

Insuring Understanding: The Tested Language Defense

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I. INTRODUCTION

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

Communication requires a common language, a commonality often lacking between insurers and consumers. I have elsewhere explored how courts unintentionally give insurers incentives to ignore the buying public.¹ This Article considers the consumer side of the question: would insurers be more attentive to their policyholders if the policyholders paid more attention to insurers?

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

Consumers' snub spares insurers the full force of reputational pressures necessary to a working market. And because the demand for consumer insurance can be inelastic, insurers have insufficient incentives to educate, entice, and satisfy their buyers. This Article seeks to break the cycle of insurer inattention to consumers and consumer inattention to insurers. If consumers understood policy language—understood what the contract promised—they would better understand the product and better judge whether a particular insurer had kept its promise. Real reputational effects would return to the market.

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

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

This Article offers the defense as a renovation to the current structure of plain-language incentives. A renovation trumps a solution because some

1. Michelle Boardman, *Contra Proferentem: The Allure of Ambiguous Boilerplate*, 104 MICH. L. REV. 1105, 1119–20 (2006).

2. See *infra* Part II.A (discussing consumer misconceptions about their insurance coverage). Law professors make mistakes too. See *infra* note 21 and accompanying text (recounting a story of two law professors' insurance misconceptions).

of the forces leading consumers to ignore policy language are intractable and rational. The same holds when insurers ignore consumers. Still, allowing for a natural separation between what insurers write and consumers read does not justify encouraging a chasm.

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

The defense has immediate implications in three areas: the doctrines of *contra proferentem* and reasonable expectations, and the task of facing natural complexity.

A. CONTRA PROFERENTEM

First, the tested language defense would enhance the doctrine of *contra proferentem*, which instructs courts to construe ambiguities against the drafter. Insurers at times entertain the paranoid fantasy that no language, however clear, can satisfy a court. Courts, for their part, entertain the hindsight fantasy that language easily could have been drafted to be more lucid or to anticipate the case at hand.³ Language drafted, tested, and redrafted would replace these fantasies with some reality.

Consumer research would show, first, whether the relevant audience in truth finds the language ambiguous. Second, where the language is open to two or more reasonable readings, the evidence would show if the policyholder's reading is among them. Finally, the evidence allows courts to decide if the insurer did its best to make the language readable. This is not to pat the insurer on the back, but to determine if punishing the insurer for not doing better will have any effect.

Punishment by *contra proferentem* has costs to consumers; it should be used only where there is a greater benefit. Where *contra proferentem* gives insurers a precise understanding of the court's interpretation of a clause, the insurer is often willing to keep its unclear language in order to rely on the court's known interpretation.⁴ Settled precedent allows courts and

3. See, e.g., *Smith v. Am. States Ins. Co.*, 586 N.W.2d 784, 787 (Minn. Ct. App. 1998) (“American States easily could have drafted its policy to preclude Smith’s recovery in this case.”); *Neal-Petit v. Lahman*, No. 91551, 2008 WL 5259726, at *1 (Ohio Ct. App. Dec. 18, 2008) (“Had Allstate intended otherwise, the policy language could easily have been drafted to reflect that intention.”), *aff’d*, 2010 WL 1816265 (Ohio May 4, 2010); *State Farm Mut. Auto. Ins. Co. v. Langridge*, 2004 WI App 113, ¶ 68, 275 Wis. 2d 35, ¶ 68, 683 N.W.2d 75, ¶ 68 (“While State Farm could have very easily drafted its policy language differently so as to preclude [the respondent’s] claim . . . , it chose not to do so.”).

4. See Boardman, *supra* note 1, at 1117–19 (discussing the value of a settled clause to an insurer).

insurers to know what a clause means. But policyholders are still in the dark because the unclear policy language stands.⁵

B. REASONABLE EXPECTATIONS

Next, the tested language defense would elicit evidence, instead of speculation, for courts applying the reasonable expectations doctrine. The original doctrine starts with the premise that “the *objectively* reasonable expectations of [policyholders] . . . will be honored even though a painstaking study of the policy provisions would have negated those expectations.”⁶ Most states only apply the doctrine to ambiguous provisions, and many states replace “painstaking study” with “average reading.”

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

C. FACING COMPLEXITY

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

From this, a court will at times conclude that *no formulation* is sufficient; insurers simply cannot have the substance they are seeking to convey. This happens now but disingenuously: courts give causes for the failure of a clause other than its substantive incomprehensibility to laymen. Insurers attempt to address these causes by redrafting or highlighting a clause, both of which can make the contract even more difficult to read.⁷

In other cases, a court may decide to accept unavoidable complexity and let the language stand. If the insurer’s meaning serves an important actuarial function, the fact that it is too complex to explain to laypeople

5. See *infra* note 8 and accompanying text (looking at the courts’ treatment of policy language).

6. Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 967 (1970) (emphasis added). The precise form of the doctrine varies by state. Its underlying goal is controversial. See *infra* Part III.C (discussing the reasonable expectations doctrine).

7. Perhaps it is better to allow courts the fiction that the insurer just needs to redraft one more time; this is considered below.

need not necessarily lead to rejection. To truly face the complexity, however, courts in this case must stop sending insurers the “redraft” signal.

The point of this defense—allowing consumer research to disprove ambiguity—is to reward insurers for drafting fairly clear language. The language will always be imperfect, especially as applied to atypical or unanticipated losses. But applying strict liability against insurers where the language is imperfect has taught insurers the wrong lesson: redrafting “plain” language is unlikely to succeed in court.

Courts apply the doctrine of *contra proferentem* in case after case, confounded that insurers do not clean up their act. What the frustrated court does not realize is that it has fired its last shot, and the insurer knows it. Now that the clause at hand has a judicially settled meaning, the clause has a precise interpretation.⁸ Coupled with statistical-loss data, the insurer now knows how much to charge for that bit of coverage.

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

If instead the insurer redrafts the clause as the court suggests, the insurer rolls the dice again. Perhaps the court will accept the new clause, but it may find the redraft ambiguous. Or perhaps it will become clear that the court has no intention of accepting the clause in any form—both *contra proferentem* and the reasonable expectations doctrine can conceal (sometimes barely) a court’s decision to mandate a type of coverage. Insurers are risk-averse and this game is not worth the candle. Unless the insurer cannot live with the coverage the court has found in its ambiguous clause, insurers find it better to provide the coverage and raise the premium.⁹

Readable policy language has thus not emerged under the current structure. If the tested language defense increases clarity, what would follow? The defense does not assume that plain contract language would spur policyholders to rush home to read by the fire, scotch glass in hand. Nor does it assume that policyholders would ask for policies in advance and vigorously comparison shop for content.¹⁰

Instead, the premise advanced here is that in insurance, more so than with other consumer contracts, there is a heavy cost to consumers not being able to understand the policy *after* a loss—when the time for the seller’s

8. It is more complex, of course. States may differ in their interpretation of the clause, and future application to new situations will be unstable.

9. See Boardman, *supra* note 1, at 1115 (noting that only in “extreme cases . . . insurers will find the expanded coverage untenable and drop . . . [it] altogether”).

10. Policyholders usually purchase first and receive the written policy second, after which they have a limited time to cancel the contract.

performance has arrived. This is because consumers do not experience the insurance “product” until a loss has occurred. Until then, the consumer has merely signed a document and sent a check.

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

When a consumer buys a physical product, say, a vacuum, he may not understand the standardized contract that accompanies it, but at least knows what he wants the vacuum to do and what failure would look like. The vacuum market works when buyers can discern their own preferences and judge the degree to which a product fulfills those preferences.¹¹ If buyers do not know what they want or, knowing what they want, do not know if they have received it, the competitive pressure on sellers to provide a good product will be weak.

If the tested language defense succeeds in making insurance contracts more plain, policyholders will: (1) more accurately judge whether an insurer has breached; (2) share that judgment with other consumers; (3) share that judgment with the state insurance commissioner; (4) decide to switch insurers; (5) decide to purchase different coverage from the same insurer; (6) decide to act because a risk (flood) or an object (boat) is not covered; or (7) decide to sue.

Part II of this Article marks the mistakes consumers make about insurance and insurers, and explores why those mistakes persist. One can blame insurers for being poor educators, but a share of the explanation lies with rational consumer choices. Part III, the core of the Article, further discusses the tested language defense and its ramifications. Part IV concludes with an analysis of the benefits that would follow from clearer language and entertains some objections to the tested language defense.

II. CONSUMER MISPERCEPTION

Consumers are mistaken about their insurance coverage. Their misperceptions, and nonperceptions, are partially rational. The time and energy it would take to increase comprehension of any particular point may not be worth the effort. After getting price quotes for homeowners insurance from three companies, for example, and selecting the policy with the lowest price for the desired deductible, a buyer will not try to change the

11. Given the existence of the \$19,000 Electrolux Ergorapido vacuum, which sports Swarovski crystals, the state of the vacuum market is debatable.

policy language and is unlikely to initiate purchasing any endorsements.¹² An individual consumer may even conclude that learning *anything* about their coverage is nonsensical; it has some cost and no benefit. But what is rational individually can harm consumers collectively. If consumers ignore policy content, insurers have less incentive to compete on substance or lucidity. There is some evidence that insurers compete on price and that consumers are price sensitive.¹³ By contrast, to read a consumer insurance policy is to know that the language—the manner by which the substance of the deal is to be communicated—was not written with the lay consumer in mind. The language does not entice, encourage purchase, or easily identify risks for which additional insurance should be sought.

A. MISTAKES

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

According to a recent survey by the National Association of Insurance Commissioners, these percentages of consumers mistakenly believe that their homeowners insurance covers the following losses:

- 68%—cars, boats, and motorcycles stolen from, or damaged on, their property;
- 51%—a break in their water supply line;
- 37%—a break in the sewer line on their property connecting to the municipal sewer system;
- 35%—damage from earthquakes;
- 34%—damage from mold;
- 31%—damage from termites,¹⁴ rats, mice, and other infestations;
- 22%—pets stolen from or injured on their property.¹⁵

12. The insurer's agent or the buyer's broker should recommend endorsements for regional risks or expensive jewelry, for example.

13. See J. David Cummins, *Property-Liability Price Insurance Deregulation: The Last Bastion?*, in *DEREGULATING PROPERTY-LIABILITY INSURANCE: RESTORING COMPETITION AND INCREASING MARKET EFFICIENCY* 1, 2–3 (J. David Cummins ed., 2002) (finding that the deregulation of markets for consumer-property-liability insurance resulted in highly competitive industries); Banks McDowell, *Competition as a Regulatory Mechanism in Insurance*, 19 *CONN. L. REV.* 287, 300–02 (1987) (providing an example of insurer competition in Georgia).

14. Another survey found that 47% of participants were confused about termite damage. Press Release, Termite Inst., Termite Institute Website Clears Up Consumer Confusion over a \$5 Billion Problem (Mar. 15, 2007).

15. Press Release, Nat'l Ass'n of Ins. Comm'rs, What Isn't Covered by Your Homeowners Insurance? (June 4, 2007), available at http://www.naic.org/Releases/2007_docs/homeowners_not_covered.htm (providing these statistics on what homeowners believe are covered by their insurance).

None of these losses are regularly covered.¹⁶

Another surprisingly stubborn insurance mistake is believing that one is covered for flood damage without buying separate flood coverage. Despite efforts by FEMA (the Federal Emergency Management Agency) to make the public aware of the National Flood Insurance Program,¹⁷ and even *after* Hurricane Katrina, one-third of people surveyed “incorrectly believe flood damages would be covered by a standard homeowners or property and liability policy.”¹⁸

Some mistakes involve not *what* is covered but *to what extent*. A recent MetLife study found that “nearly one-third of those surveyed believe their homeowners policy would reimburse them for the market value of their homes if they were destroyed by fire or in a storm.”¹⁹ This means that one-third of consumers misunderstand a central part of the contract. The calculation of payment for a destroyed house is one of the most important traits of a homeowners policy. This is not ignorance about a personal watercraft or pet-fish exclusion—it goes to the purpose for purchasing the product.

