Vol. 26 No. 2 CONNECTICUT INSURANCE LAW JOURNAL Pages 115-172 2019-2020

CONNECTICUT INSURANCE LAW JOURNAL

ARTICLES

SYMPOSIUM

Volume 26 2019-2020 Number 2

CONNECTICUT INSURANCE LAW JOURNAL

Volume 26, Number 2
Spring 2020

University of Connecticut School of Law
Hartford, Connecticut

Connecticut Insurance Law Journal (ISSN 1081-9436) is published at least twice a year by the Connecticut Insurance Law Journal Association at the University of Connecticut School of Law. Periodicals postage paid at Hartford, Connecticut. Known office of publication: 55 Elizabeth Street, Hartford, Connecticut 06105-2209. ***Printing location: Western Newspaper Publishing Company, 929 West 16th Street, Indianapolis, Indiana 46202.***

Please visit our website at http://www.insurancejournal.org or see the final page of this issue for subscription and back issue ordering information.

Postmaster: Send address changes to Connecticut Insurance Law Journal, 55 Elizabeth Street, Hartford, Connecticut 06105-2209.

The Journal welcomes the submission of articles and book reviews. Both text and notes should be double or triple-spaced. Submissions in electronic form are encouraged and should be in Microsoft™ Word™ version 97 *format or higher. Citations should conform to the most recent edition of* A UNIFORM SYSTEM OF CITATION, *published by the Harvard Law Review Association.*

It is the policy of the University of Connecticut to prohibit discrimination in education, employment, and in the provision of services on the basis of race, religion, sex, age, marital status, national origin, ancestry, sexual preference, status as a disabled veteran or veteran of the Vietnam Era, physical or mental disability, or record of such impairments, or mental retardation. University policy also prohibits discrimination in employment on the basis of a criminal record that is not related to the position being sought; and supports all state and federal civil rights statutes whether or not specifically cited within this statement.

Cite as CONN. INS. L.J.

CONNECTICUT INSURANCE LAW JOURNAL

VOLUME 26 2019-2020 NUMBER 2

UNIVERSITY OF CONNECTICUT
SCHOOL OF LAW

FACULTY AND OFFICERS OF ADMINISTRATION
FOR THE ACADEMIC YEAR 2019-2020

Officers of Administration

Thomas Katsouleas, Ph.D., *President, University of Connecticut*
John A. Elliot, Ph.D., *Interim Provost and Executive Vice President for Academic Affairs*
Timothy Fisher, J.D*., Dean, School of Law*
Paul Chill, J.D., *Associate Dean for Clinical and Experiential Education*
Darcy Kirk, J.D., *Associate Dean for Academic Affairs, Associate Dean for Library and Technology and Distinguished Professor of Law*
Leslie C. Levin*,* J.D., *Associate Dean for Research and Faculty Development*
Karen L. DeMeola, J.D., *Assistant Dean for Finance, Administration and Enrollment*

Faculty Emeriti

Robin Barnes, B.A., J.D., *Professor of Law Emerita*
Loftus E. Becker, Jr., A.B., LL.B., *Professor of Law Emeritus and Oliver Ellsworth Research Professor of Law*
Phillip I. Blumberg, A.B., J.D., LL.D. (Hon.), *Dean and Professor of Law and Business, Emeritus*
John C. Brittain, B.A., J.D., *Professor of Law Emeritus*
Deborah A. Calloway, B.A., J.D., *Professor of Law Emerita*
Clifford Davis, S.B., LL.B., *Professor of Law Emeritus*
Richard S. Kay, A.B., M.A., J.D., *Wallace Stevens Professor of Law Emeritus and Oliver Ellsworth Research Professor of Law*
Lewis S. Kurlantzick, B.A., LL.B., *Zephaniah Swift Professor of Law Emeritus and Oliver Ellsworth Research Professor of Law*
Hon. Ellen Ash Peters, B.A., Swarthmore College; LL.B., Yale University; LL.D., Yale University; University of Connecticut; et al.; *Visiting Professor of Law*
Hugh C. Macgill, B.A., LL.B., *Dean and Professor of Law Emeritus*
Patricia A. McCoy, B.A., J.D., *Professor of Law Emerita*
R. Kent Newmyer, Ph.D., *Professor of Law and History Emeritus*
Nell J. Newton, B.A., J.D., *Dean and Professor of Law Emerita*
Leonard Orland, B.A., LL.B., *Professor of Law Emeritus*
Jeremy R. Paul, A.B., J.D., *Dean and Professor of Law Emeritus*
Howard Sacks, A.B., LL.B., *Dean and Professor of Law Emeritus*
Eileen Silverstein, A.D., J.D., *Professor of Law Emerita*
Lester B. Snyder, B.S., LL.B., LL.M., *Professor of Law Emeritus*
James H. Stark, A.B., J.D., *Roger Sherman Professor of Law Emeritus and Oliver Ellsworth Research Professor of Law*
Kurt A. Strasser, B.A., J.D., LL.M., J.S.D., *Phillip Blumberg Professor of Law Emeritus*
Colin C. Tait, B.A., LL.B., *Professor of Law Emeritus*
Carol Ann Weisbrod, J.D., *Professor of Law Emerita*
Nicholas Wolfson, A.B., J.D., *Professor of Law Emeritus*

Faculty of Law

Jill C. Anderson, B.A., University of Washington; J.D., Columbia University; *Professor of Law*
Paul Bader, B.A., Duke University; J.D., Mercer University Walter F. George School of Law; *Assistant Clinical Professor of Law*
Jon Bauer, A.B., Cornell University; J.D., Yale University; *Richard D. Tulisano '69 Human Rights Scholar and Clinical Professor of Law*
Mary Beattie, B.A., Providence College; J.D., University of Bridgeport; *Assistant Clinical Professor of Law and Director, Academic Support*
Bethany Berger, B.A., Wesleyan University; J.D., Yale University; *Wallace Stevens Professor of Law*
Robert L. Birmingham, A.B., J.D., Ph.D. (Econ.), Ph.D. (Phil.), University of Pittsburgh; LL.M., Harvard University; *Professor of Law*

Kiel Brennan-Marquez, B.A., Pomona College; J.D., Yale University; *Associate Professor of Law and William T. Golden Scholar*

Sara C. Bronin, B.A., University of Texas; M.Sc., University of Oxford (Magdalen College); J.D., Yale University; *Thomas F. Gallivan, Jr. Chair in Real Property Law and Faculty Director, Center for Energy and Environmental Law*

Paul Chill, B.A., Wesleyan University; J.D., University of Connecticut; *Associate Dean for Clinical and Experiential Education and Clinical Professor of Law*

John A. Cogan, Jr., B.A., University of Massachusetts Amherst; M.A., University of Texas; J.D., University of Texas School of Law; *Associate Professor of Law and Roger S. Baldwin Scholar*

Mathilde Cohen, B.A., M.A., L.L.B., Sorbonne-École Normale Supérieure; LL.M., J.S.D., Columbia University, *Professor of Law*

Diane F. Covello, B.S., University of Kansas; J.D., Duke University School of Law; *Assistant Clinical Professor of Law and Co-Director, Intellectual Property and Entrepreneurship Law Clinic*

Anne C. Dailey, B.A., Yale University; J.D., Harvard University; *Evangeline Starr Professor of Law*

Miguel F. P. de Figueiredo, B.A., Johns Hopkins University; M.A., University of Chicago; Ph.D., University of California, Berkeley; J.D., Yale University; *Associate Professor of Law and Terry J. Tondro Research Scholar*

Jessica de Perio Wittman, B.A., State University of New York at Stony Brook; B.A, M.L.S., State University of New York at Buffalo; J.D., Seattle University School of Law; *Associate Professor of Law, Cornelius J. Scanlon Scholar and Director, Law Library*

Timothy H. Everett, B.A., M.A., Clark University; J.D., University of Connecticut; *Clinical Professor of Law*

Todd D. Fernow, B.A., Cornell University; J.D., University of Connecticut; *Professor of Law and Director, Criminal Law Clinic*

Richard Michael Fischl, B.A., University of Illinois; J.D., Harvard University; *Professor of Law*

Timothy Fisher, B.A., Yale University; J.D., Columbia University; *Dean and Professor of Law*

Valeria Gomez, B.A., Belmont University; J.D., University of Tennessee College of Law; *William R. Davis Clinical Teaching Fellow*

Hillary Greene, B.A., J.D., Yale University; *Zephaniah Swift Professor of Law*

Mark W. Janis, A.B., Princeton University; B.A., M.A., Oxford University; J.D., Harvard University; *William F. Starr Professor of Law*

Darcy Kirk, A.B., Vassar College; M.S., M.B.A., Simmons College; J.D., Boston College; *Distinguished Professor of Law, Associate Dean for Academic Affairs and Associate Dean for Library and Technology*

Peter R. Kochenburger, A.B., Yale University; J.D., Harvard University; *Associate Clinical Professor of Law, Executive Director of the Insurance LL.M. Program and Deputy Director of the Insurance Law Center*

James Kwak, A.B., Harvard College; Ph.D., University of California at Berkeley; J.D., Yale Law School; *Professor of Law*

Alexandra D. Lahav, A.B., Brown University; J.D., Harvard University; *Ellen Ash Peters Professor of Law*

Molly K. Land, B.A., Hamline University; J.D., Yale; *Professor of Law*

Leslie C. Levin, B.S.J., Northwestern University; J.D., Columbia University; *Associate Dean for Research and Faculty Development and Joel Barlow Professor of Law*

Peter L. Lindseth, B.A., J.D., Cornell University; M.A., M. Phil, Ph.D., Columbia University; *Olimpiad S. Ioffe Professor of International and Comparative Law and Director, International Programs*

Joseph A. MacDougald, A.B., Brown University; M.B.A., New York University; J.D., University of Connecticut; M.E.M., Yale University; *Professor-in-Residence; Executive Director, Center for Energy and Environmental Law; and Kurt Strasser Fellow*

Brendan S. Maher, A.B., Stanford; J.D. Harvard University; *Connecticut Mutual Professor of Law and Director of the Insurance Law Center*

Jennifer Brown Mailly, A.B., Brown University; J.D., Ohio State University; *Assistant Clinical Professor of Law and Field Placement Program Director*

