safety Nat'l Cas. Corp.*, 146 F. Supp. 2d 585, 593 (D.N.J. 2001) (noting that reinsurance is not adhesionary; thus, the reinsured "cannot argue that the policy behind the prejudice rule applies to reinsurance contracts"), *rev'd*, 335 F.3d 205, 213 (3d Cir. 2002) (overruling lower court and concluding that even between sophisticated insurance companies, "New Jersey Supreme Court would require the reinsurer

the invitation to depart from notice-prejudice rules even as to sophisticated insureds because "it results in the insured forfeiting coverage it has already paid for"¹¹⁵ and in the case of defective tender, where an insurer has actual notice of the claim but no formal tender of it, placing the burden to clarify the intent of the insured "facilitate[s] clear communication between the parties."¹¹⁶ After all, an insurer with notice of a claim "can simply ask the insured if the insurer's involvement is desired, thus eliminating any uncertainty on the question."¹¹⁷

The mere sophistication of the insured does not justify abandoning notice-prejudice rules. Forfeiture is just as harsh for a sophisticated insured as for any other insured and the presence or lack of prejudice on the insured is equally felt. In addition, like ordinary insureds, sophisticated insureds can be ignorant about the existence or nature of their insurance coverage.¹¹⁸ The notice-prejudice rule is a judicial creation designed to protect the insured public by creating a doctrine to ameliorate the effect of noncompliance with technical notice/tender provisions unilaterally imposed on insureds in insurance policies. Carving out an exception based on the insured's status raises inequality problems in jurisdictions with a notice-prejudice rule, without a sound rationale.

On the other hand, the notice-prejudice rule is inapt when the insured has actually made a strategic decision to forgo coverage. An insured has a "paramount . . . right to choose or knowingly forgo an insurer's participation in a claim" and "may knowingly forgo the insurer's assistance by instructing the insurer not to involve itself in litigation."¹¹⁹ An insured may

to demonstrate prejudice where, as here, the reinsurer relies on late notice as a defense against the otherwise legitimate claims of its reinsured"); *Cincinnati Cos. v. W. Am. Ins. Co.*, 701 N.E.2d 499, 504 (Ill. 1998) ("the better rule is on which allows actual notice of a claim to trigger the insurer's duty to defend, irrespective of the level of the insured's sophistication, except where the insured has knowingly foregone the insurer's assistance"); *Loosmore v. Parent*, 613 N.W.2d 923 (Wis. Ct. App. 2000) (placing the burden on the insurer to clarify an ambiguous tender, even where the insured is a sophisticated entity).

115. *British Ins. Co. of Cayman*, 335 F.3d at 205.

116. *Home Ins. Co. v. Nat'l Union Fire Ins. of Pittsburgh*, 658 N.W.2d 522, 533 (Minn. 2003) (citing *Towne Realty, Inc. v. Zurich Ins. Co.*, 548 N.W.2d 64, 67 (Wis. 1996)).

117. *Id.* at 533 (citing *Cincinnati Cos.*, 701 N.E.2d at 504).

118. *Amerisure Ins. Co.*, 2 F. Supp. 2d at 296, illustrates that even a sophisticated insured can be ignorant. There, insured was sued for patent violations under the Lanham Act. The insured consulted its general counsel, an attorney at a law firm employing approximately seventy employees. With advice from its general counsel, the insured also sought a patent litigation firm to represent it. In interviews with prospective law firms, the question arose whether the claim might be covered by insurance, but the insured's general counsel said, "No, of course not. It is patent litigation." *Id.* at 300. Seven months later, patent attorneys at Baker & McKenzie first determined that the insured "should give notice of the action to [its] insurers." Under a "prejudice" analysis, the court did not excuse the late notice, concluding that the insured was a sophisticated corporation represented by two law firms and failed to exercise due diligence. *Id.* at 305.