This “market value” belief contains several mistakes. For some consumers, it includes not separating land value from building value. Most homeowners have a sense of their home’s value in that they know approximately how much it would sell for on the open market and the local government assessment on which they pay taxes. If this number—house value plus land value—is the number that pops into mind when a house is destroyed, the policyholder will be sorely disappointed. Why? The policyholder still has the land and will not be compensated for land not lost.²⁰

16. Bradley Steffens, *Homeowners Insurance—Six Risks Not Covered*, Mar. 10, 2008, available at <http://business.dailydb.com/insurance/homeowners-insurance-six-risks-not-covered.html> (reporting on the survey and noting that some homeowners believe that their standard homeowners insurance covers more than it actually does). Some types of insurance will cover these types of losses for an additional premium, such as state-backed earthquake insurance in parts of California. *Id.*

17. See FEMA, *The National Flood Insurance Program*, <http://www.fema.gov/business/nfip/> (last visited Apr. 27, 2010) (providing information and facts about the National Flood Insurance Program).

18. Press Release, Nat’l Ass’n of Ins. Comm’rs, *supra* note 15.

19. Eileen Alt Powell, *Many Homeowners Confused About Insurance*, INSURANCEHEADLINES.COM, July 2, 2007, <http://www.insuranceheadlines.com/Homeowners/3450.html>.

20. In the case of a flood or earthquake where infrastructure and neighborhoods are wiped out, the value of the land may indeed be lower, but this is an investment loss for the policyholder, not an insured loss. *But see* BARRY NALEBUFF & IAN AYRES, *WHY NOT?: HOW TO USE EVERYDAY INGENUITY TO SOLVE PROBLEMS BIG AND SMALL* 53–57 (2003) (describing a rare insurance product, “Home Equity Protection,” that provides coverage protection from a zipcode-wide decrease in housing prices between the day of purchase and sale).

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

Perhaps a more common form of the "market value" mistake is to not understand that current market value of the house is not part of the equation at all. Homeowners policies either cover destroyed property at "actual cash value" or "replacement cost."²¹ For the house structure itself, replacement cost, meaning rebuilding cost, is the norm. "Actual cash value," which includes depreciation and is much lower than replacement cost, is the norm for destroyed personal belongings.²² More than 70% of those surveyed got this wrong, believing instead that they would be paid enough to replace their lost possessions.²³

To see the difference, compare the cost of buying a desirable new washer-and-dryer set with the actual cash value of your midline, ten-year-old pair, pre-loss. The actual cash value of possessions inside the house will often be cents on the dollar it would cost to buy the same possessions new. While this Article argues that many insurance misperceptions do not need to be clarified up front because the benefit of clarity can be reaped after a loss, that is not so here. The "actual cash" mistake is best corrected at the time of sale because the term can be changed. "You have to ask for replacement cost coverage, but . . . it's worth the extra money."²⁴

B. SOME IMPLICATIONS

Missing the opportunity for replacement coverage highlights that insurance buyers are uniquely positioned to benefit from readable contracts. Buyers of computers or coffeemakers do not read the contract before purchase because little can be done to change regrettable clauses. Nor do they often read it after something has gone awry, when the application of

21. See Johnny Parker, *Replacement Cost Coverage: A Legal Primer*, 34 WAKE FOREST L. REV. 295, 295–98 (1999) (describing "actual cash value" and "replacement cost" in the residential property context); Harold H. Reader III, *Modern Day Actual Cash Value: Is It What the Insurers Intend?*, 22 TORT & INS. L.J. 282, 284–88, 291–93 (1987) (comparing recovery rates between the two types of policies).

22. Press Release, Nat'l Ass'n of Ins. Comm'rs, *supra* note 15; cf. Steffens, *supra* note 16 (listing six risks to homes of which homeowners are frequently unaware).

23. Powell, *supra* note 19.

24. *Id.* (quoting the Director of Product Management for MetLife Auto & Home).

contract terms is at hand, because their primary interest is the quality of the product, not the contract.²⁵

In insurance, by contrast, there are gains to be had from understanding the contract initially and then again after a loss. When the contract first arrives (after purchase but before finality), insurance consumers have the power to request different terms on questions of real weight, such as switching to replacement value for personal property.²⁶ On the back end, after a loss, is precisely when a policyholder experiences the true operation of the product he has purchased. If the insurance policy is intelligible, this later education takes place on at least two levels.

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

Of course, in order to experience the true operation of the contract, the policyholder has to have some idea that his insurance might cover the loss in the first place. Consumers are mistaken about their homeowners coverage in both directions: they assume they are covered for more causes of loss—like flood or mold—and for more money—like replacement cost—than they are. This confusion creates a missed opportunity to buy better-suited coverage. But the evidence also suggests that people fail to file claims for losses that are covered—losses for which they have paid premiums. In the homeowners context, here are a few examples of compensable losses that are foreign to many:

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

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

- credit-card theft or fraud, in limited amounts;²⁷
- personal items lost while traveling or stolen from hotel rooms;²⁸
- loss of construction or repair materials;²⁹ and
- damage to tombstones and burial vaults located in a cemetery.³⁰

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

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

C. WHY MISTAKES PERSIST: MISPERCEPTION AND MISSING PERCEPTION

How does a homeowner judge his homeowners insurance and his insurer after a loss? Consumers only know what they want in a product or service by learning what they want through experience—usually repetitive experience.³¹ For repetition to provide cumulative feedback about preferences, however, a number of conditions must be met. First, the feedback must be decipherable. Did the product fail from poor quality or because some percentage of all products fail? With a toaster, perhaps a consumer does not need to know; he can just move on to another brand of toaster and, in the aggregate, the brand with the fewest spontaneous combustions wins. But with insurance, consumers may be in a different bind—can the consumer know that the product failed at all or did it merely disappoint?

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

27. "We will pay . . . for [t]he legal obligation of an 'insured' to pay because of the theft or unauthorized use of credit cards issued to or registered in an 'insured's' name." INSURANCE SERVICES OFFICE, INC., FORM NO. HO 00 03 10 00, § I-Property Coverages (E)(6)(a)(1), at 6 (1999).

28. "We cover personal property owned or used by an 'insured' while it is anywhere in the world." *Id.* § I-Property Coverages (C)(1), at 3.

29. "Materials and supplies located on or next to the 'residence premises' used to construct, alter or repair the dwelling or other structures on the 'residence premises' [are covered]." *Id.* § I-Property Coverages (A)(1)(b).

30. "We will pay up to \$5,000 for grave markers, including mausoleums, on or away from the 'residence premises' for loss caused by [certain perils]." *Id.* § I-Property Coverages (E)(12), at 8.

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

These skeptics will have a hard time developing a preference for a particular insurer or type of insurance.

For others, the gathering of experience and reputational data is lengthier but not necessarily more accurate.³² Consider a consumer who purchases Allstate homeowners insurance for ten years. In year ten he experience a loss, for which Allstate denies coverage. He looks around for alternatives. Neighbor Right is happy to recommend his insurer, Liberty Mutual, but he has never had a loss. Neighbor Left uses State Farm and was happy with State Farm's payment of her only claim. The consumer has learned little.

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

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

In theory, standardized products promote consumer learning from personal repeat experiences and from those of others.³³ Such enduring confusion over a standardized product in a competitive market is unexpected. Richard Epstein and Oren Bar-Gill have debated whether

32. See *infra* Appendix (discussing online methods consumers can use to compare insurers).

33. See generally Matthew Osborne, *Consumer Learning, Switching Costs, and Heterogeneity: A Structural Examination* 42–44 (Econ. Analysis Group, U.S. Dep't of Justice, Discussion Paper No. EAG 07-10, 2007), available at <http://www.justice.gov/atr/public/eag/227376.pdf> (testing the effect of consumer learning on the purchase of laundry detergents); Gregory C. Crawford & Matthew Shum, *Uncertainty and Learning in Pharmaceutical Demand*, 73 *ECONOMETRICA* 1137, 1164–68 (2005) (same, regarding pharmaceuticals); Tülin Erdem, Michael P. Keene, T. Sabri Öncü & Judi Strebler, *Learning About Computers: An Analysis of Information Search and Technology Choice*, 3 *QUANTITATIVE MARKETING & ECON.* 207, 237–43 (2005) (same, regarding personal computers).

serious consumer mistakes can (or do) persist in a working market.³⁴ Both conclude that it “is probably correct” that “mistakes about a *standardized* product are not sustainable.”³⁵

Bar-Gill points out, correctly, that the question is ultimately empirical. Epstein takes the position that, in markets of standardized products, “voluntary actions by individual consumers and their advisors, as well as by competitive sellers, tend to close an information gap” between the seller’s knowledge and the consumers.³⁶

Insurance may be the exception. Under any reasonable conception of standardization, homeowners insurance policies are a standardized product, yet consumer mistakes persist.³⁷ Whether from imperfect information and taints of monopolistic collaboration,³⁸ or from bounded rationality and limited-risk heuristics,³⁹ the market falters.

In order to purchase wisely, consumers need to learn about the products for sale *and* about their own preferences. Some will argue that consumer preferences are easy to discern: a consumer’s preference is revealed by what he buys.⁴⁰ But in attempting to determine consumer preferences from behavior and before honoring that behavior as an efficient market outcome, we need to look at whether the consumer has developed

34. For their arguments, see generally Richard A. Epstein, *The Neoclassical Economics of Consumer Contracts*, 92 MINN. L. REV. 803 (2008); Oren Bar-Gill, *The Behavioral Economics of Consumer Contracts*, 92 MINN. L. REV. 749 (2008). Their answers speak to, as Epstein puts it, “the long-standing debate over the extent to which market failures pave the way for government regulation.” Epstein, *supra*, at 803–04. Or, as Bar-Gill puts it, the question is whether the cognitive and decisional mistakes consumers make are “mistakes [that] merit legal intervention.” Bar-Gill, *supra*, at 749.

35. Bar-Gill, *supra* note 34, at 750 (emphasis added).

36. Epstein, *supra* note 34, at 809. Epstein then raises two objections to even accepting persistent consumer mistake: first to “any one-size-fits-all regulation” and second to the market distortions or barriers to entry caused by regulation. *Id.* at 809–10.

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

38. *Id.* at 804–05 (“There are . . . two sets of well-recognized circumstances in which the neoclassical theory accepts that some government intervention may make sense: private monopoly and imperfect information.”).

39. *See* Bar-Gill, *supra* note 34, at 759 (discussing the “collective action problem” and how it “prevents sellers from correcting consumer mistakes”).

40. *See* P.A. Samuelson, *A Note on the Pure Theory of Consumer’s Behaviour*, 5 *ECONOMICA* 61, 65 (1938) (original mathematical demonstration of this theory); *see also* John Beshears et al., *How Are Preferences Revealed?*, 92 *J. PUB. ECON.* 1787, 1787–90 (2008) (identifying the circumstances where revealed preferences are most likely to diverge from normative preferences).

preferences.⁴¹ Even Vilfredo Pareto (of Pareto optimality) required “repeated actions” before taking the observable act—buying—as evidence of a preference for the thing bought⁴²:

A man who buys a certain food for the first time may buy more of it than necessary to satisfy his tastes, price taken into account. But in a second purchase he will correct his error, in part at least, and thus, little by little, will end up procuring exactly what he needs. We will examine this action at that time when he has reached this state.⁴³

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

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

- to pay less rather than more;
- to receive more coverage rather than less, at a set price;
- to have a comprehensible contract or product; and
- to have covered claims paid without hassle.

A consumer’s ordering of his preferences will vary with time. Once a consumer has experienced a loss, he would rather be compensated for it. Before a loss, he would rather purchase cheaper insurance for certain losses only. In order to purchase wisely, a consumer needs to modulate his preferences.⁴⁴

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

41. For a critique of honoring revealed preferences and a defense of judicial paternalism, see generally Robin L. West, *Taking Preferences Seriously*, 64 TUL. L. REV. 659 (1990) (encouraging judges to develop a sympathetic understanding of individual litigants).

42. VILFREDO PARETO, *MANUAL OF POLITICAL ECONOMY* 103 (Ann S. Schwier & Alfred N. Page eds., Ann S. Schwier trans., 1971) (1927) (discussed to great effect in Camerer, *supra* note 31, at 88–90).

43. *Id.* at 103.