Barbara S. McGrath, B.A., Yale University; J.D., University of Connecticut; *Executive Director, Connecticut Urban Legal Initiative, Inc.*

Willajeanne F. McLean, B.A., Wellesley College; B.S., University of Massachusetts; J.D., Fordham University; LL.M., Free University of Brussels; *Distinguished Professor of Law*

Thomas H. Morawetz, A.B., Harvard College; J.D., M.Phil., Ph.D., Yale University; *Tapping Reeve Professor of Law and Ethics*

Jamelia Morgan, B.A., M.A., Stanford University; J.D., Yale University; *Associate Professor of Law and Robert D. Glass Scholar*

Minor Myers, B.A., Connecticut College; J.D., Yale University; *Professor of Law*

Ángel R. Oquendo, A.B., M.A., Ph.D., Harvard University; J.D., Yale University; *George J. and Helen M. England Professor of Law*

Sachin S. Pandya, B.A., University of California, Berkeley; M.A., Columbia University; J.D., Yale University; *Professor of Law*

Richard W. Parker, A.B., Princeton University; J.D., Yale University; D.Phil., Oxford University; *Professor of Law, Director of the Semester in DC Program and Policy Director, Center for Energy and Environmental Law*

Lisa Perkins, B.S., J.D., Michigan State University; LL.M., Georgetown University Law Center; *Clinical Professor of Law and Director, Tax Clinic*

Richard D. Pomp, B.S., University of Michigan; J.D., Harvard University; *Alva P. Loiselle Professor of Law*

Jessica S. Rubin, B.S., J.D., Cornell University; *Clinical Professor of Law and Director, Legal Practice Program*

Susan R. Schmeiser, A.B., Princeton University; J.D., Yale University; Ph.D., Brown University; *Professor of Law*

Peter Siegelman, B.A., Swarthmore College; M.S.L., Ph.D., Yale University; *Phillip I. Blumberg Professor of Law*

Julia Simon-Kerr, B.A., Wesleyan University; J.D., Yale Law School; *Professor of Law*

Douglas M. Spencer, B.A., Columbia University; M.P.P., J.D., Ph.D., University of California Berkeley; *Professor of Law and Public Policy*

Martha Stone, B.A., Wheaton College; J.D., LL.M., Georgetown University; *Director, Center for Children's Advocacy*

Stephen G. Utz, B.A., Louisiana State University; J.D., University of Texas; Ph.D., Cambridge University; *Roger Sherman Professor of Law*

Steven Wilf, B.S., Arizona State University; Ph.D., J.D., Yale University; *Anthony J. Smits Professor of Global Commerce and Professor of Law*

Richard A. Wilson, BSc., Ph.D., London School of Economics and Political Science; *Gladstein Chair and Professor of Anthropology and Law*

Adjunct Faculty of Law

Anne D. Barry, B.S., University of Connecticut; M.S., Union College; J.D., University of Connecticut; *Adjunct Professor of Law*

James W. Bergenn, B.A., Catholic University; J.D., Columbia University; *Adjunct Professor of Law*

Michael A. Cantor, B.S., J.D., University of Connecticut; *Adjunct Professor of Law*

Thomas O. Farrish, B.A., J.D., University of Connecticut; *Adjunct Professor of Law*

William D. Goddard, B.A., M.B.A., Dartmouth College, J.D., University of Connecticut; Adjunct *Professor of Law*

Andrew S. Groher, B.A., University of Virginia; J.D., University of Connecticut; *Adjunct Professor of Law*

Wesley Horton, B.A., Harvard University; J.D., University of Connecticut; *Adjunct Professor of Law*

John J. Houlihan, Jr., B.A., Providence College; J.D., St. John's University; *Adjunct Professor of Law*

Nancy Kennedy, B.A., University of Massachusetts; J.D., University of Connecticut; *Adjunct Professor of Law*

Daniel Klau, B.A., University of California; J.D., Boston University; *Adjunct Professor of Law*

John Lawrence, B.S., Washington and Lee University; J.D., University of Virginia; *Adjunct Professor of Law*

Erik T. Lohr, B.S., Thomas A. Edison State College; J.D., University of Connecticut; *Adjunct Professor of Law*

Thomas S. Marrion, A.B., College of the Holy Cross; J.D., University of Connecticut; *Adjunct Professor of Law*

Joseph Mirrione, B.A., Marist College; J.D., Vermont Law School; *Adjunct Professor of Law*

Thomas B. Mooney, B.A., Yale University; J.D., Harvard University; *Adjunct Professor of Law*

Cornelius O'Leary, B.A., Williams College; M.A., Trinity College; J.D., University of Connecticut; *Adjunct Professor of Law and Mark A. Weinstein Clinical Teaching Fellow*

Rosemarie Paine, B.S., Southern Connecticut State University; J.D., University of Connecticut; *Adjunct Professor of Law*

Humbert J. Polito, Jr., A.B., College of the Holy Cross; J.D., University of Connecticut; *Adjunct Professor of Law*

Leah M. Reimer, B.S. Baylor University; J.D., University of Connecticut; Ph.D., Stanford University; *Adjunct Professor of Law*

Patrick J. Salve, B.S., J.D., University of Pennsylvania; *Adjunct Professor of Law*

Carl Schiessl, B.A., Trinity College; J.D., University of Connecticut; *Adjunct Professor of Law*

Hon. Michael R. Sheldon, A.B., Princeton University; J.D., Yale University; *Adjunct Professor of Law*

Sandra Sherlock-White, B.A., Central Connecticut State University; J.D., Western New England College; *Adjunct Professor of Law*

Jay E. Sicklick, B.A., Colgate University; J.D., Boston College; *Adjunct Professor of Law*

Walter C. Welsh, B.S., Tufts Engineering; J.D., University of Connecticut; LL.M., New York University; *Adjunct Professor of Law*

CONNECTICUT INSURANCE LAW JOURNAL

VOLUME 26 2019-2020 NUMBER 2

CONTENTS

ARTICLES

SYMPOSIUM

"INCOMPLETE" INSURANCE COVERAGE

KENNETH S. ABRAHAM*

This Article examines the ways in which insurance coverage is incomplete, and the reasons why coverage is incomplete. It argues that, because all insurance policies and all insurance coverage is incomplete, the notions of a "gap" in coverage and "incomplete" coverage typically are unhelpful. A better understanding of the reasons for incomplete coverage would enrich the interpretation of insurance policies and produce more informed resolution of coverage disputes. The Article seeks to provide that understanding.

* David and Mary Harrison Distinguished Professor, University of Virginia School of Law.

INTRODUCTION

The world poses a nearly infinite variety of risks. Any form of insurance selects a small slice of the universe of all risks to cover. In this sense, all insurance policies provide incomplete coverage. By this I mean substantive, as distinguished from temporal or monetary incompleteness, both of which also characterize all insurance policies.[1] To be meaningful, the notion of incomplete coverage would therefore have to presuppose some substantive baseline against which the coverage provided by an insurance policy could be compared. In addition, for the notion of incomplete coverage to influence insurance rights and liabilities, it would have to be defined in a precise and operational manner. But that is not how I will use the notion here, because I am not proposing a test for liability. Rather, I am using the notion of incompleteness to explore the reasons why insurance policies cover some risks and do not cover others. The notion of incomplete coverage is simply a vehicle for identifying coverage that might plausibly be included in an insurance policy, but is not included.

Exploring the idea of incomplete insurance coverage may be useful for a number of purposes. Among other things, a better understanding of the reasons that insurance coverage may be considered incomplete may help courts facing insurance coverage disputes to understand seemingly opaque or arbitrary limitations on coverage.[2] This understanding may also help counsel for insureds and insurers to develop arguments for their positions about the meaning and application of contested policy provisions, and it may help policyholders and insurers to assess the reasonableness of claim denials. Finally, a better understanding of what it means for coverage to be incomplete may help regulators determine which policies and policy provisions to approve or disapprove.

There is a sense in which this Article develops a theory of incomplete insurance coverage. There are a sufficient number of reasons for incomplete coverage, however, that referring to "a theory" risks the misleading implication that there is a single reason for incomplete coverage, when that is not the case. Rather, there is a series of different explanations for incomplete coverage. They fall into three general categories. Part I addresses the *path-dependence* of coverage. Much of what is covered under particular policies but not covered by others is not a function of logic, but of

---

[1] That is, all policies cover only a finite slice of time, and a finite sum of monetary loss.

[2] For discussion of the normative presumptions underlying the courts' reading of the "whole" insurance policy, see Kenneth S. Abraham*, Plain Meaning, Extrinsic Evidence, and Ambiguity: Myth and Reality in Insurance Policy Interpretation*, 25 CONN. INS. L.J. 329, 341-45 (2019).

the history of insurance. For reasons that I will explore, some kinds of coverage have come to be bundled together over time, while others have been fragmented. Once insurance develops in this manner, it tends to stay that way.

Part II examines the second general reason for incomplete coverage, certain aspects of the *dynamics and economics* of insurance. Insurance functions best under a particular set of conditions and is subject to a number of threats to its effective operation. These include, but are not limited to, the familiar phenomena of adverse selection and moral hazard. Insurance coverage is often incomplete in order to combat these threats, or because certain kinds of risks are difficult to insure. This Part examines those reasons.

Part III concerns *verbal incompleteness*. It explores the ways in which insurance policy language may omit coverage that is in fact, or arguably, provided by the policy. Even aside from ambiguity, which has garnered more than enough attention elsewhere,[3] coverage may be unambiguously incomplete by failing to mention a risk, providing underinclusive coverage, or being vague at the borderline. The reasons insurance policies do not say things is sometimes as important as the reasons they do. Often verbal incompleteness serves a legitimate purpose, but sometimes it does not. This Part explores the ways, and the reasons, that insurance policies leave some things unsaid.