119. *Home Ins. Co.*, 658 N.W.2d at 522 (citing *Richard Marker Assocs. v. Pekin Ins. Co.*, 743 N.E.2d 1078, 1081 (Ill. App. Ct. 2001)).

forgo a defense with one carrier because other insurance exists, or because the insured wants to proceed with its own defense.¹²⁰ The insured's sophistication and experience may be relevant to determining whether its failure to give notice was a conscious strategic decision or the result of mere ignorance or neglect.¹²¹

C. *Waiving Formal Statutory Requirements*

Insurers have also sought to excuse their own lapses when the other party is sophisticated. For example, in many states, insurers are required to make a written offer of uninsured¹²² and underinsured¹²³ motorist coverage to insureds and, in some states, the statutes specify how the offer of coverage is to be made and the manner in which an insured may decline such coverage. Without a proper offer of coverage, the insured will be deemed not to have waived the optional coverage, and so coverage will be imputed.¹²⁴

These cases typically arise where an insured is an employer and the injured party is an employee or passenger to whom the insured employer has no tort liability. Thus, UM/UIM insurance coverage is not particularly advantageous to the employer-insured, and when the insurer attempts to show that the employer knowingly waived such coverage, even though it was not properly offered, the employer does not object to the insurer's position. The employer-insured may even concede that it did not desire such coverage. The injured employee desires the coverage as a beneficiary under the policy and is left to argue what logically ought to be the insured employer's position in favor of UM/UIM coverage.

Many courts have established a bright line approach and require strict adherence to the statutory requirements of offer and waiver of coverage, even when the insured is a sophisticated entity that knowingly waived coverage.¹²⁵ For example, in *Estate of Ball v. American Motorists Insurance*

120. See, e.g., *Aetna Cas. & Sur. Co. v. Chicago Ins. Co.*, 994 F.2d 1254 (7th Cir. 1993) (noting that where an insured is covered under several policies, the sophisticated insured may rationally conclude that representation by one insurer better suited his defense than representation by another).

121. See, e.g., *Employers Ins. of Wausau v. James McHugh Constr. Co.*, 144 F.3d 1097, 1103-04 (7th Cir. 1998) (holding that evidence that risk manager wrote that insured was "expressly electing to tender the defense and indemnity of this case to you, and not to our other carrier" constituted a targeted tender, and notice-prejudice rule was inapplicable); *Erie Ins. Exch. v. Virgin Islands Enterps., Inc.*, 264 F. Supp. 2d 261, 264 (D.V.I. 2003) (holding as to pre-tender costs that in the case of a sophisticated insured having multiple coverages, "it was reasonable for Avis to conclude that [the insureds] wanted Erie to defend them rather than Avis").

122. Hereinafter UM.

123. Hereinafter UIM.

124. See, e.g., *Ammons v. Transp. Ins. Co.*, 219 F. Supp. 2d 885 (S.D. Ohio 2002).

125. See, e.g., *id.* at 894-95 (holding that an insurer's failure to comply with statutory requirements for offering optional UM coverage precluded waiver regardless of insured's status as a "sophisticated, corporate consumer[]"); *Bernier v. Transam. Ins. Co.*, 574 N.E.2d

Co.,¹²⁶ decedent Jennifer Ball was employed by the insured, a national food service corporation with a fleet of 3,000 vehicles in twenty states.¹²⁷ A drunk driver killed Ball while she was driving a company vehicle in Arizona. Ball's estate sought UIM coverage under Fleming's policy with American Motorists Insurance Company. The insurer rejected the claim on the grounds that Fleming had not purchased UIM coverage. Fleming's risk manager, when soliciting bids from insurers, had indicated that Fleming only wanted that insurance required by state law.¹²⁸ The policy issued afforded \$3 million in liability coverage but nothing in UIM coverage. Arizona law requires all insurers writing automobile policies to make a written offer to insureds of UIM coverage in the amount of the liability coverage under the policy, but also allows insureds to decline properly offered coverage.¹²⁹ The insurer conceded that it had not complied with the statutory written offer rule, but contended that Fleming, as a "sophisticated business with a professional risk manager, knew what it wanted, and made a knowing waiver."¹³⁰ After the accident, Fleming agreed with the insurer that coverage was not desired. The Arizona Supreme Court, en banc, rejected the insurer's position:

Allowing the insurer and named insured to agree to facts and the legal significance of documents after the claim arises defeats the protective purpose of the statute. It lets the insurer and named insured bind a person insured under the policy to their post-claim statement of facts. But it is this person, the driver, that the statute was designed to protect.¹³¹