44. Your present self has a fiduciary duty to your future selves. See, e.g., RICHARD A. POSNER, *AGING AND OLD AGE* 84–94, 262–64 (1995) (discussing compulsory pension programs). Posner explains how an individual at working age (A_w) owes a duty to himself at retirement age (A_r) to plan accordingly for retirement. *Id.* at 263. A_w serves as a trustee of A_r , the body that both A_w and A_r inhabit, and thus a compulsory pension program imposes a fiduciary duty on A_w . *Id.*

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

- (1) Loss Obviously Covered:
Lightening strikes the house, causing a roof fire. Sprinkler systems, smoke detectors, and the absence of inappropriately stored flammable materials mitigate the loss.⁴⁵
- (2) Loss “Obviously” Covered, But *Not* Covered in Fact:
A tree falls on the garage, damaging the boat, motorcycle, or car within.⁴⁶
- (3) Loss Obviously *Not* Covered:
Policyholder sets fire to his house and is caught. An innocent co-insured may be covered, however.⁴⁷
- (4) Loss “Obviously” Not Covered, But Covered in Fact:
On vacation, a gold necklace is stolen from a hotel room.⁴⁸
- (5) Policyholder Uncertain, Loss Is Covered:
Damaged construction materials on the premises during a renovation.⁴⁹

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

46. According to the former CEO of the National Association of Insurance Commissioners, Cathy Weatherford, one “misconception held by more than two-thirds of policyholders is the belief that cars, boats or motorcycles stolen from their property or damaged on their property are covered by homeowners policies.” Powell, *supra* note 19.

47. If the policy is jointly held between husband and wife, the nonarsonist has suffered an unintentional loss; whether that loss is covered depends on the contract and the state. Susan Randall, *Freedom of Contract in Insurance*, 14 CONN. INS. L.J. 107, 144–45 (2007). Randall states:

Whether the intentional acts of a co-insured will defeat coverage for an innocent co-insured turns on the exclusionary language used in the policy. A policy excluding losses caused by intentional acts of “any insured” or “an insured” creates a joint obligation among co-insureds and bars coverage for both the malefactor and innocent co-insureds. Where the policy uses the words, “the insured”, the obligation is several, and the exclusion applies only to the insured who intended the act and caused injury, not an innocent co-insured.

Id. (citation omitted); see also *N.J. Mfrs. Ins. Co. v. Carney*, No. 3:04-CV-2468, 2006 WL 2092571, at *3–4 (M.D. Pa. July 26, 2006) (holding that a wife’s arson does not stop her husband’s recovery as an innocent co-insured when the policy language is ambiguous) (citation omitted).

48. “We cover personal property owned or used by an ‘insured’ while it is anywhere in the world.” INSURANCE SERVICES OFFICE, INC., *supra* note 27, § I–Property Coverages (C)(1), at 3. Jewelry is covered at limits in the few thousands of dollars, which can be increased by enumerating the pieces and paying an additional fee. *Id.*

49. “Materials and supplies located on or adjacent to the ‘residence premises’ used to construct, alter or repair the dwelling or other structures on the ‘residence premises’” are

- (6) Policyholder Uncertain, Loss Is *Not* Covered:
 Stolen construction materials on the premises during construction of an addition or separate structure like a pool house or stand-alone garage.⁵⁰
 or
 Exploding frozen pipes, where the homeowner has failed to properly heat or drain pipes.⁵¹

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

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

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

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

covered. *Id.* § I-Property Coverages (A)(1)(b).

50. The loss is excluded if it is “[c]aused by . . . [t]heft in or to a dwelling under construction, or of materials and supplies for use in the construction until the dwelling is finished and occupied.” *Id.* § I-Perils Insured Against (A)(2)(c)(3), at 9.

51. The loss is excluded if it is

[c]aused by . . . [f]reezing of a plumbing, heating, air conditioning or automatic fire protective sprinkler system or of a household appliance, or by discharge, leakage or overflow from within the system or appliance caused by freezing. This provision does not apply if you have used reasonable care to: (a) [m]aintain heat in the building; or (b) [s]hut off the water supply and drain all systems and appliances of water.

Id. § I-Perils Insured Against (A)(2)(c)(1), at 8–9.

The debate over whether consumer mistakes about standardized products or contracts endure includes the underlying premise that standardization has value for the consumer. Both Epstein and Bar-Gill start from the position that there is greater reason to expect, over time, correction of mistakes about standardized products than mistakes about non-standardized products.⁵² This is plausible; consumers are able to learn from the experience of many others, all of whom have purchased the same product a new buyer would be purchasing. The more consumers using the product, the more accurate a picture the buyer will compose.

On the other hand, the downsides of standardized contracts are familiar. No one has ever complimented a contract with the labels “adhesive” or “boilerplate.”⁵³

The drafting of standard forms by national enterprises has properly been described as “unilateral private ordering of terms imposed by the dominant party” and has been denounced by a prominent scholar as the equivalent of legislation by the likes of unelected . . . firms that present standard forms to consumers on a take-it-or-leave-it basis.⁵⁴ While it stops short of electing policyholders to an insurer’s board of directors, the tested language doctrine could diminish these objections to standardization. The tested language defense would encourage a “democratization” of the drafting process. Policyholders would not become drafters, but they would become part of the process. As portions of the policy become understood by and known to consumers, insurers might even find that research on what consumers want, in addition to what they understand, is profitable.⁵⁵ This would not result in the collaborative consumer process that Joseph Perillo has recently proposed in which the American Law Institute would “take its

52. See Bar-Gill, *supra* note 34, at 750 (“[M]istakes about a standardized product are not sustainable.”); Epstein, *supra* note 34, at 814 (arguing that standardized products are easier to understand and master).

53. *But see* Rissman v. Rissman, 213 F.3d 381, 385 (7th Cir. 2000) (“[T]he fact that language has been used before does not make it less binding when used again. Phrases become boilerplate when many parties find that the language serves their ends. That’s a reason to enforce the promises, not to disregard them.”).

54. Joseph M. Perillo, *Neutral Standardizing of Contracts*, 28 PACE L. REV. 179, 182–83 (2008) (citations omitted); *see also* Henningsen v. Bloomfield Motors, Inc., 161 A.2d 69, 86 (N.J. 1960) (“Such standardized contracts have been described as those in which one predominant party will dictate its law to an undetermined multiple rather than to an individual. They are said to resemble a law rather than a meeting of the minds.”); Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581, 1585 (2005) (“[F]orm contracts used in transactions with consumers tend to be one-sided because they are drafted by firms, trade associations, or professional associations, which want such contracts to be slanted in their favor.”).

55. Going a long step further, insurers could enter into collaborative drafting with a consumer interest group representing current and future policyholders. *See* Perillo, *supra* note 54, at 185–87 (discussing the collaborative, “paternalistic,” and “collective bargain” approaches to drafting neutral standard-form contracts).

hand at the drafting of commonly used standard forms for consumer transactions after receiving input from all stakeholders involved in the transaction-type.”⁵⁶ Nonetheless, it would bring consumer opinion more solidly into the ring.

D. INSURERS AS POOR EDUCATORS

Why do insurers not try to fix policyholder misperceptions through advertising or customer relations?⁵⁷ The previous President of the Insurance Information Institute, Gordon Stewart, argues that insurers suffer from what this Article will call “reputational defeatism.”⁵⁸ Going beyond consumer misperception, he identifies “enduring misperceptions” held by the industry. These include “the conviction that the industry’s supposedly low standing with the public is a kind of ‘state of nature.’”⁵⁹ A “state of nature” has two relevant traits: it is inescapable and it is exogenous.⁶⁰ If it is inescapable, the insurers have no incentive to attempt to improve their reputation, individually or as an industry. If the cause is external—led by media, political attacks, or the intractable complexity of the product—and thus not caused by insurer behavior, there is no incentive for insurers to improve their behavior.

The view that insurers can shift their reputation somewhat, not by deed but by image, “lead[s] to periodic calls for massive reputation campaigns.”⁶¹ Campaigns that seek to raise the reputation of the industry as a whole, as opposed to any individual insurer, are most likely aimed at regulators and legislatures. Given the relative inelasticity of consumer demand for insurance, improving *consumers’* views of the industry as a whole is not calculated to increase overall sales. Insurers cannot count on consumers’ affection, but they can count on their business: a stage set for neglect.

56. *Id.* at 193. Perillo does not include consumers directly but does include “business leaders and consumer activists and their lawyers.” *Id.*; see also Shmuel I. Becher, *A “Fair Contracts” Approval Mechanism: Reconciling Consumer Contracts and Conventional Contract Law*, 42 U. MICH. J.L. REFORM 747, 751 n.15 (2009) (noting that Perillo’s idea is somewhat analogous to the “fair contracts” approval mechanism for standard form contracts).

57. There is a rich, largely theoretical, literature about the incentives sellers may have to educate consumers. See, e.g., R. Ted Cruz & Jeffrey J. Hince, *Not My Brother’s Keeper: The Inability of an Informed Minority to Correct for Imperfect Information*, 47 HASTINGS L.J. 635, 659–60 (1996) (discussing the problems with advertising, including free riding and costs, that often outweigh the benefits); Xavier Gabaix & David Laibson, *Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets*, 121 Q.J. ECON. 505, 507–11 (2006) (discussing the reasons why companies shroud add-on prices instead of advertising them to consumers).

58. See Gordon Stewart, *Can Reputations Be “Managed”?*, 31 GENEVA PAPERS ON RISK & INS. 480, 487 (2006) (discussing “obstacles to improving the relationship between insurance and the public”).

59. *Id.*

60. *Id.*

61. *Id.*

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

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

If cars were advertised by insurers, the ad copy would read, "You can trust Our Cars!" or "You're in a good car with Our Car."⁶² There would be no specifics about why the car is trustworthy, no discussion of airbags or crash-test ratings, and no acceleration time given for zero to sixty.⁶³ It is not shocking that insurers rarely mention the substance of coverage, as it will vary little from competitors' coverage.⁶⁴ But nor do insurance ads regularly tout their customer-satisfaction numbers, the number of claims agents per customer, turnaround time, or litigation rate. Instead, we hear versions of: "We drive where you drive."⁶⁵ "Cars. Because Driving HappenZ."⁶⁶ and "Our Car. The Car You Keep."⁶⁷

62. See the Allstate Insurance Company, which uses the slogan, "You're in good hands." Allstate Insurance, <http://www.allstate.com> (last visited Apr. 28, 2010).

63. Of course, there is a genre of car ads showing only the car exterior, driving down a winding autumn road with Vivaldi's *Four Seasons* in the background.

64. Car *insurers* advertise almost exclusively on the basis of price, though this may make sense. Differences in car insurance really do come down to deductibles, caps, extent of coverage, and price—in other words, to money. Each car insurer sells different packages of deductibles, caps, and coverage, but the choices do not vary much. Nor do the perils to cars and drivers.

65. State Farm Insurance Company: "We live where you live." Database of Slogans, Insurance Advertising Slogans, <http://www.textart.ru/database/slogan/insurance-advertising-slogans.html> (last visited Apr. 28, 2010).

66. Zurich Insurance Group: "Zurich. Because Change HappenZ." *Id.*

67. New York Life Insurance Company: "New York Life. The Company You Keep." New York Life Insurance Company Home Page, <http://www.newyorklife.com> (last visited Apr. 28, 2010). In fairness, the double entendre of the New York Life slogan is lost when "car" supplants "company." Still, either slogan simply says you will like the product enough to retain it.

Recently, State Farm has seized directly on the public perception that insurers play word games.⁶⁸ In its “Hidden Camera” ad series, State Farm portrays vendors who rely too heavily on the literal meaning of a phrase to the customers’ surprise and disgust: a vendor whose sign reads “Hot Dogs” does not provide buns; a “Shoe Shine” refers to one shoe, not two; and paying for a “Car Wash” does not include a car rinse.⁶⁹ These ads ask variations on, “Is your insurer selling you a hot dog without the bun?” and close with the slogan “Find Out. State Farm.”⁷⁰

These ads acknowledge a negative perception that insurers play “gotcha” with language that might technically be narrow but is commonly understood more expansively. The set-up of the ads also contrasts what is advertised—a shoe shine—with what is delivered—one shiny shoe. Perhaps it is too subtle a thread to unwind from a television commercial, but these two “admissions” about the insurance industry are separate. The first claim is *ex post*: after a loss, insurers (save State Farm, presumably) fall back on overly technical readings of policy language to support providing as little coverage as possible. The second claim is *ex ante*: insurers hoodwink consumers into buying one product while planning to deliver a lesser one.