Parts I through III are descriptive and analytical. Taken together, they comprise what amounts to a theory of incomplete coverage. In contrast, Part IV is more nearly normative. This Part considers the implications of the analysis. It suggests that the notions of a "gap" in coverage and "incomplete" coverage tend not to be helpful. In addition, while recognizing that resolving insurance disputes as a matter of law necessarily limits the factual material that courts may take into account in this setting, this Part argues that the tools currently used to interpret insurance policies are impoverished. The binary distinction between policy language with a plain meaning and ambiguous policy language is inadequate to the task of assessing the meaning of arguably incomplete insurance policies. This Part argues, among other things, that more extensive consideration of the reasons for incomplete coverage would enrich the interpretation of insurance policies and produce more informed resolution of coverage disputes.

---

[3] *See, e.g.*, *id.*; Michelle E. Boardman, Contra Proferentem: *The Allure of Ambiguous Boilerplate*, 104 MICH. L. REV. 1105 (2006); Kenneth S. Abraham, *A Theory of Insurance Policy Interpretation*, 95 MICH. L. REV. 531 (1997); Oliver Wendell Holmes, *The Theory of Legal Interpretation*, 12 HARV. L. REV. 417 (1899).

I. THE PATH DEPENDENCE OF COVERAGE

Without demand for it, insurance does not come into being, although demand can be created by external forces, including insurers themselves. For example, after the Great Fire of London in 1666, fire insurance developed as property owners came to appreciate the risk they faced.[4] In mid-nineteenth century America, breadwinners came to appreciate their families' economic dependence and to regard the purchase of life insurance as an act of morality rather than tampering with fate – partly through the persistence and ingenuity of insurance salesmen[5] –and life insurance spread. In the late nineteenth century, a group of textile manufacturers in Massachusetts became concerned about the risk of incurring tort liability for injury to their employees, and formed a company to sell the first form of liability insurance – "Employers Liability" insurance – ever offered in the United States.[6] After automobiles were invented, auto liability was first provided under the "team" (of horses) insurance policies that already existed, but very quickly, auto liability insurance came into being.[7] To simplify just a bit, in each of these instances, demand for insurance against a particular, discrete risk preceded supply, and the capital necessary for the existence of insurance – the availability of which is clearly a prerequisite – was supplied in order to meet that demand.

A. BUNDLING COVERAGE

Once a form of insurance is in place, insurers of course try to fuel demand by marketing it. An important marketing technique is "bundling": expanding the set of risks covered by a form of policy that originally covered only a single, discrete risk.[8] The newly-covered risks typically are associated enough with the original risk to make the expansion attractive and seamless. Thus, after it was introduced, fire insurance on real property added coverage of personal property, as well as coverage of perils other than fire, such as

---

[4] STEPHEN PORTER, THE GREAT FIRE OF LONDON 34, 70-72 (1996); Kenneth S. Abraham, *Jefferson's Fire Insurance Policy and Monticello's Reconstruction of Slavery*, 19 GREEN BAG 2D 11 (2015).

[5] *See generally* VIVIANA A. ROTMAN ZELIZER, MORALS AND MARKETS: THE DEVELOPMENT OF LIFE INSURANCE IN THE UNITED STATES (2017).

[6] KENNETH S. ABRAHAM, THE LIABILITY CENTURY: INSURANCE AND TORT LAW FROM THE PROGRESSIVE ERA TO 9/11 28-32 (2008).

[7] *Id.* at 71.

[8] *See generally* Symposium, *Fragmented Risk: An Introduction*, 11 RUTGERS J. OF L. & PUB. POL'Y 1 (2013).

wind and theft.[9] Eventually it became "all-risk" coverage.[10] Similarly, Employers Liability insurance expanded to cover "public liability" – the risk of liability to individuals who are not employees.[11] Over time, auto liability insurance also expanded, adding (among other things) omnibus and drive-other-cars liability coverage, first-party property damage insurance on insured vehicles, a small slice of first-party medical coverage, and uninsured motorists coverage.[12]

Sometimes bundling occurs not merely for marketing purposes, but as a response to an imperfection in the market. Even after fire insurance evolved into all-risk property insurance covering personal residences, it was first-party insurance only. Third-party personal liability insurance (non-auto, non-professional, non-business liability insurance) still had to be purchased separately. Individuals had little exposure to these forms of liability, as well as little awareness of their exposure. Demand for personal liability insurance was therefore weak, especially since the administrative costs associated with selling free-standing policies insuring against minimal liability risk inflated premiums. The solution was to add a personal liability insurance component to first-party all-risk property insurance.[13] For a brief time in some places this was optional, but eventually the two forms of coverage were tied together automatically, and the liability insurance component added only minimally to the total premium.

Expanding from initial, single-risk coverage to the bundling of coverage of similar, related risks has thus been the repeated pattern. Each form of insurance followed this particular pattern of development, though each did so in a different manner because of the particular exigencies that were operating when it came into being.

B. FRAGMENTATION

If we think of bundling as the result of centripetal force, then fragmentation is the opposite. It is the result of centrifugal force. Some risks that might seem to belong in a particular form of policy are instead covered by another form of policy. As I use the term here, fragmentation refers to the omission of coverage from one form of policy but its inclusion in another form of insurance policy. Fragmentation does not mean that something is

---

[9] KENNETH S. ABRAHAM & DANIEL SCHWARCZ, INSURANCE LAW & REGULATION 184 (6th ed. 2015).

[10] *See id.*

[11] *See* ABRAHAM, *supra* note 6, at 32-35.

[12] *Id.* at 77-80.

[13] *Id*. at 174-78.

missing from the overall fabric of available insurance coverage; quite the contrary.

Like bundled coverage, what ends up being covered in one type of policy and not in another has been to some extent path-dependent, rather than a consequence of some natural way in which we divide up and categorize the world of risk and insurance against it. For example, insurance of all property risks, including the risk of physical damage to cars, could have been bundled into a single property insurance policy. Home and auto property insurance would then have been covered by a single insurance policy. But once auto *liability* insurance emerged, it was more efficient in a number of different ways for auto insurance to include a component of first-party property insurance, rather than to bundle this with residential or commercial property insurance.

Similarly, health insurance might have been bundled with life insurance. There might have been significant underwriting efficiencies to bundling insurance against the related risks of sickness, injury, and death. But because health insurance first appeared in a significant way as group insurance provided as a fringe benefit of employment, it was not bundled with life insurance, which had already been sold individually for over a century at that point.

Despite the fact that there is a certain path-dependence and therefore contingency about what different types of policies cover, some omissions from coverage under certain kinds of policies would be surprising, based on the kind of policy involved. No one would expect a health insurance policy to exclude coverage of the cost of medical treatment of feet, leaving such coverage for a hypothetical "podiatry" treatment policy. No one would expect an auto liability policy to exclude coverage of liability of an insured driver for negligently failing to get of his vehicle to signal oncoming traffic after the vehicle had broken down, and instead leaving the liability insurance component of homeowners and renters policies to provide that coverage. These hypothetically non-covered liabilities fall too close to the core of health and auto liability insurance for these limitations on coverage to be routine. The core concept of health and auto insurance is an appropriate baseline for determining whether coverage is fragmented and results in what everyone would agree is a "gap" in these examples.

On the other hand, there are also instances in which coverage seemingly close to the core of a particular form of insurance is not provided and can only be obtained by another policy or the purchase of coverage as an add-on. The exclusion of coverage of loss caused by flood under Homeowners policies is the paradigm example. There are historical reasons for this fragmentation.[14] And since 1986, also for reasons of history,

[14] *See* ABRAHAM & SCHWARCZ, *supra* note 9, at 253.

standard-form CGL insurance policies have contained an absolute pollution exclusion. The limited coverage of liability for pollution that is potentially available must be obtained separately, either under a freestanding pollution liability insurance policy or through the purchase of a pollution "buyback" endorsement to the standard-form policy.[15]

My point here is that the very notion of fragmentation sometimes has a pejorative connotation, because it inaccurately presupposes that the divide between bundling and fragmentation is both logical and determinate. In fact, however, the degree and kind of bundling and fragmentation that actually occur often is historically contingent and path-dependent. It turns out that the only dependable way to ascertain why coverage that might be expected under one type of policy is actually excluded or limited but covered by another kind insurance policy, is to consider the reasons that a particular exclusion or limitation on coverage exists.

II. THE DYNAMICS AND ECONOMICS OF INSURANCE

In contrast to path-dependence, which helps to explain why a particular risk is covered under one type of policy rather than another, often coverage of a particular risk is not covered under any type of policy. Although no theory can account for every exclusion from or limitation on coverage in every type of insurance policy, there are a handful of explanations for the existence of most such provisions, all of which involve the dynamics and economics of the insurance function.

A. COMBATTING ADVERSE SELECTION

Adverse selection is the disproportionate tendency of those who believe they are at higher-than-average risk of suffering a loss to seek insurance of that loss.[16] Insurers try to combat this phenomenon by obtaining information – often on an application for insurance – about the risk levels posed by applicants for coverage.[17] Applicants are then charged premiums proportionate to the risks they pose and adverse selection is at least partly neutralized. Sometimes, however, gathering the information about certain risks that is necessary to set accurate premiums is either infeasible or too costly. In such instances, exclusions and limitations addressing those risks are employed in order to combat adverse selection.

There are any number of such provisions in a variety of different types of policies. For example, claims-made liability insurance policies often

---

[15] *Id.* at 526.
[16] *Id.* at 6-7.
[17] *Id.* at 7.

contain broad exclusions applicable to claims that are "related" to the facts or circumstances associated with a claim made against the insured during an earlier policy period.[18] Similarly, many life insurance policies contain a delivery-in-good-health clause that precludes the policy from taking effect if the applicant's health status has changed in the period between the time of application and the time of issue.[19]

Provisions such as these circumvent the difficulty that insurers would otherwise face in obtaining information about risks known to the applicant but not the insurer. In theory an application can ask for information about facts or circumstances related to prior claims. But the ability of an insurer later to prove that a misrepresentation occurred is limited. Similarly, the moment of adverse selection in life insurance occurs at the time of application. But applicants may have suspicions, or even knowledge, about their health status that an insurer will never be able to prove the applicant had. For example, an applicant who has a numb foot and suspects he has a brain tumor might apply for insurance, pass a required physical examination, and then, only after a policy was issued, consult a physician and be diagnosed. A delivery-in-good-health clause sidesteps the difficulty of proving that the insured adversely selected in this situation.