Recently, a few courts have reached an opposite conclusion, concluding that a sophisticated insured can make a knowing waiver of coverage, even if the statutory provisions are not strictly met.¹³² For example, in *Lumber-*

873 (Ill. App. Ct. 1991); *Nat'l Union Fire Ins. Co., v. Irex Corp.*, 713 A.2d 1145 (Pa. Super. 1998) (imputing coverage where insurer fails to comply with UM/UIM statutory requirements even though evidence suggested vice president intended to reject coverage); *Clements v. Travelers Indem. Co.*, 850 P.2d 1298 (Wash. 1993) (adopting a bright line test requiring insurer to conform to statute, even though corporate risk manager stated that employer did not want UIM coverage).

126. 888 P.2d 1311 (Ariz. 1995) (en banc).

127. *Id.* at 1311-12.

128. *Id.* at 1312.

129. *Id.*

130. *Id.* at 1312-13.

131. *Id.* at 1313.

132. See, e.g., *McDonald v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, No. CV 0005955175, 2002 WL 495126, at *3 (Conn. Super. Ct. Mar. 4, 2002) (holding that strict adherence to statutory provisions for reducing UM/UIM coverage is not required on a commercial fleet policy, noting that "decisions regarding commercial coverage limits are generally made by professionals who have a degree of sophistication in such matters" . . . and "if adherence had been precise in this case . . . it is absolutely clear that the result would have been the same"); *Manalo v. Lumberman's Mut. Cas. Co.*, No. 19391, 2003 WL 264344 (Ohio Ct. App. Feb. 7, 2003) (holding that where the named insured, Avon, is a sophisticated large corporation and its risk manager states that he knowingly selected particular coverage, precise form of offer and rejection prescribed by case law is not required); *Lumbermens Mut. Cas. Co. v. Sowell*, No. 00-CP-24-713, 2002 WL 864241 (S.C. C.P. Apr. 26, 2002).

mens Mutual Casualty Co. v. Sowell,¹³³ at issue was whether an automobile policy issued by Lumbermens to SmithKline Beecham contained UIM coverage. Lumbermens' offer of UIM coverage failed to comply with statutory requirements because it did not list the premium prices for UIM coverage on the form. However, SmithKline's risk manager stated that he had had no intention of buying UIM coverage, that he was familiar with the policy and UIM coverage, and that he "ma[de] no claims of misunderstanding or ignorance in the rejection of the UIM insurance."¹³⁴ The court explained,

Looking at the UIM cases that have been before the Supreme Court and Court of Appeals, the insured claims ignorance or failure to inform on the part of the insurance company. The insured claims that had he known of his options or that UIM coverage existed, he would not have rejected coverage. . . . These insured are not sophisticated business entities. However, the insured in the case before the court is a sophisticated business entity. Also, the insured does not claim that its insurance company failed to make a meaningful offer.

. . . The person intended to be protected by Section 38-77-350, which is SmithKline, has been protected. While this court can find no exception to Section 38-77-350, the public policy that drives the existence of the code section cannot be served by reforming the insurance contract at hand.¹³⁵

Thus, unlike Arizona, this South Carolina court viewed the statutory provisions as inuring a benefit to the policyholder and not to beneficiaries under the policy. The South Carolina court also considered that SmithKline's knowing waiver achieved the statute's purpose, even if the statutory requirements were not met.

Carving out a status-based exception to the statutory requirement imposed on insurers to offer certain coverage is unjustified. These statutes were designed for the protection of the insured public, to make sure that all insureds are offered UM/UIM coverage because it is valuable insurance. Creating an exception to the statutory requirement for sophisticated insureds that knowingly forgo coverage raises the same equality questions that interpreting standardized agreements poses. By turning waiver into a factual issue rather than a matter of statutory compliance, courts circumvent the legislative design to protect insurance consumers by establishing a clear prophylactic rule.¹³⁶ What would next prevent a court from negating

133. *Sowell*, 2002 WL 864241, at *1.

134. *Id.* at * 1. Undoubtedly SmithKline took the position that it did not want coverage because it had no liability to its injured employee who was seeking the UIM coverage under the policy.