The other three ads in the same “Hidden Camera” series are more random. A beachside bike-rental place takes the customer’s five dollars, only to wheel out a bike with no seat.⁷¹ This customer is getting less than anticipated but not because of a linguistic ruse. “Hot dog” can refer both to the meatlike object and to the combination of meatlike object with bun, but “bike” does not refer both to a usable bike and to a bike with no seat. In the last ad, a man in an ice-cream truck hands out frozen novelties without sticks or cups; children have to hold the popsicle in their hands as they eat it.⁷² A popsicle without a stick is akin to a hot dog without a bun, but the ad does not play it that way; customers are simply getting less than expected.

What doesn’t make for a great commercial may still be the best analogy.⁷³ Customers run after the ice-cream truck, expectations in hand.

68. For an excellent analysis of State Farm’s advertising, see Posting of Jeffrey W. Stempel to Insurance Law Center Blog, March Madness Makes It “Official”: State Farm Embraces the Reasonable Expectations Doctrine and Rejects Linguistic Literalism, http://www.lexisnexis.com/Community/insurancelaw/blogs/insurancelawblog/archive/2010/02/17/March-Madness-Makes-It-1C20_Official_1D203A00_-State-Farm-Embraces-the-Reasonable-Expectations-Doctrine-and-Rejects-Linguistic-Literalism.aspx (Mar. 22, 2009, 21:50 EST).

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

73. The worst analogy is made in an ad where customers are disappointed to find that the boardwalk “foot massage” only means massaging one foot. Stempel, *supra* note 68. Again, this action does not fit any definition, however technical, of a foot massage.irate policyholders do not believe their insurers perform a bizarre and different service from the one desired—they believe the insurers fail to perform altogether.

Those who do not read the “Ice Cream” sign on the side of the truck have the *identical* expectation to those who do—both expect a stick. Customers who purchase from the “insurance truck” likewise have a set of expectations without reading word one of the policy. It is not the sign that misleads the buyers, nor does the seller hide behind the language; he just shrugs off his customers’ desires for a stick.

Is State Farm claiming to communicate more clearly or simply give customers what they expect? Insurance scholar Jeffrey Stempel reads State Farm to be embracing the reasonable expectations doctrine.⁷⁴ Some of the ads end with the question, “Is your insurance company giving you less than you expected?”⁷⁵ If so, State Farm has taken an astounding counterposition to the tested language doctrine. Instead of starting out with a conception of what to cover actuarially, and working from that to discover how to convey that fixed conception in a common language, State Farm would have to start with what consumers expect and work to change policy language to deliver it.⁷⁶

State Farm’s new ads are not the only insurance ads ever to address consumer expectation or disappointment. But they are unusual, as a brief survey of current television ads reveals.⁷⁷

Travelers Insurance’s commercials focus on the synergistic nature of its products through ads such as the “delivery” commercial.⁷⁸ In the “delivery” commercial a twenty-five-foot umbrella is used to solve various problems (transporting people who have lost their boat, fixing a broken bicycle) and ends with the umbrella coming to rest over an office building.⁷⁹ The inference is that Travelers, and its umbrella of coverage, can help solve a variety of insurance problems.⁸⁰ Travelers’ other ads focus on security. In one ad, a dog tries to find a way to protect his “most prized possession”—a

74. *Id.*

75. *Ice Cream Truck* (State Farm Insurance Company television advertisement July 2008), available at <http://www.coloribus.com/adsarchive/tv-commercials/state-farm-ice-cream-truck-512728/> (subscription required).

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

77. One can see a broader review of insurance commercials at <http://www.coloribus.com> by searching for “insurance.”

78. *Delivery* (Travelers Insurance television advertisement May 20, 2009), available at <http://www.youtube.com/user/TravelersInsurance#p/u/10/8rVMQdSxr4>. Other Travelers ads are available at Travelers’ YouTube page, <http://www.youtube.com/user/TravelersInsurance>.

79. *Id.*

80. Travelers also has an ad that shows how it can insure against all worries, such as dust, trees, and shopping carts, which turn out to be threats to a computer-manufacturing business, a home, and a car—illustrating once again how it has the ability to cover a variety of objects. *No Worries* (Travelers Insurance television advertisement May 21, 2009), available at http://www.youtube.com/user/TravelersInsurance#p/u/8/1-5_NA4e0K0.

bone.⁸¹ After burying it, dreaming of its capture, digging it up, putting it in a safe-deposit box, and fearing a bank heist, the dog ends up “insuring” it with Travelers.⁸²

Many of MetLife’s advertisements follow one theme—how MetLife can help consumers with the “Ifs” in life.⁸³ Some of these commercials tell consumers to “call on MetLife’s expertise.” MetLife strikes a caring tone, focusing on how it can make consumers’ choices easier, and occasionally referencing its size (seventy-million insured) or its long history of insuring consumers. The use of Snoopy, and of animation in general, coupled with the focus on “your family’s dreams,” creates a warm fuzzy approach to insurance.

MetLife does have one line of ads that points to consumer education. These ads illustrate MetLife’s “Simplifier” tools—applications that allow consumers to compare different types of insurance and, theoretically, make the best insurance choices for their individual situation. Finding these tools on MetLife’s website, however, is not easy. There is one tool for employee benefits and one for life insurance.⁸⁴ MetLife also has an ad that guarantees the “full replacement cost” of homes and cars. This ad stands out because it conveys important substantive information about MetLife’s policies.

New York Life’s commercials are positive but substance-free.⁸⁵ MassMutual commercials close with the note that MassMutual is “owned by its policyholders,” implying that, as a mutual company, MassMutual is more focused on its customers than other companies. The rest of the ad content is unhelpful to consumers, however.⁸⁶ Allstate takes a dual approach. First, it

81. *Prized Possession (Dog Commercial)* (Travelers Insurance television advertisement June 23, 2009), available at <http://www.youtube.com/user/TravelersInsurance#p/u/1/5G7bGBUlx2M>.

82. *Id.*

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

84. See MetLife, Employee Benefits Simplifier Tool, [http://www.metlife.com/individual/employee-benefits/employee-benefits-tool/index.html?MCAT\[66\]=x](http://www.metlife.com/individual/employee-benefits/employee-benefits-tool/index.html?MCAT[66]=x) (last visited Apr. 28, 2010) (discussing employee benefits); MetLife, Term Life and Disability Package, [http://www.metlife.com/individual/insurance/term-life-disability/index.html?MCAT\[63\]=x&WT.ac=Pro1_TermDisIFDiv_5-15721_T3619-IN-individual&oc_id=Pro1_TermDisIFDiv_5-15721_T3619-IN-individual#term-life-disability-basics](http://www.metlife.com/individual/insurance/term-life-disability/index.html?MCAT[63]=x&WT.ac=Pro1_TermDisIFDiv_5-15721_T3619-IN-individual&oc_id=Pro1_TermDisIFDiv_5-15721_T3619-IN-individual#term-life-disability-basics) (last visited Apr. 28, 2010) (discussing life insurance).

85. See, e.g., *Generations* (New York Life Insurance Company television advertisement Sept. 2002), available at <http://www.coloribus.com/adsarchive/tv-commercials/new-york-life-generations-126006/> (subscription only) (noting the long history the company has, that “some things never change,” that they only serve “the interest[s] of [their] customers,” and finishing with the tag line, “the company you keep,” suggesting that once you choose New York Life, you never have to shop for insurance again); *Lifetime of Firsts* (New York Life Insurance Company television advertisement 2008) (focusing on what life insurance can do for small children because “only one gift protects a lifetime of firsts”).

86. See MassMutual Financial Group, Sponsorships, Awards & Advertising, <http://www.massmutual.com/aboutmassmutual/saa/advertising> (last visited Apr. 28, 2010) (featuring a

emphasizes the low cost of its insurance, stating that you can save between three-hundred and five-hundred dollars a year over its competitors.⁸⁷ Second, it runs a more fearful series of ads that illustrate the risk of harm you face, such as the “one in eight” chance of crashing a car.

In short, a consumer looking to learn about insurance and insurers should turn off the television. A distinction should be drawn between swaying consumers and educating them. “You can trust us,” “We deliver,” and “We care about your problems” are not educational statements unless they are followed by evidence, such as the percentage of current buyers who endorse the claim. A seller moves beyond persuasion to education when it perceives the buyer will both (a) learn from the lesson and (b) change buying behavior.

The ultimate question is to what extent insurers attempt to attract additional market share by action in addition to image. If it is right that policyholders are ill-equipped to judge action, in the absence of intelligible promises, tinkering with image may be the wiser course. If an individual insurer has limited effect on the reputation of the industry as a whole, and also has a hard time affecting consumers’ perceptions of it as separate from the entire industry, there is limited reputational pressure on the insurer’s actions. The rub is that service reputation *should* be the battleground between two competitors who offer nearly interchangeable contracts.⁸⁸

changing selection of MassMutual commercials and print advertisements). MassMutual focuses on uncertainty in life, with one commercial, which is no longer available online, that explains how a couple’s child keeps returning—first from camp, later from college and Europe—and that they are not “renting out his room,” since he may return to live with them after his honeymoon. MassMutual’s ads focus on the idea that consumers “can’t predict[, but] can prepare” for the future. My Life Insured, Life Insurance Companies: MassMutual, <http://www.my-life-insured.com/massmutual.php> (last visited Apr. 28, 2010). Other MassMutual ads focus on the “sign of a good decision.” For example, in one ad, an entrepreneur foregoes an office with an imposing view over a major city in favor of an office in his home so he can be closer to his children; in another commercial, a fishing boat, after leaving its dock, turns back around in the face of an impending storm, cutting short the fishing trip but potentially saving the lives of those on board. MassMutual Financial Group, Sponsorships, Awards & Advertising, *supra*. Both commercials close with the idea that a “good decision,” when it comes to the world of personal finance, is choosing MassMutual. *Id.*

87. The series includes some lighthearted commercials, such as the “Bergwood” commercials that focus on a football-crazed fan and his hijinks. Bergwood has a website and his own YouTube channel featuring all of his recent videos. Allstate, Bergwood.net, <http://bergwood.net> (last visited Apr. 28, 2010); YouTube.com, bergwoood’s Channel, <http://www.youtube.com/user/bergwoood> (last visited Apr. 28, 2010).

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

III. REWARDING PLAIN LANGUAGE

A. TESTING THE LANGUAGE

Here again is the proposed tested language defense:

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

Consumer research is a robust field and it is outside the scope of this Article to suggest the best detailed approach to testing contract language.⁸⁹ Still, a concise discussion is warranted. During the drafting stage, an insurer would present test consumers with several variations on a particular clause. To bring the defense in court, the insurer would show that the clause it chose, while not perfectly understood by all consumers, beat out the next best alternatives, drawn from a pool of initially reasonable candidates. This evidence would inform *but not control* the court's decision.

Existing consumer-research techniques could be used to assess the readability and accuracy of contract language. If the Insurance Services Office ("ISO") continues to be the collective drafter for many forms of insurance,⁹⁰ the research would be conducted collectively, not by lone insurers. On the other hand, if the defense increases the value of competition over policy language, larger insurers may strike out from the pack.

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

89. The Journal of Consumer Research, published by the University of Chicago, prints articles of varying levels of accessibility to those in the law. See Chicago Journals, Journal of Consumer Research, <http://www.journals.uchicago.edu/page/jcr/brief.html> (last visited Apr. 28, 2010) ("[The Journal] publishes scholarly research that describes and explains consumer behavior. Empirical, theoretical, and methodological articles spanning fields such as psychology, marketing, sociology, economics, and anthropology are featured in this interdisciplinary journal.").

90. ISO's current role in group drafting could be threatened if the McCarran-Ferguson Act, which partially exempts insurance companies from federal antitrust laws, were repealed. As of January 2010, the House of Representatives' health-care-reform bill contains a section repealing portions of the McCarran-Ferguson Act but only as to health insurers. See Health Insurance Industry Antitrust Enforcement Act of 2009, H.R. 3596, 111th Cong. § 3 (2009) ("[N]othing in the [a]ct . . . shall be construed to permit health insurance issuers . . . to engage in any form of price fixing, bid rigging, or market allocations in connection with the conduct of the business of providing health insurance coverage . . . or coverage for medical malpractice claims or actions."). As of January 5, 2010, the Senate's version of the bill does not include a similar provision; Senator Patrick Leahy's "Health Insurance Industry Antitrust Enforcement Act" has been dropped from the bill.