Other exclusions combatting adverse selection are put in place not because of the difficulty of obtaining accurate information about the risk posed by the applicant, but because of the administrative cost that would be associated with setting accurate premiums for the excluded coverage. For example, Homeowners policies exclude coverage of loss caused by earth movement – mainly earthquakes.[20] Only a small percentage of policyholders poses a significant risk of suffering loss caused by earthquake. The costs of determining which small percentage of applicants pose such a risk and calibrating premiums to this risk, however, probably would not be worth the benefit of doing so. Consequently, if earthquake loss were covered without calibrating premiums, high risk applicants would be more likely to seek coverage. The simplest way to combat adverse selection of this sort is to exclude coverage of loss caused by earthquake on a blanket basis.[21]

---

[18] *Id.* at 567.

[19] *Id.* at 30.

[20] *Id.* at 241-42.

[21] Another way exclusions that are in place under such circumstances are sometimes understood is to say that they are designed to avoid cross-subsidization, or that the exclusions reflect market "segmentation." *See, e.g.*, TOM BAKER & KYLE D. LOGUE, INSURANCE LAW & POLICY 417 (3d ed. 2013). Therefore, for example, if a party wants earthquake insurance, it must be separately purchased and priced. The problem with these explanations is that they do not identify the reason for avoiding cross-

B. MORAL HAZARD

Moral hazard is the tendency of a party, other things being equal, to exercise less care to avoid causing a loss that is insured than that party would exercise of the loss were not insured.[22] Unlike adverse selection, moral hazard results not only in fragmentation of coverage, but also, in some instances, in the complete unavailability of coverage.

The most salient example of the latter is the exclusion of coverage, in all policies, for loss that the insured intended or expected to occur.[23] Similarly, many policies exclude coverage of liability for loss resulting from criminal violations and fraud.[24] The moral hazard that would result if these forms of loss were insured is too great to be insurable.

Other common exclusions serve the same purpose, though less obviously. CGL insurance policies, for example, exclude coverage of liability for damage to the insured's own product or work.[25] Otherwise, the cost of replacing products damaged by the policyholder's own defective manufacture or design would not be shouldered by the policyholder, but by its insurer. The moral hazard that would be generated if a product maker were insured against liability arising out of poor quality control would be significant. The maker would have a significantly reduced incentive to maintain quality.

Similarly, Homeowners policies cover loss of trees caused by certain specified perils such as fire, lightning, and explosion, but these perils do not include wind or snow.[26] It seems likely that the absence of such coverage can be attributed to the moral hazard that it would otherwise generate, since poor tree maintenance – including inadequate pruning – will aggravate the risk that wind and snow will damage trees.

---

subsidization, or for segmenting the insurance market. In each instance, the adverse selection that would result if cross-subsidization were facilitated, or if the market was not segmented, is the root cause of these effects. Cross-subsidization is not avoided for its own sake, but because it increases the risk of adverse selection. Market segmentation does not occur because of anything intrinsically desirable about separately covering the risk of earthquake loss, but because the administrative cost of bundling this coverage with other risks would increase adverse selection.

[22] ABRAHAM & SCHWARCZ, *supra* note 9, at 7.

[23] *Id.* at 440.

[24] *Id.* at 541.

[25] *Id.* at 443.

[26] *Id.* at 191.

Finally, burglary policies may exclude coverage unless the premises in question show visible evidence of forcible entry.[27] The limitation of coverage is a means of encouraging insureds to make reasonable efforts to secure the premises. Burglaries can occur without leaving visible evidence of forcible entry, but they are much less likely to occur without leaving such evidence if the premises have been properly secured against easy entry by a burglar. The evidence requirement combats this moral hazard.

Still other exclusions and limitations are designed to combat "ex post" moral hazard.[28] Homeowners policies exclude coverage of loss resulting from the neglect of the insured to use reasonable means to preserve property at and after the time of loss.[29] Uninsured motorist insurance covers hit-and-run losses when the responsible driver cannot be identified, but does not cover losses that occur without an actual "hit," in order to deal with the "phantom headlight" problem.[30] And cargo insurance policies cover the risk of livestock mortality but exclude coverage of animals that can walk away after an accident, in order (among other things) to encourage insureds to nurse the animals back to full health.[31]

C. CORRELATED LOSS

Insurance depends on the law of averages in order to operate successfully. For this to occur, the risks that are insured must be independent of each other, or uncorrelated. Otherwise losses will not be distributed randomly; a single event or cause will result in a large number of losses.[32] Either the insurer will profit enormously because there are no insured losses, or it will be stressed or rendered insolvent because of a large number of correlated losses. For example, flood losses, and especially flooding caused by hurricane-related storm-surge, are highly correlated. Homeowners policies therefore have long excluded coverage of loss caused by flood.[33] Similarly, Homeowners policies exclude coverage of loss caused by power

---

[27] *Id.* at 54-63.

[28] This is the tendency of the insured to consume insurance after a loss occurs. Health insurance is the prime example. *See id.* at 352. Among other devices, deductibles, co-pays, and coinsurance address this problem.

[29] *Id.* at 198.

[30] *Id*. at 706.

[31] *See* Roseth v. St. Paul Prop. & Liab. Ins. Co., 374 N.W.2d 105 (S.D. 1985).

[32] *See* ABRAHAM & SCHWARCZ, *supra* note 9, at 4.

[33] *See generally* Jennifer Wriggins, *Flood Money: The Challenge of U.S. Flood Insurance Reform in a Warming World*, 119 PA. ST. L. REV. 361 (2014).

failure occurring off the insured premises.[34] And a "war" exclusion is included in both Homeowners and CGL insurance policies.[35] These all tend to be correlated losses.

D. UNCERTAINTY

Insurance functions best when it has reliable data about risk – the possibility of loss. When there is a chance of loss, but it is difficult or impossible to quantify the magnitude of that chance, insurance does not function well, because insurers do not know what to charge for coverage.[36] About a century ago, the economist Frank Knight captured this difference by coining the distinction between risk and uncertainty. Risk refers to a quantifiable probability of an event occurring, whereas uncertainty obtains when that probability cannot be quantified.[37]

Insurers have a decided tendency not to cover losses whose occurrence is characterized by uncertainty.[38] Business Interruption and Contingent Business Interruption policies, for example, typically require that loss of revenue or profits be the result of property damage rather than other forces, even though the property damage they require is not to the property of the insured, and sometimes not even to the property of a customer or supplier.[39] The property damage requirement is, among other things, a method of conditioning coverage on the quantifiable risk that property damage of some sort will occur and cause economic loss, rather than on unspecifiable and therefore uncertain causes of economic loss. Similarly, the war exclusions that I discussed above in connection with correlated loss also have been adopted because the chance of war occurring is uncertain and therefore difficult to quantify.

Perhaps the paradigm example of an exclusion involving uncertainty is the absolute pollution exclusion that was incorporated into standard-form CGL insurance policies in 1986.[40] There are a number of independent explanations for that exclusion, as I have already indicated, but uncertainty

---

[34] ABRAHAM & SCHWARCZ, *supra* note 9, at 198.

[35] *Id.* at 198, 442.

[36] *See* KENNETH S. ABRAHAM, DISTRIBUTING RISK: INSURANCE, LEGAL THEORY, AND PUBLIC POLICY 65 (1986).

[37] The seminal distinction comes from FRANK H. KNIGHT, RISK, UNCERTAINTY, AND PROFIT 197-263 (1921).

[38] I am indebted to Tom Baker for pointing out that a number of typical exclusions are related to the uncertainty difficulty.

[39] ABRAHAM & SCHWARCZ, *supra* note 9, at 228.

[40] For discussion of the points made in this paragraph and the two paragraphs that follow it see ABRAHAM, *supra* note 6, at 155-65.

– of two different sorts – also figures centrally in its history. Prior to 1986, the standard-form CGL insurance policy contained what was referred to as a "qualified" pollution exclusion. That provision excluded coverage of liability for harm caused by pollution, but included an exception to the exclusion if the discharge, dispersal, release, or escape was "sudden and accidental." The risk that an explosion or other abrupt event would cause pollution was apparently sufficiently quantifiable for that sort of event to be insurable. However, within a decade, a number of courts held (for reasons that have been explained in detail) that the word "sudden" did not necessarily have a temporal component, and therefore that gradual, unexpected pollution might fall within the exception to the exclusion.[41] Other courts held that the word "sudden" means "abrupt." This created considerable "juridical" uncertainty. There was no easy way to quantify the possibility that courts would hold that the word "sudden" could mean gradual.

In addition, the split created substantive uncertainty. There was apparently no sufficiently reliable way to quantify the possibility that a policyholder would be held liable for injury or damage caused by gradual, unexpected pollution, or the magnitude of that liability if it were imposed. Because there had been very little pollution liability until the enactment of the federal Superfund Act (CERCLA) in 1980, there was uncertainty about the scope of potential liability under that environmental cleanup regime.

The result, after considerable debate and controversy within the Insurance Services Office, the policy-drafting arm of the insurance industry, was the absolute pollution exclusion. Both juridical and substantive uncertainty had rendered it too difficult, at that point, to insure against pollution liability. For a considerable period of time, pollution liability insurance simply was unavailable. Slowly, insurance against liability arising out of abrupt events (defined by reference to a number of days rather than by an adjective such as "sudden") became selectively available again.[42] And some insurance against liability for gradual pollution – a specialty insurance product – also became selectively available, as actuarial experience made that possible.

E. AVOIDING DUPLICATION

The last major reason for exclusions is to avoiding insuring the same risk concurrently under two different policies – to implement a particular fragmentation and avoid what might be called "double bundling" that would needlessly increase the costs of both selling coverage and processing claims. Consequently, certain risks that might otherwise be covered under one type

---

[41] *See id.* at 160-61.

[42] *See* ABRAHAM & SCHWARCZ, *supra* note 9, at 526.

of policy are excluded, because they are routinely covered under another type of policy.[43]

For example, Homeowners policies exclude coverage of damage to, and liability arising out of, the ownership or operation of motor vehicles.[44] These risks are covered by auto insurance. Directors & Officers liability insurance policies exclude coverage of liability for bodily injury and property damage.[45] These risks are covered by CGL policies. CGL policies exclude coverage of auto liability, which is, obviously, covered by auto insurance.[46]

III. VERBAL INCOMPLETENESS

In contrast to the absence of coverage – either an omission or a "gap," as I have been calling it – are situations in which there is at least arguably coverage, but language missing from the policy leaves coverage incompletely specified. There are three main ways in which insurance policies leave things unsaid.