135. *Id.* at **2-3.

136. Cf. RESTATEMENT (SECOND) OF CONTRACTS § 211, cmt. e ("In the case of a public utility, that assumption is fortified by statutory and common law limitations on discrimination among customers; a term prescribed by statute or regulation in the case of an insurance policy also carries an assurance of equal treatment.").

the rule in every case where any insured knowingly waived coverage despite the insurer's failure to comply, thus eviscerating the statute? The legislature sought to avoid the problems created by making each case of waiver a factual dispute by requiring insurers to abide by certain formalities. In this instance, invoking a sophisticated insured exception undermines the uniformity of law that the legislature desired.

IV. THE INSURED'S SOPHISTICATION SHOULD BE CONSIDERED ONLY WHEN THE DISPUTE IS FACTUAL

No doubt insurers will continue to urge courts to consider the insured's sophistication when resolving disputes where traditional rules attempt to equalize the imbalance of power between the consumer and the insurer. The rules created by courts and statutes to protect the insured public and to promote sound public policy are not less applicable merely because an insured is a commercial entity with wealth and sophistication. Altering these rules based on the insured's status threatens mischief where predictability, equality, and uniformity are desirable.

In the case of standardized agreements or terms, applying a sophisticated insured exception to *contra proferentem* means that the sophisticated insured obtains a different product than other insureds when choosing standardized language, although that was not the intent of the parties. Treating insureds differently in this situation undermines the desirability of standardization of the provisions. It gives sophisticated insureds inferior product and treats them differently from other insureds. Similarly, the notice-prejudice rule is a judicial creation to protect insureds from technical, unilateral notice provisions in an insurance contract where forfeiture will result and there is no harm to the insurer. The public policy behind these rules is equally compelling regardless of the status of the insured. Finally, statutory written waiver requirements of UM/UIM coverage represent a legislative scheme designed to assure that the motoring public is offered particular valuable insurance and are afforded the opportunity to decline coverage after meaningful deliberation. The rule's rigidity is desirable to both insured and insurer, because by mandating a clear offer and waiver of coverage, the insured can make a knowing decision and the insurer will clearly know what coverage is provided under the policy, thus avoiding disputes about intent. An exception here undermines the legislature by creating a factual question of waiver where the legislature desired certainty.

Consideration of the insured's sophistication has a place in insurance law, however, when the dispute is factual and there is no danger of inconsistency, inequality, and uncertainty. Thus, when equal parties jointly draft nonstandardized insurance language, considering the sophistication of the parties is merely an aid in interpretation and does not have implications

outside of that case. Similarly, when deciding whether the insured's delay or defect in notice or tender was the result of ignorance or represented a conscious choice to forgo coverage, the insured's knowledge, experience, and understanding of insurance lends insight into the insured's conduct and should be considered.

V. CONCLUSION

There is little to justify changing long-held principles of insurance contract interpretation and treating insureds differently based on their wealth, size, or power alone. The pro-insured rules are not premised merely on these inequalities. Among other reasons, they also represent a judicial bias toward coverage based on public policy considerations. The functional approach proposed by Professor Stempel has become a dominant approach in deciding when to abandon these traditional rules. One caveat remains: whenever the language is standardized, regardless of who offered it or how much negotiation occurred, it should be interpreted consistently with how it is interpreted generally. This includes the *contra proferentem* bias. This limitation is justified where parties selecting standard language expect courts to apply standard interpretation consistent with other cases. By individualizing the interpretation of standardized language, courts allow the possibility of an opportunistic advantage unintended by the parties. The inequality, inconsistency, and unpredictability of individualizing the interpretation of standard insurance language are not desirable.

In the context of statutory mandates and notice-prejudice rules, it is undesirable for courts to depart from insurance rules aimed at protecting the insured public generally for certain classes of insureds, because doing so undermines the desirable goals of uniformity in interpretation, predictability of judicial outcomes, and equal treatment among insureds.

There is a place, however, for considering the sophistication of insureds in the context of ascribing a meaning to the conduct of a party. When disputes between insureds and insurers are factual and resolution depends upon determining what these parties meant with regard to their own unique dispute, consideration of the insured's sophistication is a useful and illuminating tool.