Focus groups or one-on-one interviews are the logical first step. Open-ended questions about how a consumer reads a clause and the ability to ask follow-up questions would reveal pitfalls and potential solutions. After redrafting to address the first pitfalls, round two may reveal new ones. This type of research is exploratory, allowing insurers to rework language, but it can also be used to make a final choice between clauses.

Focus groups can generate substantial “pretesting” knowledge, both about how survey questions should be shaped and what respondents think of the questions, given a chance to think about them. A focus group is designed as a discussion, not a series of questions and answers. The knowledge generated cannot be relied upon statistically, since the sample size is small, and, by design, biased.⁹¹ Properly run, however, a focus group can lead to deep pretest results.

Pretesting covers a wide range of action, all intended to create a higher-quality survey before the full-scale survey is released.⁹² Pretesting typically falls into two categories: prefield and field testing.⁹³ Prefield testing includes “focus groups and cognitive laboratory interviews.”⁹⁴ In these, the interviewer can either “think through” the questionnaire with the survey respondent, or do an “exit interview,” asking questions after the survey is completed.⁹⁵ These interviews spot problems quickly. For example, if a particular question has a recurring problem, the question can be fixed before inclusion in a full-scale survey.⁹⁶ This correction can occur in as few as fifteen cognitive interviews.⁹⁷ In addition, coding the behaviors of survey respondents can lead to better questions.⁹⁸ If a particular question requires clarification repeatedly, coding this behavior detects systematic problems.⁹⁹

The problem with using open-ended questions to select a clause, of course, is that the answers consumers give require some interpretation in order to yield meaningful collective results. The question asked can also influence the answer, both with interviews and with surveys. Interviews allow questions such as, “What does this sentence mean?,” which will result in as many answers as there are subjects. Narrower questions, such as, “Does this

91. FRITZ SCHEUREN, WHAT IS A SURVEY 37 (2d ed. 2004), available at <http://www.whatisa-survey.info/>. Focus groups are designed to have similar people participate, but none of the participants should know one another. *Id.*

92. For an example, see generally Ruth N. Bolton, *An Exploratory Investigation of Questionnaire Pretesting with Verbal Protocol Analysis*, 18 ADVANCES CONSUMER RES. 558, 559–60 (1991) (discussing pretesting).

93. SCHEUREN, *supra* note 91, at 45.

94. *Id.*

95. *Id.* at 46.

96. *Id.*

97. See Bolton, *supra* note 92, at 560 (discussing a questionnaire pretest involving fifteen customers).

98. SCHEUREN, *supra* note 91, at 47.

99. *Id.*

sentence mean you will not be paid for mold damage?,” still have some effect on the answer. It focuses the test subject on the possibility that the sentence might do as the question asks and may suggest an answer. Results can still be useful, of course, as long as the limitations of the research are disclosed.

If the early qualitative research produces several good versions of a clause, the next stage can be more quantitative. Survey questions, with multiple choice and “yes/no” answers, will yield numerical results.¹⁰⁰ These remain open to different types of bias, including leading questions, just as with all consumer research.¹⁰¹

Regardless of how well the insurance industry’s research expert designs the final survey, courts will regard her warily. The key in redrafting language is for insurers’ incentives to be aligned with consumers’. But the insurer’s incentives change from drafting to final testing. At the redrafting stage, the insurer is not looking to slant the data but to find the best way to convey its meaning.¹⁰²

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

100. Today, mail surveys are still the most common kind of quantitative research, due to their low cost. If an insurer targets a specific subset of the population, mail surveys can be particularly effective. These need not be the old mail-out, mail-in method. Increasingly, researchers use the Internet for these types of surveys.

The other main type of survey is the interview survey, which researchers can do in person or on the telephone. Experienced questionnaire designers tend to work backwards, drafting an outline of what the final report or paper will contain, allowing them to pinpoint the exact data they wish to find. In this case, the focus would be which use of language best conveys a point to consumers. See generally Elizabeth C. Hirschman, *Scientific Style and the Conduct of Consumer Research*, 12 J. CONSUMER RES. 225 (1985) (explaining that researchers have choices in how they phrase questions and these choices impact the outcome).

101. For example, a test subject could be asked to read a clause and answer “yes” or “no” to whether he would be covered for flooding from a broken pipe. While a subject may check “no,” inside that “no” could be the longer, “I hadn’t thought about it the first time I read the sentence but, now that you mention it, no.”

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

B. THE DEFENSE APPLIED TO CONTRA PROFERENTEM

Contra proferentem, “one of the most common grounds of the law,” writes Francis Bacon, is the “rule that a man’s deedes and his words shall be taken strongliest against himselfe.”¹⁰³ As applied in 1923 by the United States Supreme Court, the doctrine requires “in case of ambiguity that construction of the [insurance] policy will be adopted which is most favorable to the insured.”¹⁰⁴ In other words, courts construe ambiguous terms against the drafter.

Here, the drafter is the insurer and it is probably still true today that *contra proferentem* is “the most familiar expression in the reports of insurance cases.”¹⁰⁵ Currently, a court decides ambiguity based on its own reading of the text and the policyholder’s claim that it reads the language in a particular way. The insurer’s reading matters but cannot be dispositive. To win, the insurer must show that its interpretation is *the* interpretation. To win, the policyholder need only show that both readings are plausible.

The question is not whether the policyholder finds the language ambiguous but whether a reasonable person in the policyholder’s position would. The consumer-testing evidence speaks directly to this question. The research would show, first, whether the relevant audience finds the language ambiguous. Second, if the clause could not be made wholly unambiguous, the evidence would reveal whether the reading the policyholder proposes in court is among the objective interpretations. If the clause is ambiguous but the policyholder’s reading is not among the options, the court can construe the clause against the insurer without construing in precise favor of the policyholder.

Finally, evidence on the ambiguity front would save the doctrine in the eyes of some courts. Arizona courts, for example, have “abandoned” the *contra proferentem* approach, believing that “a finding of ambiguity is the easy way out since it permits the court to create its own version of the contract and to find, or fail to find, ambiguity in order to justify an almost predetermined result.”¹⁰⁶ Research showing that consumers do or do not find language ambiguous is an antidote to concerns that courts are making it up as they go along.

103. Francis Bacon, *A Collection of Some Principall Rules and Maximes of the Common Lawes of England*, in THE ELEMENTS OF THE COMMON LAWS OF ENGLAND 1, 11 (Da Capo Press & Theatrum Orbis Terrarum Ltd., photo. reprint 1969) (1630). The doctrine “is a Schoolemaster of wisdome & diligence in making men watchful in their owne businesse.” *Id.* Of course, it is likely that *contra proferentem* is less “common” today, compared with other “grounds of the law,” than it was in Bacon’s time.

104. *Mut. Life Ins. Co. of N.Y. v. Hurmi Packing Co.*, 263 U.S. 167, 174 (1923).

105. 2 GEORGE J. COUCH, RONALD A. ANDERSON & MARK S. RHODES, COUCH: CYCLOPEDIA OF INSURANCE LAW § 15:74 (2d ed., rev. vol. 1984).

106. *Ohio Cas. Ins. Co. v. Henderson*, 939 P.2d 1337, 1339 (Ariz. 1997) (quoting *Transamerica Ins. Group v. Meere*, 694 P.2d 181, 185 (Ariz. 1984)).

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

One Contra Proferentem Decision Tree

- (1) Do consumers as a group find the language ambiguous?
 - No → The language is applied as written.
 - No, but the court finds it ambiguous as applied → Go to 3.
 - Yes → Go to 2.
- (2) Is the policyholder's reading one other consumers share?
 - Yes → The policyholder's reading is reasonable and can be enforced against the insurer.
 - No → The insurer has drafted and retained ambiguous language but the policyholder's reading is not a viable alternative.

The court can:

 - (a) Punish the insurer by providing coverage anyway, which may or may not be as much coverage as the policyholder's reading provided. This may result in no coverage.
 - (b) Construe the language against the insurer but in favor of the general consumers' reading, as opposed to the policyholder's.
 - (c) Construe the language in keeping with the insurer's reading, assuming its reading is one shared by some consumers.
- (3) The language is not ambiguous on its face but it is ambiguous as applied. Should the insurer bear responsibility for failing to foresee the ambiguous application?
 - Yes, the application was foreseeable and the insurer failed to prevent the ambiguity → The court will punitively apply *contra proferentem*.
 - No, because the risk is too new or emergent → *Contra proferentem* may not apply.

A full decision tree will have many more branches because consumer research will also reveal what *percentage* of consumers understand the chosen clause. State courts will have to develop a conception about what level triggers legal ambiguity and how to handle different types of results. For example, if 75% of consumers tested understood the clause to mean A and

the remaining 25% understood the clause to mean *B*, how should a court address a plaintiff proposing reading *B*? A court might conclude that any alternative reading at 25% or above is classic ambiguity. But if the insurer can show that efforts to get agreement above 75% were futile, perhaps the clause should be allowed to stand, even in the face of 25% confusion.¹⁰⁷

A difficult question arises if 65% of consumers tested take the clause to mean *A* and the remaining 35% take the clause to mean *B*, but the plaintiff proposes meaning *C*. On the one hand, the insurer has willfully used language that confuses 35% of consumers, a choice that in most cases should be strongly discouraged and certainly not rewarded. The language should be construed against the insurer in some fashion.

On the other hand, if the consumer in court is proffering reading *C*, we can safely anticipate *C* to be the reading that provides coverage, and hence the reading that “punishes” the insurer. Yet the evidence suggests that reading *C* is unreasonable. If courts routinely award reading *C* in these cases, consumer-tested language would be underused. It would still show ambiguity, but the court would not need to know the *content* of average consumer readings, only the percentage breakdown of the possible readings. In other words, the court would need to know that the disputed term had more than one plausible definition, but it would not need to identify those definitions; the policyholder’s definition wins regardless.

This raises a question about the fundamental operation of *contra proferentem* that is often dodged. Which of the following is the rule?

- (1) “If the language of a policy is reasonably susceptible to more than one interpretation and one interpretation favors coverage, the policy will be construed in favor of the insured and against the insurer.”¹⁰⁸

or

- (2) If the language of a policy is reasonably susceptible to more than one interpretation, the policy will be construed in favor of the insured and against the insurer.¹⁰⁹

107. See *infra* Part III.D (proposing answers in the discussion of ambiguity and complexity).

108. *Hudson v. Farm Family Mut. Ins. Co.*, 697 A.2d 501, 503 (N.H. 1997) (citing *Green Mountain Ins. Co. v. George*, 634 A.2d 1011, 1014 (N.H. 1993)) (emphasis added).

109. “If an exclusion ambiguously lends itself to two or more reasonable constructions, the ambiguity will be resolved against the insurer and in favor of coverage.” *Church Mut. Ins. Co. v. U.S. Liab. Ins. Co.*, 347 F. Supp. 2d 880, 884 (S.D. Cal. 2004) (citing *Smith Kandal Real Estate v. Cont’l Cas. Co.*, 79 Cal. Rptr. 2d 52, 56 (Cal. Ct. App. 1998)). A version of this statement can be found in many opinions; a full reading of the opinion is required to know if the court is embracing version one or two. There are cases where courts conclude that an ambiguity created by the interaction of two clauses cannot be sensibly resolved, in which case there is no unified reading that is reasonable. Where “it is not possible to give effect to both of these provisions in a manner that resolves the ambiguity created by the policy language,” the court simply provides coverage. *Israel v. State Farm Mut. Auto. Ins. Co.*, 789 A.2d 974, 977 (Conn. 2002).

Kenneth Abraham calls version (2) the “strict liability” version of *contra proferentem*.¹¹⁰ All that is required to trigger a pro-coverage interpretation is a finding of ambiguity. Abraham also posits a negligence version of the doctrine that applies only if the ambiguity should have been anticipated *and* corrected.¹¹¹ The tested language defense would provide evidence of both plausible anticipation and possible correction.