A. THREE FORMS OF INCOMPLETENESS

Insurance policies leaves things unsaid in three different ways. First, some relevant, or potentially relevant, subjects of coverage are simply not addressed. These are pure omissions. Second, some subjects are addressed, but addressed incompletely. Third, some subjects are addressed, but vaguely or imprecisely, because they involve matters of degree.

---

[43] This has sometimes also been called "market segmentation." *See* BAKER & LOGUE, *supra* note 21, at 417.

[44] *See* ABRAHAM & SCHWARCZ, *supra* note 9, at 189, 202.

[45] *Id*. at 541.

[46] It is worth noting, however, that not all duplication can be avoided through the use of exclusions. Some potential duplication occurs because an insured has access to concurrent coverage provided by two or more policies of the same type. An individual may be driving someone else's car, in which case both the driver's and the owner's auto insurance would cover him against liability. Or an individual may have health insurance provided by his own employer, as well as separate health insurance provided to him by his spouse's employer as a family member of the spouse. In instances such as these, separate provisions in each policy, labeled "other insurance" or "coordination of coverage" will specify which policy has primary and which policy has only secondary coverage responsibility.

1. Omissions

True omissions from insurance policies – instances in which there is no policy language bearing on an issue posed by a particular claim, but there is nonetheless a legitimate question whether there is coverage – are rare. When there is coverage, or it is arguable that there is coverage, there is almost always some language that has a bearing on the issue. But sometimes the relation between policy language and a particular claim is so attenuated that it amounts to an omission rather than merely incomplete expression. For example, business interruption coverage sometimes refers to the amount of time that "would be required" to "rebuild, repair, or replace" damaged, insured property.[47] If the damaged property is a drug store in one of the World Trade Center towers, then this provision is silent about what standard to use: a) the amount of time that would be required to build something that never existed – a freestanding drug store building, or b) the amount of time that would be required to rebuild the entire World Trade Center tower in which the drug store was located.[48]

Similarly, many insurance policies contain express subrogation provisions. Those provisions grant insurers the insured's right of recovery against third parties to the extent of the insurer's payment to the insured on account of a loss for which the insured has such a right of recovery. But those provisions say nothing about what happens when the insured exercises its own right of recovery against a third party, including what happens when the insured settles a claim against the third party for less than the full amount of the loss.[49] Neither of these cases involves a gap – the problem is not whether there could be coverage at all, but rather an omission of what the terms of coverage are. The policy omits mentioning what is necessary to make that determination.

2. Incompleteness

Many insurance policy provisions incompletely address the subject to which they pertain. For example, Homeowners policies contain exclusions applying to "intentional" property loss,[50] and CGL insurance policies insure

---

[47] *See, e.g.*, Duane Reade, Inc. v. St. Paul Fire & Marine Ins. Co., 279 F. Supp. 2d 235, 237 (S.D.N.Y. 2003).

[48] *See id.* at 239 (holding that the former is the relevant time period).

[49] *See, e.g.*, ABRAHAM & SCHWARCZ, *supra* note 9, at 208; Associated Hosp. Serv. of Phila. v. Pustilnik, 396 A.2d 1332, 1338 (Pa. Super. Ct. 1979) (addressing the insurer's rights when the insured settles a suit against a third party).

[50] *See* ABRAHAM & SCHWARCZ, *supra* note 9, at 198.

against liability for bodily injury or property damage that is "expected or intended."[51] Neither provision specifies whether coverage is excluded when the insured expects, or intends, one type of bodily injury or property damage and a different type occurs, or whether coverage is excluded when property damage is expected or intended and bodily injury occurs instead.[52] Similarly, auto liability insurance policies cover liability for bodily injury or property damage caused by an "auto accident," without defining that term.[53] Beyond collisions, which would undoubtedly be considered "auto accidents," the term does not indicate what fortuitous occurrences involving an automobile are included. Each of these provisions is an example of incomplete specification.

Sometimes there is only a fine line, however, between a provision that is incomplete, and a provision that is complete but requires application to a particular set of facts. Although few policy provisions are self-applying in all situations, most policy provisions are not incomplete. Rather, even "complete" provisions often still require active interpretation when they are applied to the particular facts of a claim. For example, in *Port Authority of New York and New Jersey v. Affiliated FM Ins. Co.*[54] the question was whether the mere presence of asbestos containing materials in the policyholder's buildings constituted "physical loss or damage" under its property insurance policies. There is admittedly a sense in which that phrase is incomplete; the policy could have further defined it. But it seems more accurate to say that the phrase required application to a particular set of facts.

On the other hand, suppose that an auto liability insurance policy covers liability for injury "arising out of the use" of an auto, and the insured is sued for injury caused by throwing a firecracker out the window of a parked car.[55] There is admittedly a sense in which a coverage determination would merely constitute application of the term "use" to this set of facts. But it seems more accurate to say that the term use, standing alone, is incomplete in this context. But both situations are close.

3. Vagueness

The term "vagueness" is sometimes used interchangeably or along with "ambiguity." As I use the term here, a term is vague if its boundaries are indistinct or indeterminate, even if its core meaning is unambiguous. For

---

[51] *Id.* at 440.

[52] Interestingly, Homeowners policies do so specify. *Id.* at 204.

[53] *Id.* at 639.

[54] 311 F.3d 226, 236 (3d Cir. 2002).

[55] *See* Farm Bureau Mut. Ins. Co., Inc. v. Evans, 637 P.2d 491, 493 (Kan. Ct. App. 1981).

example, many claims-made policies contain exclusions applicable to claims that are "related" to a claim that was made against the insured during an earlier policy period.[56] Obviously, claims that are identical or nearly identical are "related." Such claims fall within the core meaning of the term. But the term "related" is vague at the borderline. It does not specify the degree of similarity that two claims must share in order to be "related."

Occurrence-based CGL insurance policies also contain certain vague provisions. For example, the very definition of an occurrence is "an accident, including continuous or repeated exposure to substantially the same general harmful conditions."[57] The phrase "substantially the same general harmful conditions" is vague in two respects. The terms "substantially" and "general" are both indistinct at their boundaries.

Similarly, the standard-form CGL policy covers liability incurred because of bodily injury or property damage that occurs "during the policy period," and further provides that such bodily injury or property damage "includes any continuation, change or resumption of *that* 'bodily injury' or 'property damage' after the end of the policy period."[58] This is sometimes referred to as the "Montrose" clause, after the case that seems to have generated insurers' decision to incorporate the clause in CGL insurance policies.[59] The entire phrase "bodily injury or property damage" is vague. It does not indicate what constitutes "that" (i.e., prior – bodily injury or property) and what constitutes new, and therefore not "that" bodily injury or property damage. Clearly, if a fire starts burning, appears to have been extinguished, and then starts to burn in exactly the same place, the reignited fire is a resumption of "that" property damage. But beyond this core meaning of "that" property damage, the point at which subsequent harm ceases to be part of prior harm and is now new harm is indistinct. For example, suppose the fire spreads to another piece of property after it reignites.

The point is not that such issues cannot be resolved. On the contrary, the courts have long been in the business of resolving such issues by means of interpretation that makes reference, among other things, to the purposes that underlie provisions such as "that bodily injury or property damage." The point is that the provisions they are interpreting in such situations are vague,

---

[56] Some policies go on to define a related claim as one arising from the same or related facts, circumstances, or wrongful act, which of course is not entirely helpful, in that the definition employs the defined term. ABRAHAM & SCHWARCZ, *supra* note 9, at 553.

[57] *Id.* at 453.

[58] *Id.* at 439 (italics added).

[59] *See* Craig F. Stanovich, *The Montrose Endorsement—15 Years Later*, IRMI (Sept. 2014), https://www.irmi.com/articles/expert-commentary/the-montrose-endorsement-15-years-later.

and that this very vagueness is what requires a process of interpretation of this sort, because something has been left unsaid in the insurance policy.

B. REASONS FOR VERBAL INCOMPLETENESS

There are roughly half a dozen reasons why insurance policies leave things unsaid. Some are linked predominately to omissions, incompleteness, or vagueness, whereas others apply to more than one of these forms of imperfect expression. They run along a spectrum from inevitable, or at least often benign or desirable reasons, to avoidable and undesirable reasons. I will discuss them in this order.

1. Avoiding Excessive Complexity

Insurance policies are necessarily complex documents. In order to specify what is and what is not insured, it is often necessary to articulate the terms of coverage in considerable detail. But there is a practical limit to the amount of specification that is desirable or even tolerable. Although greater specification often adds clarity, adding words also risks detracting from clarity. In any event, even when greater specification unquestionably would enhance clarity, it may have disadvantages. As Judge Posner put the point:

> Drafters cannot anticipate all possible interactions of fact and text, and if they could, to attempt to cope with them in advance would leave behind a contract more like a federal procurement manual than like a traditional insurance policy. Insureds would not be made better off in the process. The resulting contract would not only be incomprehensible but also more expensive.[60]

An insurance world in which an ordinary lawyer with a general civil practice would require several hours to understand a standard consumer or auto insurance policy in order to advise her client probably is not worth the enhanced clarity that much more explicit language in insurance policies would provide. This does not mean, of course, that every omission, incompleteness, or vagueness reflects an optimal level of specificity. Some provisions could be improved with little to no risk of facing the disadvantages that sometimes accompany greater specificity.