Jurisdictions choose, sometimes unconsciously, between versions (1) and (2) and choose a place on the spectrum between strict liability and negligence. Even if a court clearly chooses version (1)—the policyholder’s reading must be among the options—what would such a court do if the evidence shows consumers fall out at 65% for A, 25% for B, and 10% for C? The evidence suggests that C is a mistake, idiosyncratic but not unique. Here, the choice between strict liability and negligence may be determinative. Under negligence, if 10% of consumers cling to C regardless of changes in language, then perhaps the insurer should not be saddled with C. Under strict liability, it does not matter; the insurer intentionally used language with various meanings at 65%, 25%, and 10%, (a clean case of ambiguity) and the policyholder’s reading of C is one of the options.

Recall that the primary function of *contra proferentem* is to give the insurer an incentive to draft clean, unambiguous language.¹¹² I have argued elsewhere that this function often reverses itself in the insurance context.¹¹³ Insurers draft as an industry and pool the resulting loss data. A clause that is backed by existing data has a known cost, even if that cost is higher than originally anticipated because courts have construed it against insurers. Drafting new language to respond to the widespread application of *contra proferentem* is expensive and risky; there is no guarantee that the revised language will be read as wished either. Wherever insurers prefer a known

110. See Kenneth S. Abraham, *A Theory of Insurance Policy Interpretation*, 95 MICH. L. REV. 531, 537–44 (1996) (explaining the differences between a “strict liability” and a “negligence” version of *contra proferentem*).

111. *Id.* at 540–44.

112. Omri Ben-Shahar has identified a principle that reverses *contra proferentem* in certain circumstances. See generally Omri Ben-Shahar, *A Bargaining Power Theory of Default Rules*, 109 COLUM. L. REV. 396 (2009) (discussing the bargain-mimicking principle and how it functions). Ben-Shahar states:

[T]he bargain-mimicking principle supplies a term that is most favorable to the drafter and that most closely resembles the deal the drafter would have been able to dictate. While the *contra proferentem* doctrine relies on the notion that the strong party should be “punished” for leaving ambiguity or indefiniteness in the contract, the bargain-mimicking principle gives the strong party what she could have gotten explicitly through bargaining.

Id. at 406 (footnote omitted). Ben-Shahar argues that the principle applies to purely distributive terms. *Id.* at 429.

113. See Boardman, *supra* note 1, at 1121–22 (describing the principle and how it evolved in the insurance context).

interpretation to a particular interpretation, *contra proferentem* serves to ensure that insurers will hold on to language that is ambiguous on the page but no longer ambiguous in court precedent.¹¹⁴

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

The second function of *contra proferentem* is to protect the policyholder from harm by an ambiguity of the drafter's own making. Flipped, it precludes the drafter from benefitting from an ambiguity of its own making. One limitation of consumer evidence is that it cannot completely track the divide between abstract ambiguity and ambiguity as applied. A clause must be ambiguous as applied to the facts of the loss, rather than in the abstract.¹¹⁵ Consider a scenario in which, despite the insurer's best research efforts, a clause is ambiguous *as applied* to a particular context. Assume the evidence shows that 90% of consumers understood the clause similarly but that the loss at hand is an unexpected context. Perhaps a court should still employ *contra proferentem* to protect the policyholder. While the court is not interested in punishing the insurer, it may hold that the risk of emergent ambiguities remains with the insurer. Moreover, there is less risk of the perverse effect described above; the insurer already has a strong incentive to retain the clause, which is understood in its main context by 90% of consumers.

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

114. *Id.* at 1126–27.

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

drafted and sold industry-wide, an insurer using that language is bound by the evidence of the original drafter.¹¹⁶

C. *THE DEFENSE APPLIED TO REASONABLE EXPECTATIONS*

The doctrine of reasonable expectations was recognized, or created, depending on one's view, in 1970.¹¹⁷ Its precise form varies with the jurisdiction but, as originally stated, it held:

The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations.¹¹⁸

In the many articles written on reasonable expectations since 1970, one central question has been how to handle language that would have negated expectations under more casual study.¹¹⁹ Another has been whether ambiguous language is a prerequisite to application of the doctrine.¹²⁰ There is also the question of whether the doctrine, as applied, truly seeks to enforce consumer expectations instead of consumer preferences.¹²¹

116. Courts have taken a similar position where ISO made representations about the meaning of a clause to state regulators while seeking permission to use the language. See John R. Prince, III, *Where No Minds Meet: Insurance Policy Interpretation and the Use of Drafting History*, 18 VT. L. REV. 409, 436 (1994) (discussing the admissibility of drafting history evidence).

117. Keeton, *supra* note 6, at 966–67 (explaining the origins and development of the reasonable expectation doctrine). A few states reject the doctrine. See *Wallace v. Balint*, 761 N.E.2d 598, 606 (Ohio 2002) (“[T]here is not yet a majority on this court willing to accept the reasonable-expectations doctrine.”); *Dakota, Minn. & E. R.R. Corp. v. Heritage Mut. Ins. Co.*, 2002 SD 7, ¶ 37, 639 N.W.2d 513, 519 (“[T]he doctrine of reasonable expectations has never been adopted by South Dakota; in fact, this Court has repeatedly declined to adopt the doctrine . . .” (internal citations omitted)).

118. Keeton, *supra* note 6, at 967. The Restatement (Second) of Contracts section 211(3), addressing “Standardized Agreements,” reads: “Where the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement.” 2 RESTATEMENT (SECOND) OF CONTRACTS § 211(3) (1981). This formulation differs substantially from the variations on the doctrine courts follow. Although it is considered the Restatement’s version of the reasonable expectations doctrine, section 211(3) is rarely mentioned or cited by courts in insurance cases.

119. See James M. Fischer, *The Doctrine of Reasonable Expectations Is Indispensible, If We Only Knew What for?*, 5 CONN. INS. L.J. 151, 155 (1998) (discussing the weak and strong interpretations of the doctrine); Roger C. Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L.J. 823, 842–46 (1990) (discussing the analysis of the doctrine in various jurisdictions); Peter Nash Swisher, *Symposium Introduction*, 5 CONN. INS. L.J. 1, 5–7 (1998) (introducing the Symposium: The Insurance Law Doctrine of Reasonable Expectations After Three Decades).

120. See 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, 189, 191–95 (1998) (examining seven possible versions of the reasonable expectations doctrine).

121. For an interesting discussion of the possible divergence, see Daphna Lewinsohn-Zamir, *Consumer Preferences, Citizen Preferences, and the Provision of Public Goods*, 108 YALE L.J. 377, 391–406 (1998).

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

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

Second, in some states it is "a precondition to reliance" on reasonable expectations "that an ordinary layperson would misunderstand the policy coverage."¹²² Instead of speculating about what an ordinary layperson would or would not understand, courts could evaluate the evidence submitted under the tested language doctrine. Other states explicitly require that a policyholder's expectations be confirmed only if the policy language is ambiguous.¹²³ Here, the court would engage in the same ambiguity analysis required under *contra proferentem*.

Consumer evidence cannot do it all: to the extent the doctrine compares two states of the world—the consumers' expectation both *before* and *after* reading the contract—the research suggested here directly informs only the second part of the equation. Depending on a court's approach, each of these states could be definitive standing alone, even in the absence of knowledge about the other state. Courts that are highly skeptical of a policyholder's duty to read, on the one hand, may be satisfied that pre-reading expectations should prevail regardless of what would happen *if* the policy were read. These courts will not be interested in evidence on how consumers read clauses.

Courts that mean to compare both states, on the other hand, may be able to make a decision with only the consumer testing proposed here. (Evidence of the first state remains desirable; without actual proof of a default expectation of coverage, the court may be engaging in a reasonable expectations analysis when the objective consumer does not expect coverage

122. Randall, *supra* note 47, at 113 (citing *Bituminous Cas. Corp. v. Sand Livestock Sys., Inc.*, 728 N.W.2d 216, 220–21 (Iowa 2007), and *Iowa Comprehensive Petroleum Underground Storage Tank Fund Bd. v. Federated Mut. Ins. Co.*, 596 N.W.2d 546, 551 (Iowa 1999)).

123. See, e.g., *Merino v. Allstate Indem. Co.*, 231 F. App'x 682, 683 (9th Cir. 2007) (applying California law and holding that since the word "you" is not ambiguous, the reasonable expectations doctrine does not apply); *Kolb v. Paul Revere Life Ins. Co.*, 355 F.3d 1132, 1135–36 (8th Cir. 2004) (applying Arkansas law and holding that, consistent with the average person's expectations, the word "accidental" includes complications arising from a surgical procedure); *Peck v. Pub. Serv. Mut. Ins. Co.*, 363 F. Supp. 2d 137, 145 (D. Conn. 2005) (noting that only ambiguous terms are interpreted in light of the insured's reasonable expectations).

either before or after reading the policy.) A court will only need evidence of the second state to make a decision *if* the evidence shows that the language *would have* rendered the pre-reading expectation unreasonable. In these cases, the consumer evidence generated under the tested language defense would be definitive by itself, without evidence of prior expectations.

Using data about what consumers expect would further what Kenneth Abraham has called the “expectations principle”¹²⁴:

This is the notion that people should be able to buy the insurance that they reasonably want. Accompanying this notion is a corollary: people should not be led to believe that they have the insurance they reasonably want, when in fact they do not have that insurance. Since both the principle and the corollary refer to *reasonable* expectations of coverage, these are for the most part statements about the expectations of the vast majority of policyholders, not of isolated individuals. An expectation of coverage is most likely to be reasonable, after all, if a large number of people hold it in common. Indeed, most expectations of coverage held by the vast majority of policyholders are reasonable, and most expectations that are not held by the vast majority of policyholders are not reasonable.¹²⁵

Because expectations of coverage come from many sources other than (and perhaps excluding) the written policy, the evidence proposed here would not answer every question. In fact, policyholder lawyers might counter with evidence about what consumers believe a priori, without any policy language before them. If 90% of people believe they have coverage X, *but* 85% would realize they do not have coverage X upon reading the consumer-crafted clause *and* only 25% of policyholders read their policies, what is a court to do? This evidentiary showdown would force courts to explicitly decide what role, if any, the contract language plays in pursuing the expectations principles.

Finally, there is a potential spillover benefit here. In the many cases where consumer research will remain unavailable, the tested language defense may still aid courts in making more accurate guesses about a consumer’s “reasonable expectations.” For now, there is empirical evidence that judges and policyholders are inclined to simply believe that their first

124. Kenneth S. Abraham, *The Expectations Principle as a Regulative Ideal*, 5 CONN. INS. L.J. 59, 61 (1998) [hereinafter Abraham, *The Expectations Principle*] (arguing that the reasonable expectations doctrine is (or was in 1998) relatively minor but that “the expectations ‘principle’ that lies behind the doctrine is of major significance”). See generally Kenneth S. Abraham, *Judge-Made Law and Judge-Made Insurance: Honoring the Reasonable Expectations of the Insured*, 67 VA. L. REV. 1151 (1981) (thoroughly analyzing the reasonable expectations principle both descriptively and prescriptively).

125. Abraham, *The Expectations Principle*, *supra* note 124, at 63–64.

reading is the most common.¹²⁶ Several years of this type of evidence would school insurers and courts both in the types of reading mistakes consumers make and what level of linguistic complexity nonlawyers can understand.

D. AMBIGUITY AND COMPLEXITY

The third use of the tested language defense may be more controversial. The evidence should allow a court to decide if the insurer did its best to make the language readable. This is not to pat the insurer on the back, but to determine if punishing the insurer for not doing better will have any positive effect. In other words, should we apply a penalty default rule whenever the language is ambiguous? Or should we refrain from applying a penalty default where the ambiguity stems from *unavoidable* complexity?¹²⁷

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

When answering the “false hope” question, consumer-testing evidence comes in at two points. First, it places the clause on the ambiguity spectrum.

126. See Lawrence Solan, Terri Rosenblatt & Daniel Osherson, *False Consensus Bias in Contract Interpretation*, 108 COLUM. L. REV. 1268, 1290 (2008) (noting, in their study on how laypeople interpret contracts, that “[p]eople believed that their understanding of the story was significantly more common than was the reality”). After experimental studies on “false consensus bias” using insurance contract language, the authors concluded that:

When individuals are given scenarios that have led to differences of opinion among the courts, they do not understand contractual language uniformly and, because they are subject to false consensus bias, believe that their interpretation is the normal interpretation, even when it is not. This is true whatever the scenario, whatever the interpretation, and whichever party will be assisted by one interpretation or the other.