For example, I am not at all sure that including more detail in the Montrose clause that was quoted earlier would be worth the greater

---

[60] Harnischfeger Corp. v. Harbor Ins. Co., 927 F.2d 974, 976 (7th Cir. 1991).

complexity that would accompany doing so. Without a great deal more language, revision through elaboration still would be unlikely to resolve many of the issues that would continue to arise in interpreting the clause. For example, one of the scenarios to which the clause applies is leakage of hazardous waste. Suppose that in policy year one, waste leaks from a site and contaminates groundwater (underground water) lying fifty feet beyond the boundary of the site where it was deposited. That is "property damage." Suppose further, however, that in policy year two, the waste that was already in the groundwater migrates further, and contaminates previously-uncontaminated groundwater lying between 50 and 500 feet beyond the boundary of the site. Redrafting the clause to make it clear whether it applies to this scenario would require considerable additional language. But such redrafting would not address other possible scenarios – for example, suppose that additional pollutants further contaminated the already-contaminated groundwater during year two. Still more language could be required to address this type of scenario. In the end, without complex elaboration, the different permutations that could arise cannot be addressed so as to be effectively self-applying.

Similarly, the liability insurance provided by the standard Homeowners policy contains an exclusion pertaining to "sexual molestation, corporal punishment or physical or mental abuse."[61] The term "abuse" is undoubtedly imprecise, but more precise language would be difficult to fashion without providing a series of non-exclusive illustrations, which would themselves be subject to interpretation. The game does not seem worth the candle in this situation.

On the other hand, it is not difficult to find policy provisions that leave things unsaid unnecessarily, because a few extra words could substantially increase their clarity. For example, for several decades, insurers have sometimes argued that they have a right to recoup the costs of defense from insureds they have defended when it is subsequently decided that there was no duty to defend.[62] Insurers could easily remedy this purported omission by providing for such a right with language to the effect of: "[i]f we defend you and it is later determined that we had no duty to do so, we have the right to be reimbursed by you for our costs of defense." Such a provision would not introduce excessive complexity.

Another provision that could benefit substantially from short and simple elaboration is the "expected or intended" harm exclusion in CGL insurance policies. As I noted earlier, that provision is incomplete in that it does not indicate whether liability for harm that is different from what the insured expected is excluded. Suppose the insured expects property damage

---

[61] ABRAHAM & SCHWARCZ, *supra* note 9, at 204.

[62] *Id.* at 600-01.

but bodily injury occurs. Suppose the insured expects minor injury to one person and a dozen people are seriously injured. These omissions could be addressed, for example, by providing that the exclusion applies "even if the injury or damage that occurs is different in kind or magnitude from what was expected or intended."[63]

2. Accommodating Matters of Degree

Matters of degree are difficult to capture with bright-line, hard-edged language. That is as true of insurance policy provisions as it is of common law definitions of concepts such as negligence or reliance. Policy provisions that hinge on matters of degree are therefore likely to have an unavoidable measure of vagueness at the margin. The term "related," as described earlier in connection with "related claims" exclusions in claims-made policies, involves a matter of degree. The same is true of an exclusion of coverage in a property insurance policy when the insured property is "vacant" for a specified period.[64] Even definitions of coverage terms can fall prey to this problem. For example, by definition, an insured must be "disabled" under most Disability Insurance policies. One policy provided that the insured was disabled if he was "not able to engage in any gainful occupation" in which he "might reasonably be expected to engage because of education, training or experience."[65] The term "able" in this context poses a question of degree that the second quoted clause qualifies, but could never fully eliminate.

In contrast to omissions and incompleteness, the most effective remedy for the vagueness associated with policy provisions that involve matters of degree usually is not greater specification of the concept. The concepts of relatedness, vacancy, and ability to work will remain vague, though perhaps a bit less vague, even after greater specification, because they will remain matters of degree. Rather, a solution to the problem posed by concepts involving matters of degree is sometimes to shift to a less vague, though more rigid, proxy.

A classic example is the exception to the pollution exclusion for "sudden and accidental" discharges of pollutants that was contained in standard-form CGL insurance policies between 1973 and 1986. The term "sudden" is a question of degree, and posed a series of other interpretive

---

[63] For a provision in the standard-form homeowners policy that says essentially that see *id.* at 204.

[64] *See, e.g.*, Langill v. Vermont Mut. Ins. Co., 268 F.3d 46, 47 (1st Cir. 2001).

[65] *See* Mossa v. Provident Life and Cas. Ins. Co., 36 F. Supp. 2d 524, 526 (E.D.N.Y. 1999).

problems. An "absolute" pollution exclusion was substituted, but a pollution "buyback" was sometimes offered, permitting coverage if the discharge of pollutants was discovered by the insured within a specified number of days after it commenced, and reported to the insurer within a certain number of days after that.[66] The vague concept of suddenness was replaced with a specified number of days, which is a concrete, though more rigid, concept.

3. Acquiescing in an Established Judicial Gloss

The final justifiable reason for not saying something in an insurance policy is that insurers sometimes find the courts' prior interpretation of omissions, incompleteness, or vagueness to be acceptable, even if the interpretations were not what the insurer originally intended. As long as the courts tend to produce similar or identical interpretations, and outcomes of claims are therefore predictable, insurers can calculate the appropriate additional premium to charge for coverage that the courts have held is broader than insurers intended.

The courts' interpretations of the duty to defend, contained in almost all standard-form liability insurance policies, is an example. That provision is brief in the extreme; it is a classic example of an incomplete provision. Consequently, many issues about the scope of the duty, that the provision does not address, have arisen over the years. Yet the standard-form provision has never been modified. Insurers have simply acquiesced in the scope of the duty that the courts have defined and have charged premiums accordingly.[67] This has been even more dramatically the case for liability insurers' duty to settle, which is not embodied in policy language at all. Liability insurance policies have always purported to give insurers discretion as to whether to settle claims against their insureds.[68] Yet the courts have fashioned a duty to accept reasonable settlement offers, and insurers have never modified their policies to specify that they have no such duty or to define the duty's scope. They have simply acquiesced in the duty as the courts have defined it.[69]

Obviously, not all insurers' decisions not to modify policy language constitute acquiescence in the gloss that the courts have placed on this language. There may be other reasons, specific to the particular situation, that prompt insurers to leave something unsaid, even if they object to the interpretations the courts have adopted. For example, a standard-form policy provision that has been interpreted differently in two different states would

---

[66] *See* ABRAHAM & SCHWARCZ, *supra* note 9, at 526.

[67] *Id.* at 577.

[68] *Id.* at 609.

[69] *See* RESTATEMENT OF THE LAW LIAB. INS. § 24 (AM. LAW INST. 2019).

require a modification in one of the states to conform its meaning to that which already prevails in the other state. This would render the wording of the two provisions different, and therefore non-standard. Other things being equal, that is undesirable. In addition, changes in policy language typically require state regulatory approval or acquiescence before they can take effect.[70] Proposing a modification therefore risks drawing attention to the change and resulting regulatory rejection.

4. Deliberate Overbreadth

In contrast to the preceding reasons for verbally incomplete coverage, the following reasons usually are not justifiable. One example is an unnecessarily overbroad limitation on coverage. An overbroad limitation on coverage gives the insurer discretion to deny some claims based on the language of the limitation, but to pay some claims that the language also purports to preclude. Such a provision leaves the actual scope of the limitation on coverage unstated. Perhaps the classic example of this approach is the definition of "pollutants" in CGL insurance policies. These are defined as "any solid, liquid, gaseous or thermal irritant or contaminant."[71]

This language is broad enough that it could easily be applied to harm caused by substances that in most settings are not pollutants in any plausible sense, such as catsup or salt, which could irritate a person's eye or contaminate a batch of flour. The breadth of the policy language leaves unstated which substances the insurer will actually classify as pollutants and which it will not when a claim for coverage is actually made.

Overbreadth of this sort has two disadvantages. First, overbreadth undermines predictability of outcome. Insureds have less ability to determine whether a claim is likely to be paid, and both insureds and insurers have less ability predict the outcome of disputed claims in litigation. Second, overbreadth accords insurers discretion to pay or not to pay claims that is potentially subject to abuse. Insurers may treat identical claims differently for reasons that have nothing to do with the nature or merits of the claim itself. Like claims, then, are not treated alike. Although there is obviously no equal protection right accorded to policyholders, there is an implicit contractual norm that the same coverage rights apply to all claimants.[72] Selective payment of identical claims pursuant to overbroad limitations on coverage would violate this norm.

---

[70] ABRAHAM & SCHWARCZ, *supra* note 9, at 142.

[71] *Id.* at 453.

[72] *See* Kenneth S. Abraham, *Four Conceptions of Insurance,* 161 U. PA. L. REV. 653, 691-93 (2013).

5. Coverage Information Asymmetry

Most insurers know more about what their policies cover than most insureds. Insurers not only know more about the language of their policies, but also more about how the courts have interpreted them. Sometimes an insured, or an insured's lawyer, interprets a policy not to provide coverage when it does provide it. This may be the result of misreading complicated language, interpreting ambiguous policy language against coverage, or not recognizing that the courts have held that a particular provision actually provides coverage. In this latter situation the policy leaves unsaid, or partially unsaid, the fact that the claim is covered. Modifying the policy to clarify that there is coverage in the relevant situations would result in more claims, without any obvious corresponding benefit. Consequently, the fact that there is coverage is left unsaid.

IV. IMPLICATIONS

The principal message of my analysis is that there are many reasons why insurance coverage is always incomplete in the sense that I have used this term here. In order to avoid making simplistic assumptions about the completeness or incompleteness of insurance coverage, courts, regulators, and commentators would benefit from a more sophisticated understanding of what it means to consider whether coverage is "incomplete." This means appreciating that the notion of a "gap" in coverage, standing alone, is usually unhelpful; recognizing that the notion of incompleteness is not meaningful without a particular baseline for comparison; and adopting an approach to interpretation that goes beyond the simple distinction between plain and ambiguous policy language.

A. "GAPS" IN COVERAGE

Insurance law scholars[73] and the courts[74] sometimes refer to a "gap" in the coverage provided by an insurance policy or by a particular form of

---

[73] *See, e.g.*, Jay M. Feinman, *Fragmented Risk: An Introduction*, 11 RUTGERS J. L. & PUB. POL'Y 11, 6 (2013); Erik S. Knutsen*, Confusion about Causation in Insurance: Solutions for Catastrophic Losses,* 61 ALA. L. REV. 957, 986 (2010); Alexia Brunet Marks, *Under Attack: Terrorism Risk Insurance Regulation*, 89 N.C. L. REV. 387, 390-91 (2011); Jeffrey W. Stempel, *Rediscovering the Sawyer Solution: Bundling Risk for Protection and Profit,* 11 RUTGERS J. L. & PUB. POL'Y 171, 200 (2013).

[74] *See, e.g.,* Farm Family Cas. Ins. Co. v. Henderson, 116 N.Y.S.3d 771, 774 (N.Y. App. Div. 2020) (referring to "policies that leave gaps in

insurance in general. The very idea of a gap, however, at least implicitly presupposes some reference-class or baseline of comparison that does not contain a gap. When we speak of a gap between two mountains, for example, we are envisioning a continuous range of mountains with the same elevation and comparing it to a configuration of mountains that is not continuous. Without envisioning a continuous elevation, the notion of a "gap" would not have meaning. There would simply be mountains in some places and not in others.

Many references to, and arguments regarding, gaps in coverage, however, employ no express or obvious baseline. Some use the term "gap" simply to refer to something that is not covered. Others seem to presuppose some form of broader coverage, even if only as an ideal. Both uses of "gap" rhetorically trade on the pejorative connotation of the term, whether intentionally or subconsciously.[75] In contrast to the neutral notion of coverage that is not provided by an insurance policy, a "gap" in coverage implies that coverage which should be provided is omitted. The use of the term suggests that if there is a "gap" in coverage, that coverage is missing rather than just not provided.

For example, the insuring agreement of CGL insurance policies cover liability payable "as damages because of bodily injury or property damage . . ."[76] By virtue of this provision, liability for physical damage is covered, and liability for non-physical loss is not. To the extent that the absence of coverage of liability for non-physical loss is a "gap," it is a "gap" in the CGL policy's affirmative grant of coverage. But there are innumerable other risks that the policy does not affirmatively cover because of the kind of policy it is and is not. To think of all coverage that is not affirmatively provided as reflecting a "gap" would be fallacious.

Similarly, like all policies, the CGL policy goes on to reduce the coverage provided by the insuring agreement through the incorporation of exclusions, conditions, and other limitations on coverage. The coverage provided by the policy – the coverage carved *into* the policy out of the

---

coverage"); Finch v. Steve Cardell Agency, 25 N.Y.S.3d 441, 443 (N.Y. App. Div. 2016) (referring to agent's failure to inform insured of an exclusion that create a "gap" in coverage); Dahms v. Nodak Mut. Ins. Co., 920 N.W.2d 293, 295 (N.D. 2018) (referring to brokers failure to procure policy that did not create "gaps in coverage"); First Mercury Ins. Co. v. Russell, 806 S.E.2d 429, 434 (W. Va. 2017) (referring to a "gap" in coverage lying in between two source of protection).

[75] As I noted at the outset, I am concerned here with substantive gaps, not temporal or monetary gaps. I have no quarrel with use of the term to apply to the latter two notions.

[76] ABRAHAM & SCHWARCZ, *supra* note 9, at 439.

universe of risks that it could insure, less the coverage that is then limited or excluded – is simply the combination of the insuring agreement and the other provisions in the policy. What is carved in is the coverage provided by the insuring agreement, net of the coverage removed by the exclusions, conditions, and other limitations.

In short, all insurance policies identify and insure a limited set of risks out of the universe of risks that an individual or entity faces. All insurance policies cover some risks but not others. This is the case regardless of whether this is done through limitations in the affirmative grant of coverage, exclusions and conditions that restrict the scope of that grant, or both. In order to determine whether, and in what sense, a policy contains a "gap" in coverage, it is necessary to have a baseline against which to measure or assess the coverage that the policy provides.

B. BASELINES

We have just seen that the notion of a "gap" in coverage, or coverage that is "incomplete," is likely not meaningful because there are always gaps and coverage is always incomplete. For the notion of a "gap" to be meaningful, the baseline being employed must be identified. There are a number of possible baselines, but each fails in different ways.

First, the scope of past coverage is likely to be an unsuitable baseline. Coverage often evolves in two directions: by expansion and contraction. Some risks that previously were not insured are added to coverage, but some risks that previously were insured are omitted or excluded. For example, Homeowners policies now cover losses resulting from credit card theft[77] whereas in the past they did not.[78] These policies now contain an extensive limitation on coverage of loss involving the collapse of insured property.[79] In the past they contained no such limitation.[80]

There are countless examples of evolving expansion and contraction of other types of policies as well. Changes in coverage, including new restrictions, are common. In this context, a restriction cannot automatically be considered a gap in coverage in the pejorative sense, simply by virtue of the fact that it is a restriction.

Second, even focusing exclusively on restrictions of coverage, the reason coverage that was once provided is now omitted or excluded is potentially relevant to the question of whether a restriction constitutes a gap.

---

[77] *Id.* at 191.

[78] See the standard-form Homeowners policy set out in KENNETH S. ABRAHAM, INSURANCE LAW & REGULATION 184-95 (1st ed. 1990).

[79] *See* ABRAHAM & SCHWARCZ, *supra* note 9, at 194.

[80] *See* ABRAHAM, *supra* note 78.

The liability insurance portion of Homeowners policies now excludes coverage of liability for "sexual molestation," apparently regardless of whether any bodily injury associated with such molestation was "expected or intended."[81] Most people, I think, would not consider this new restriction a gap in coverage, but instead would view it as an appropriate limitation on what is insured.

Third, an alternative possible baseline is the coverage provided by contemporary standard-form policies. This approach has the great advantage of circumventing the principal deficiencies associated with using past policies as a baseline. The fact that a policy provides narrower coverage than a contemporary standard-form policy suggests that, however the expansion and contraction of coverage has evolved, the particular policy in question has evolved in a less expansive way than would have been feasible, and that any special restriction it embodies is probably not consonant with what would be viewed as a necessary or appropriate restriction on coverage. In an important study, for example, Daniel Schwarcz demonstrated that many Homeowners insurance policies have gaps in coverage, as compared to the standard-form Insurance Services Office (ISO) policy.[82] The idea of a gap, in that sense, is meaningful and useful. However, even if this is potentially an appropriate baseline, it does not follow that any variance between standard-form coverage and the coverage provided by the policy in question actually reflects a gap. There may still be good reason for an omission of coverage.

In addition, the deficiency of employing standard-form policies as a baseline is that this approach is necessarily incomplete. Although the coverage provided by a standard-form policy might be a suitable criterion by which to assess the coverage provided by a non-standard policy, that criterion cannot serve as a baseline for assessing whether the standard-form policy contains gaps of its own, and most policies are standard forms. That would be a completely circular test. To assess whether a standard-form policy contains a gap in coverage, a baseline external to the policy is required.

Finally, a very different baseline for determining whether a policy contains a gap in coverage could be the optimal set of coverages that a policy of that type would contain. Unfortunately, however, although this baseline is superior in principle to the other possible baselines, it is impractical in the extreme for a number of reasons.

The main reason is that the scope of coverage that is optimal for one policyholder is not necessarily optimal for others. A prototypical policyholder's preferences would have to be the model for this approach, and

---

[81] ABRAHAM & SCHWARCZ, *supra* note 9, at 204.

[82] *See generally* Daniel Schwarcz, *Reevaluating Standardized Insurance Policies,* 78 U. CHI. L. REV. 1263 (2011).

it is far from clear what the characteristics of a prototypical policyholder are. Even setting this consideration aside, the prototypical policyholder's preferences are not necessarily congruent with the coverage that a prototypical insurer would be willing to provide. Various considerations influence that decision, and the premiums a prototypical insurer would charge will obviously depend on what the terms of coverage are. Consequently, the optimality standard would have to presuppose that each prototypical party had knowledge of the other party's preferences, as well as the constraints – administrative, financial, etc. – under which the other party was operating.

In any event, whoever were to decide whether a policy contained a gap based on that baseline would have to have that same knowledge. Academic analysts, courts, and even insurance commissioners fall far short of having such knowledge. Decades ago, during the high-water mark of common law judicial activism, there was experimentation with a modest version of the optimality baseline. Some courts held that the reasonable expectations of the insured as to coverage should be honored, despite unambiguous, fine-print policy language precluding coverage.[83] As many as a dozen or so jurisdictions purported to adopt this doctrine (perhaps provisionally adopted is a better description). A number have since backed away from the doctrine, and there is reason to wonder whether it is completely a thing of the past.[84]

Regardless of whether the doctrine still exists in a few states, I think that its failure to thrive can be attributed in part to the same kinds of practical difficulties that would be involved in identifying the optimal scope of coverage for a particular type of insurance policy. The courts asked to apply the doctrine often had no way of knowing the expectations of the typical policyholder. There does not appear to have been factual testimony about policyholder expectations generally, or about what would make an expectation reasonable, in any of the reasonable expectations cases.

Rather, whether a policyholder would reasonably expect the coverage in question seems to have been treated as a mixed question of fact and law, but ultimately a question to be decided as a matter of law by the court rather than by a jury. In some very simple cases, a court could see itself – or think that it could see itself – as the prototypical policyholder, and decide without evidence whether that policyholder would have expected the coverage at issue. But in any complex case, a sensible court would have to be agnostic. Exactly what coverage limitations a policyholder would reasonably expect, or not expect, would be difficult to know. The upshot was

---

[83] *See generally* Symposium, *The Insurance Law Doctrine of Reasonable Expectations after Three Decades*, 5 CONN. INS. L.J. 1 (1998).

[84] *See* ABRAHAM & SCHWARCZ, *supra* note 9, at 59.

that, although it seems likely that some coverage limitations violate the prototypical policyholder's reasonable expectations, the game of identifying which limitations those were was not worth the candle. Moreover, as the era of judicial common law activism came to an end, it became an increasingly improper role for courts to play.

Insurance commissioners, in contrast to courts, are theoretically better equipped to independently investigate and make factual determinations regarding what risks prototypical policyholders would expect to be covered, and what exigencies and constraints might limit insurers' capacity to provide coverage that meets all these expectations. Realistically, however, regulatory resources are limited. Full-blown investigations will be rare. Instead, insurance commissioners are likely to use past policies and existing standard-form policies as baselines. The issue will be what changes a policy incorporates, and what justification can be given for the change. Only when there is an uninsured risk whose salience has recently increased will something resembling scrutiny from the ground up occur.