Id. at 1269. Judges experience the same phenomenon. *Id.*

127. The debate over whether penalty default rules exist in contract law is not settled here. See Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 91 (1989) (introducing penalty default rules). Compare Eric A. Posner, *There Are No Penalty Default Rules in Contract Law*, 33 FLA. ST. U. L. REV. 563, 565 (2006) (denying their existence), with Ian Ayres, *Ya-Huh: There Are and Should Be Penalty Defaults*, 33 FLA. ST. U. L. REV. 589, 590 (2006) (“ya-huhing” their existence). Whether one should count interpretive rules like *contra proferentem* in the potential penalty default category is also a question. See Posner, *supra*, at 578–80 (discussing whether *contra proferentem* is a useful rule for the potential penalty default rule).

What percentage of consumers shares a common understanding of the clause? Ninety percent? This may be the best real-world outcome. Seventy-five percent? Many courts may find this ambiguous but acceptable if the rest of the test is passed. Fifty percent? Atrociously ambiguous.

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

But the court must answer a second question before it decides to punish the insurer. Is the concept the provision attempts to convey complex enough that even the most artfully drafted clause will create consumer confusion?¹²⁸ The ambiguity spectrum, coupled on occasion with evidence that consumer understanding of certain complex concepts hits a ceiling, may determine how a court treats “natural” and unavoidable complexity.

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

- (1) 90% of consumers understand the language as intended; 10% have random readings or claim no understanding.
Conclusion: This language is not ambiguous, as least as written. It may become ambiguous as applied to new or unusual facts.
- (2) 80% of consumers understand the language as intended to mean “A”; 20% understand the language to mean “A + B” where “B” = “more coverage.”
Conclusion: States may differ on whether these percentages support a finding of ambiguity. The 20% who read “B” may have false hope. The court needs to know if reasonable attempts to remove that hope failed.
- (3) 65% of consumers understand the language as intended, to mean “A”; 25% understand the language to mean “C” where “C” is *not* more attractive to consumers than “A”; 10% have random readings or claim no understanding.
Conclusion: This looks like classic ambiguity, although at least the insurer is not creating or benefiting from false hope.

128. For a variation on this idea, see Dudi Schwartz, *Interpretation and Disclosure in Insurance Contracts*, 21 LOY. CONSUMER L. REV. 105, 118 (2008) (“Although it can be argued that whereas an Insurer who negligently drafts vague policy terms should bear the resulting costs, an Insurer who takes due care in drafting terms that are in fact impossible to phrase in a less ambiguous manner should not be subject to the rule.”).

But suppose in scenario (3) that the insurer has submitted its alternate attempts to improve consumer understanding and has proven that consumer understanding above 65% is not possible. The concept behind the provision is inherently complex, not merely conveyed complexly. *But then suppose the clause has a strong basis in actuarial need.* The complexity might even stem from an attempt to provide *more* coverage rather than less. It is simple to include a blanket exclusion, but complex to add back in pockets of coverage within the general exclusion; the insurer could simplify the language and improve the testing numbers by providing no coverage at all, to policyholders' detriment.

This type of layered complexity is most likely in the infamous (among students of insurance) but common case of exceptions to exclusions.¹²⁹ An exception to an exclusion proceeds in three steps. The number of steps itself can cause confusion, as can the fact that the steps may be taken on different pages of the policy.

The policy starts with a grant of coverage—physical damage to one's home, say. The grant is limited by an exclusion of coverage—no payment for damage from mold, fungus, or wet rot.¹³⁰ Some coverage is granted back, however, by an *exception* to the exclusion—“we *do insure* for loss caused by mold, fungus or wet rot that is hidden within the walls or ceilings or beneath the floors or above the ceilings of a structure *if such loss results from* the accidental discharge or overflow of water or steam from within” various pipe systems.¹³¹

The exception expands the scope of coverage; it is therefore consumer friendly. To maintain the general exclusion on mold and rot, however, the exception is twice as long as this quotation and none of it less verbose. If a court decides that insurers must go whole hog in one direction or the other for the sake of clarity, consumers will lose all mold coverage. Insurers have concluded that mold and toxic-mold claims, which include both property damage and health problems, may be “the next asbestos.”¹³² In other words, the claims may be enough to bankrupt individual insurers if exclusions fail.¹³³

This is one of many exceptions to exclusions and one of many that courts looking to protect consumers should be wary of disrupting. Whether

129. Thomas E. Chase, *All-Risks Insurance, Exceptions to Exclusions: Burden of Proof?*, N.Y.L.J., Apr. 28, 2005, at 4, 7.

130. INSURANCE SERVICES OFFICE, INC., *supra* note 27, § I-Perils Insured Against (A)(2)(c)(5), at 9.

131. *Id.* (emphasis added).

132. See Thelma Jarman-Felstiner, *Mold Is Gold: But, Will It Be the Next Asbestos?*, 30 PEPP. L. REV. 529, 540–50 (2003) (comparing toxic-mold litigation with asbestos litigation).

133. See John T. Waldron III & Timothy P. Palmer, *Insurance Coverage for Mold and Fungi Claims: The Next Battleground?*, 38 TORT TRIAL & INS. PRAC. L.J. 49, 50 (2002) (providing examples of jury verdicts of up to eighty-five-million dollars).

one believes that insurers regularly manufacture complexity where none need exist, at times complexity surely arises as a natural result of pursuing a legitimate goal. Courts must decide whether the goal should be sacrificed to gain greater clarity. Tested language evidence could show where sacrifice is necessary by identifying those cases where greater clarity cannot be achieved without diminishing substance.

Second, in handing courts a tool to engage complexity by better dividing artificial from natural or endogenous complexity, courts can stop sending inaccurate signals about naturally complex (and desirable) terms. Where changes in language will never lead to a sufficient increase in consumer understanding, the “redraft” signal sent by *contra proferentem* and reasonable expectations is both false and wasteful. It is false because the full “redraft” signal reads, “redraft well and next time your substantive meaning will be allowed.” Over time, the false commands to redraft have weakened the value of the redraft signal. The signal is also wasteful because it encourages insurers to spend resources on useless redrafting.

What signal should courts send instead? Option one: reject the substance of the clause because it cannot be conveyed to consumers. Insurers should remove the clause and adjust other clauses, premiums, and loss calculations accordingly. Removal of the clause is key if it creates false hope. Option two: retain the substance of the clause because of its value. Insurers need not spend additional time and money rewriting, and often lengthening, the clause. In limited cases, a public information campaign will be warranted to try to educate the public, about say, flood protection, but of course this is not the domain of the judiciary.

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

IV. ENJOYING PLAIN LANGUAGE

A. BENEFITTING FROM PLAIN LANGUAGE

It is commonly assumed that more accessible contract language is in the consumer’s interest, but this should not be taken for granted. In *The Myth of ‘Opportunity to Read’ in Contract Law*, Omri Ben-Shahar argues against giving consumers greater access to boilerplate contract language.¹³⁴ Efforts such as making the contract more readily available beforehand are useless and distract from valid reform, he argues.¹³⁵ Instead, consumers “would benefit

134. Omri Ben-Shahar, *The Myth of ‘Opportunity to Read’ in Contract Law*, 5 EUR. REV. CONT. L. 1, 2–4 (2009).

135. *Id.* at 21–22.

from mechanisms that accord them more meaningful information about the *product* (as opposed to the contract).”¹³⁶

The problem in insurance, of course, is that the contract and the product coincide. The two are not easily distinguishable. While Ben-Shahar’s analysis is not meant to encompass insurance,¹³⁷ some points apply equally well; making the contract more accessible pre-purchase and more readable will not, by itself, tempt the majority to read.

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

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

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

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

These acts follow an internal and external education. The policyholder learns more about his own preferences, informing his next purchase. He learns about the quality of his insurer, opening the insurer up to reputational pressures, the threat of which should improve the insurer’s

136. *Id.* at 6.

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

behavior. He can calculate more readily how to handle the results of the contract at hand, such as how hard to press for payment and whether to sue or file a regulatory complaint.

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

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

B. SOME OBJECTIONS TO THE DEFENSE

1. Necessity

One might question why we need a new doctrine or defense in order for insurers to start test driving their policy language. However disjointed the market for consumer insurance may be, surely the insurer who announced a plain-language policy, proven to be “plain” by actual homeowners on the street, could attract some attention. This potential plain-language insurer has at least two serious hesitations. First, plain language may excite some buyers, but the cost is starting afresh with the application of actuarial data to the new language and giving up a known quantity for a (perceived) high risk that courts will interpret the new language in unknown ways.¹³⁸ In other words, the cyclical reinforcement of collective drafting and settled court interpretation exerts too much gravity.

Second, without the defense, insurers should be wary that their efforts at test driving will be used against them. The outcome of even the most carefully drafted and consumer tested language will not be that 98% of

138. See The Insurance Services Office, *Helping Insurers Price Their Products*, <http://www.iso.com/About-ISO/ISO-Services-for-Property-Casualty-Insurance/Helping-Insurers-Price-Their-Products.html> (last visited Apr. 28, 2010). The ISO explained:

Pricing insurance is difficult. Unlike most businesses, an insurance company can't set its prices based on known costs for production and distribution. Instead, an insurer needs to project the costs of future claims by examining historical data. The process is reliable only when the insurer uses a sufficient amount of accurate data.

Id.

consumers come close to a single accurate understanding. The consumer-research joke that one can find 10% of people who believe anything is funny because it's true.¹³⁹ What the research is more likely to show is a mix of reactions, with the best language garnering the most "votes" but still confusing some readers.

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

2. Giving an "A" for Effort

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

Nor does the tested language defense require courts to award an "A" for every effort. The defense would instruct a court to allow the insurer to present its consumer evidence and require the court to take seriously the possibility that it should not find the consumer-influenced language ambiguous or that it should narrow the ramifications of ambiguity. In some cases, consumer research will change a court's reasoning without changing the case outcome.

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

139. Perhaps it is 10% of people who will *say* they believe something, such as that "Elvis is Alive." The encouraging news is that the percentage of people who believe ELVIS lives had dropped to 7% by 2002. See Jaime Holguin, "The King's" Popularity Constant, CBSNEWS, Aug. 11, 2002, <http://www.cbsnews.com/stories/2002/08/11/opinion/polls/main518294.shtml>.

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

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

The analogy therefore is a rich one, deserving of exploration, but one danger will be considered here. It is a short step from categorizing an insurance policy as a consumer product to consciously treating insurance policies under a regime akin to products liability. This step is already being advocated.¹⁴⁰ Product liability regimes differ by state but are generally strict liability once the product has been shown to be defective. The care the maker takes in the product's creation is not a defense under strict liability. The tested language defense is therefore a step in the opposite direction from the growing "consumer insurance product" trend.

With a physical product, strict liability has much to recommend it.¹⁴¹ It gives manufacturers an incentive to take care by requiring the maker to internalize the costs of loss from defective products. Of course, all products are imperfect and will fail on occasion even if made with best efforts or (lowering the precaution level) optimal efforts. When strict liability makes the manufacturer pay for a loss from an optimally created product, it allows the cost of loss to be spread across purchasers instead of falling disproportionately on the consumer who randomly experiences the loss from inevitable imperfection. At least in theory, the cost of these unavoidable losses will be added to the price of the product.

This is where the temptation to protect policyholders as just another set of consumers should be resisted. First, the initial loss is not caused by the "maker"—the insurer—it is caused by an outside risk, such as a falling tree or a kitchen fire. The party that has the best chance of avoiding or mitigating the loss is the consumer, not the insurer. Converse to the products-liability scenario, the more an insurer pays for a loss, the more

140. For the best defense to date, see generally Daniel Schwarcz, *A Products Liability Theory for the Judicial Regulation of Insurance Policies*, 48 WM. & MARY L. REV. 1389 (2007).

141. See W. Kip Viscusi, *Individual Rationality, Hazard Warnings, and the Foundations of Tort Law*, 48 RUTGERS L. REV. 625, 639 (1996) ("[A]dditional tort liability or strict liability for the product injury is required to provide manufacturers with the appropriate incentive to produce safe products.").

likely the loss is to happen. (Of course, people's misuse of a product can cause or exacerbate a loss, so there is moral hazard¹⁴² in strict liability for products as well.¹⁴³)

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

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

Most courts do not apply this form of strict liability. Even a court willing to find ambiguity around every page corner is unlikely to award coverage to the policyholder who burns down his own home. (On the other hand, what

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

143. Many jurisdictions require manufacturers to anticipate likely misuse of a product and to address that potential with improved design or warning. See Howard Latin, "Good" Warnings, Bad Products, and Cognitive Limitations, 41 UCLA L. REV. 1193, 1201 (1994). Latin, quoting an American Law Institute report, states:

"The object of a good warning is to provide users with information about risk levels so that users can harmonize their use preferences with their safety preferences in an informed way, to provide users with information about safe and dangerous use so that they can choose optimal risk reduction strategies, or to provide both types of information."

Id. (quoting 2 AM. LAW INST., REPORTER'S STUDY: ENTERPRISE RESPONSIBILITY FOR PERSONAL INJURY—APPROACHES TO LEGAL AND INSTITUTIONAL CHANGE 66 (1991)); see also Lars Noah, *The Imperative to Warn: Disentangling the "Right to Know" from the "Need to Know" About Consumer Product Hazards*, 11 YALE J. ON REG. 293, 293 (1994) (discussing the overabundance of product-warning-label requirements imposed by Congress, federal regulators, and state legislatures).

court will require the coffee-pot manufacturer to compensate the buyer who pours gasoline into his pot and then lights a match?) But if “strict liability” means the insurer pays whenever there is arguable ambiguity, the scope of coverage will still increase dramatically. To the extent providing coverage becomes a stubborn default, resistant to all but the most robust rebuttal, courts are forcing future policyholders to purchase additional insurance.

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

The initial impulse to place the risk of all ambiguity on the insurer is sensible; insurers shift risk by definition and the insurer is in a better position to anticipate emerging risks and new ambiguities.¹⁴⁴ If placing the risk with insurers were costless to policyholders, or at least always cost justified, the impulse might be followed. In the end, however, it is not necessarily to policyholders’ advantage to have the risk of every loss spread across the group and added to the price.

3. Structural Ambiguity

It is not just the language of insurance policies that makes for difficult reading. The order of the language, the parochronistic structure of the policy, and the intimate connection between clauses found in separate “sections” pages apart, sap the reader’s will to continue, assuming sufficient fortitude to begin. A consumer who reads from page one and stops when he reaches a clause on point will often miss additional controlling clauses. Robert Jerry refers to this as “ambiguity of organization.”¹⁴⁵ This form of ambiguity is more than inconsistent terms in the same contract.¹⁴⁶

The tested language defense does not provide a direct incentive to fix structure. However, a court is likely to rebuff the defense if the interaction between two clear clauses is unclear. In some cases, therefore, improvements to structure may be required before an insurer can take advantage of the tested language defense. Improvements in structure theoretically could be

144. See W. KIP VISCUSI, *REFORMING PRODUCTS LIABILITY* 64–66 (1991) (stating that the purpose of products-liability law is to address “inadequate risk information,” which is the “chief inadequacy of the market”).

145. ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, *UNDERSTANDING INSURANCE LAW* § 25A[a], at 145 n.316, 146 (4th ed. 2007) (adding “ambiguity of organization” to the Farnsworthian categories of imprecise language); see also E. Allan Farnsworth, “*Meaning*” in the *Law of Contracts*, 76 *YALE L.J.* 939, 954 (1967) (classifying ambiguities as either “term” or “syntax” ambiguities).

146. See Farnsworth, *supra* note 145, at 956 (“Ambiguity in contracts may also result from inconsistent or conflicting language.”).

tested using consumer research, although the time and attention required of test subjects would make the project unwieldy. A common-sense structure, even chosen in the absence of consumer testing, would beat out a fossilized structure.

4. Overt Judicial Regulation

Finally, it is worth considering if the clarity the tested language defense pursues is less desirable than a more subtle, more fictional understanding of how courts interpret contract language. If courts have a particular regulatory end in mind from which they will not be turned, for good or ill, the defense may undermine judicial credibility by leading courts to make incredible statements. Today, courts take positions on how a reasonable consumer would read language and whether it is ambiguous. When one party objects, we do not take it as evidence that the court is wrong; we expect the parties to disagree. And since insurance language is rarely clear in all applications, a court's conclusion that a certain clause is ambiguous, and therefore malleable, is difficult to reject out of hand.¹⁴⁷

The tested language defense changes this. Evidence of consumer understanding renders a court's proposition testable and falsifiable. Of course, knowledge has its costs. In a pair of Ukrainian short stories,¹⁴⁸ the narrator discovers that factories are making super-high-wattage bulbs in order to meet a government quota for more bulbs, measured in watts.¹⁴⁹ When the new bulbs are installed, the residents in a communal apartment realize the squalor in which they live.¹⁵⁰ We may find we prefer our old bulbs; spreading more light over judicial decision making may be depressing.

147. Many have concluded that excessive play in the joints of ambiguity has led courts to "fabricate ambiguities." Stephen J. Ware, *A Critique of the Reasonable Expectations Doctrine*, 56 U. CHI. L. REV. 1461, 1469 (1989). Michael Rappaport has suggested:

The underinclusiveness of the ambiguity rule is even more problematic because it often leads judges to manufacture ambiguities. Although the ambiguity rule by its terms does not apply to inefficient, unambiguous provisions, judges sometimes—perhaps often—hold unambiguous terms to be ambiguous to avoid giving effect to provisions they perceive to be harsh.

Michael B. Rappaport, *The Ambiguity Rule and Insurance Law: Why Insurance Contracts Should Not Be Construed Against the Drafter*, 30 GA. L. REV. 171, 224–25 (1995).

148. Ukrainian novelist Mikhail Zoshchenko wrote two adjoining stories on the danger of sharp clarity. Thank you to Professor Julia Chadaga, specialist in twentieth-century Russian literature and culture, for helping me locate these stories outside of my memory. Julia Bekman Chadaga, *Light in Captivity: Spectacular Glass and Soviet Power in the 1920s and 1930s*, 66 SLAVIC REV. 82, 91–92 (2007).

149. MIKHAIL ZOSHCHENKO, *A Clever Little Trick*, in *NERVOUS PEOPLE AND OTHER SATIRES* 176, 176–78 (Hugh McLean ed., Maria Gordon & Hugh McLean trans., 1963).

150. MIKHAIL ZOSHCHENKO, *Poverty*, in *NERVOUS PEOPLE AND OTHER SATIRES*, *supra* note 149, at 141, 141–43.

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

V. CONCLUSION

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

This Article seeks to break the cycle of insurer inattention to consumers and consumer inattention to insurers. It is an interactive problem—consumers do not read what insurers write and insurers do not write to consumers. Insurers and courts are locked in a repetitive waltz. Consumers are not even invited to the dance.

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

APPENDIX: OTHER EDUCATIONAL SOURCES

Insurers do not have a monopoly on educational insurance information, of course. Perhaps consumers can simply rely on neutral third parties to provide data and ratings, an insurance version of *Consumer Reports*.¹ Indeed, *Consumer Reports* does provide some homeowners insurance reporting.² There does not appear to be any information about the percentage of consumers who use these reports; one does have to subscribe to the magazine, either in print or online.

Although we do not know if consumers take advantage of the sources described here, the description is worth making. An online survey of sources for consumer information on homeowners insurance suggests that even if consumers were digging around, they would end up with little more than dirt. State regulatory offices could be a good source of information. The Commonwealth of Virginia's site is indicative of other states' sites. The primary source is the website for the Virginia State Corporation Commission's Bureau of Insurance.³ This site has detailed information on all insurance companies operating in Virginia, broken down by category of insurance. It provides information on each company's financial position, including assets and liabilities, premiums written, and premiums earned. The problem with this website is its lack of analysis.

The financial forms are long and simply list the data without explaining its relevance or making any analytical comparisons between companies. This information would be useful to a very savvy purchaser of insurance, but probably not to an average buyer. Notably, the website does have a page titled "Shopping Tips for Insurance."⁴ However, this page contains only general advice about shopping for insurance and provides some questions to ask an insurance agent. It does not offer specific advice for comparing insurance companies.

The remaining results of an online search relating to purchasing homeowners insurance fall into two major categories: (1) private insurance

1. *Consumer Reports* does provide a video warning of loopholes in homeowners insurance. ConsumerReports.org, Insuring Your Home, <http://www.consumerreports.org/cro/video-hub/search/Insuring+Your+Home/insuring-your-home/43610503001/> (last visited Apr. 28, 2010).

2. See generally *Insuring Your Home: How to Find the Best Coverage for Whatever Comes Your Way*, CONSUMER REP., Sept. 2009, at 30, available at <http://www.consumerreports.org/cro/magazine-archive/september-2009/home-garden/homeowners-insurance/overview/home-owners-insurance-ov.htm> (providing advice to consumers on how to find the best insurance for their homes).

3. Virginia State Corporation Commission, Bureau of Insurance, Home Page, <http://www.scc.virginia.gov/division/boi/webpages/boihomepage.htm> (last visited Apr. 28, 2010).

4. Virginia State Corporation Commission, Bureau of Insurance, Shopping Tips for Insurance, <http://www.scc.virginia.gov/division/boi/webpages/boishoppingtips.htm> (last visited Apr. 28, 2010).

companies' websites, and (2) short, simple internet sites containing general advice about purchasing insurance (similar to the tips found on Virginia's Bureau of Insurance site). If one digs through the advice sites, one can find suggestions for good analytical websites. The most user-friendly and insurance-oriented site is A.M. Best.⁵ Its Property/Casualty Center has industry news and announcements regarding ratings activity. Upon registration, users can also access financial data and company ratings. Another helpful site is J.D. Power and Associates' annual ratings of homeowners insurance providers.⁶ It ranks insurers according to customer satisfaction in a variety of categories, including pricing, filing claims, and contact with the insurer.⁷

J.D. Power's three top-rated homeowners insurance providers in the country are Amica Mutual, Auto Club of Southern California, and Cincinnati Insurance.⁸ Amica's website is user-friendly, with drop-down menus that display what types of policies are available in each state.⁹ However, it does not offer anything beyond general statements and empty claims. Auto Club's website is slightly more comprehensive, breaking down its discussion of homeowners insurance by dwelling type.¹⁰ However, it too is mostly a sales pitch, and does not offer any type of sophisticated analysis. Similarly, Cincinnati Insurance's website offers brief descriptions of the various types of homeowners policies it carries, but like the other two insurers, its website serves mostly as a vehicle to get consumers to contact its insurance agents.¹¹

There are several general watchdog organizations that focus at least in part on general homeowners insurance policies. ConsumerWatchdog.org has an Affordable Car and Home Insurance branch that offers detailed advice on purchasing homeowners insurance.¹² Although stationed in California, the group is dedicated to insurance reform throughout the country, and as a result, it offers some general advice for purchasers nationwide. However, this site is primarily designed as a vehicle for the

5. A.M. Best, Best's Property/Casualty Center, <http://www3.ambest.com/pc/default.asp> (last visited Apr. 28, 2010).

6. J.D. Power and Associates, 2009 National Homeowners Insurance Study, <http://www.jdpower.com/homes/ratings/homeowners-insurance-company-ratings> (last visited Apr. 28, 2010).

7. *Id.*

8. *Id.*

9. Amica, Home Page, <http://www.amica.com/> (last visited Apr. 28, 2010).

10. Auto Club of Southern California, Auto Club Insurance Services, <http://www.aaa-calif.com/insurance/index.aspx?zip=90001> (last visited Apr. 28, 2010).

11. Cincinnati Financial Corporation, Home Page, <http://www.cinfin.com/> (last visited Apr. 28, 2010).

12. ConsumerWatchdog.org, Affordable Car & Home Insurance, <http://www.consumerwatchdog.org/insurance> (last visited Apr. 28, 2010).

group's political activism, rather than an analytical tool for consumers trying to size up various insurers.

On a general nationwide level, the best consumer source seems to be A.M. Best, but only some of its information is freely available. Insurers themselves offer little more than sales pitches. In short, even if the average consumer were inclined to look, he would have a hard time finding useful information online.