In short, for both courts and regulators, the optimal scope of coverage may seem to be an ideal baseline in principle, but it is not likely to be workable or employed often. Some metric other than the kinds of baselines we have considered must be used to determine whether a policy contains a gap in coverage, but it is not clear what that metric would be. The analysis thus far yields the conclusion that, without a baseline, the notions of a gap in coverage and incomplete coverage are not meaningful. And there is no generally suitable baseline available.

C. INTERPRETATION

The last implication of my analysis is that the stark distinction between plain meaning and ambiguity is often too simplistic to deal adequately with what might be considered incomplete coverage. The notions of plain meaning and ambiguity are often capable of dealing adequately with the interpretation of express policy language. But they are more likely to be unsophisticated tools for addressing the meaning and significance of what insurance policies do not say. There are too many potentially good reasons that a policy does not provide coverage, or leaves something unsaid, for either plain meaning or ambiguity to always control the characterization of the wide range of alternatives.

The principal device that the courts now use to deal with this phenomenon is to not mention it and then to develop a legal doctrine that addresses the problem. The courts' tendency to develop doctrines when insurance policies leave things unsaid, rather than invoking the blunt distinction between plain meaning and ambiguity, is an implicit recognition

of the inadequacy of the distinction in many contexts.[85] The problem with this approach, however, is that it does not recognize the reason for the problem and therefore does not lead naturally to the source of its solution. The courts, in effect, simply leave themselves with the need to devise a doctrinal solution.

But the source of the problem should inform the solution. As I have indicated, some "incomplete" coverage is the product of inevitable fragmentation. Some things are left unsaid in order to avoid unnecessary complexity or because vagueness at the borderline of a concept cannot be avoided. When this is the case, an attempt to fashion a doctrine or doctrinal interpretation without any artificial favoring of coverage is likely to be sensible. On the other hand, in cases of easily avoidable incompleteness, overbreadth, or apparent information asymmetry, a soft presumption in favor of coverage is more justified. Candid identification of the particular source of the problem, rather than non-interpretive silence followed by doctrinal elaboration, is a prerequisite to this approach.

I recognize that courts and the public usually have a strong interest in adjudicating insurance contract disputes as a matter of law. An approach that depends to some extent on resolution of questions of fact, and therefore often leads to the denial of summary judgment followed by discovery, is undesirable. But the need to identify the reasons insurance policies leave things unsaid should not often preclude summary judgment. These reasons are not adjudicative facts requiring fact-finding when they are disputed. They are "legislative," or policy-related facts that do not depend on the introduction of evidence.

Considering matters regarding what different kinds of standard-form insurance policies cover, for example, does not violate the rules precluding the admission of extrinsic evidence. Rather they relate to the kinds of (public) policy issues that courts are permitted to consider without the need for formal admission into evidence or fact-finding. Information about what different forms of standard-form policies are available and cover is available in treatises, casebooks, law review articles, and monographs that can be cited in briefs without being introduced into evidence or violating prohibitions on consideration of extrinsic evidence in the absence of ambiguity.[86]

As for omissions, incompleteness, and vagueness, the justification, or lack thereof, for policy provisions that leave something unsaid is one subject that the courts are capable of addressing without the aid of extrinsic evidence such as expert testimony. Judges are lawyers who can assess the quality of a policy's drafting, and the ease and simplicity with which a provision could have been more clear, with the input and arguments of

---

[85] For discussion, see ABRAHAM & SCHWARCZ, *supra* note 9, at 359-61.

[86] *Id.* at 352-54.

counsel. This usually can be done on summary judgment without the need for fact or expert discovery.

In short, we need courts to have a more sophisticated understanding of the reasons that insurance policies sometimes leave things unsaid, as well as more candor from the courts about the bases for decisions that involve matters that policies have left unsaid. Insurance policy language often does not fit comfortably in the binary world in which language either has a plain meaning or is ambiguous. Pretending that it does will not produce progress or insight on this front.

CONCLUSION

All insurance policies, and consequently all insurance coverage, are incomplete. The notion of a gap in coverage is, therefore, unhelpful at best, and likely to be misleading. For reasons of historical path-dependence, coverage may be bundled or fragmented. For reasons associated with the dynamics and economics of the insurance function, coverage of certain risks will be excluded from, or limited by, insurance policies that might at first glance seem appropriate to cover these risks. And for both good reasons and bad, insurance policies leave some aspects of coverage unsaid. We would all do well to recognize these phenomena, and to bring a more sophisticated appreciation of the ways in which insurance coverage is incomplete and the reasons it is incomplete, to the task of understanding, interpreting, and applying insurance policies.

INSURANCE LAW BETWEEN COMMERCIAL LAW AND CONSUMER LAW: CAN THE UNITED STATES INSPIRE CHINA IN INSURANCE MISREPRESENTATION

QIHAO HE* & CHUN-YUAN CHEN**

The theoretical argument behind the "pro-insured" or "pro-insurer" debate contains elements of contract law, business law, and consumer law. This article reexamines the insurance misrepresentation rule under the RLLI, ands compares it to insurance law in China. This comparison demonstrates the struggle between preference for insured or insurer. We have reconsidered the subtopics of misrepresentation, including innocent misrepresentation, materiality, reliance, remedy, contribute-to-the-loss approach and others, from not only the perspective of either party of the insurance contract, but also the overall efficiency of the insurance market and society. For the structure and remedy of insurance misrepresentation, we recommend a reasonable rule, which allows rescission for any kind of misrepresentation, but this is not equivalent to a rule that an insurer can rescind contract for any mistake of a policyholder. Rather than presetting remedies for misrepresentations, this rule asks a court to decide the proper remedy according to any important circumstances of the case, including severity of misrepresentation, accountability of policyholder, factual causation and so on.

I. INTRODUCTION

* Associate Professor of Law, China University of Political Science and Law, College of Comparative Law. Beijing, China. S.J.D., LL.M (Honors) in Insurance Law, University of Connecticut School of Law.

** Corresponding author. Associate Professor, Department of Risk Management and Insurance, College of Commerce, National Cheng-Chi University, Taiwan. J. S. D., LL.M., University of Illinois at Urbana-Champaign. Ph.D. in Law, China University of Political Science and Law. Ph.D. in Law, M.S., LL.B., National Cheng-Chi University. E-mail: cyc@mail2.nccu.tw.

The authors would like to thank the participants in the symposium of Was the World Turned Upside Down? The ALI Restatement of the Law, Liability Insurance held at the University of Connecticut School of Law & Rutgers Law School. Qihao He acknowledges the financial support of Ministry of Education Research Program on Catastrophe Insurance (No. 18YJC820024), and China University of Political Science and Law Research Program on Climate Change Insurance (No. 10818433), and Comparative Private Law Innovation Project of CUPL(No.18CXTD05).

This research aims to analyze and compare the development of the Restatement of the Law of Liability Insurance ("RLLI") in the United States and the Insurance Act in China, with a focus on misrepresentation. By exploring their theoretical bases, especially the consideration of consumer protection, we will examine their uniformity and then provide recommendations. In recent years, many countries have significantly modified their insurance laws. In 2008, Germany, the United Kingdom, and the United States all modified their respective insurance contract law[1] with the intention of enhancing the protection of insurance consumers. Additionally, the U.K. enacted a new Consumer Insurance (Disclosure and Representations) Act in 2012 and Insurance Act in 2015, significantly modifying the preexisting regulation structure of Marine Insurance Act 1906 ("MIA") and demonstrating different treatment for consumer insurance law and commercial insurance law.[2] In the U.S., the most recent and important innovation is the publishing of the Restatement of the Law of Liability Insurance, which includes many critical rules of insurance law. Similarly, the Principles of the Law of Liability Insurance ("PLLI"), an earlier version of the RLLI, contained relevant discussions reflecting concerns about the "pro-insurer rule" and the "pro-insured rule." These developments demonstrate the continuing struggle for balancing the interests of policyholders and insurers.

The RLLI was recently published and is still developing and attracting discussion from scholars and practitioners. This is in contrast to Germany and the U.K., which have both finished revolutionizing their insurance law. Despite its recent publication, the RLLI continues to attract criticism.[3] More importantly, the current RLLI does not use a pro-insured approach for all of its rules,[4] and thus provides a valuable opportunity to reconsider and reexamine the current and popular pro-insured rule.

China is another important and interesting jurisdiction. It is

---

[1] Versicherungsvertragsgesetz [VVG] [Insurance Contract Act 2008], Nov. 23, 2007, BGBL I at 2631, last amended by BGBL I at 3214 (Ger.), https://www.gesetze-im-internet.de/englisch_vvg/englisch_vvg.html#p0111.

[2] Paul Jaffe, *Reform of the Insurance Law of England and Wales-Separate Laws for the Different Needs of Businesses and Consumers*, 87 TUL. L. REV. 1075, 1078 (2013); Chun-Yuan Chen, *Reassessing Accountability and Sophistication of Insured in Insurance Misrepresentation: Lessons and Implications for Taiwan*, 9 ASIAN J.L. & ECON. 1, 3 (2018).

[3] George L. Priest, *A Principled Approach Toward Insurance Law: The Economics of Insurance and the Current Restatement Project*, 24 GEO. MASON L. REV. 635, 662 (2017).

[4] *E.g.*, Tom Baker & Kyle D. Logue, *In Defense of the Restatement of Liability Insurance Law*, 24 GEO. MASON L. REV. 767, 783 (2017).

now the second largest insurance market in the world, and remains on track to become the biggest by the mid-2030s.[5] China has had a long-term debate about the position of insurance law in relation to commercial law. In other words, is insurance law a part of commercial law, which requires less preference for the insured in legislation, or a part of consumer protection law, which implies more protection mechanisms for consumers? More importantly, this argument in China substantially originates from another fundamental controversy: separation or integration of the civil code and the commercial code. This issue is highly controversial when considered with the General Principles of Commercial Law, which consists of general provisions of commercial code, and the General Rules of the Civil Law. Relevant debates did not stop after the General Rules of the Civil Law of the People's Republic of China was promulgated in 2017.[6] Based on such similarity, they are a possible reference for each other.

Since misrepresentation is one of the most important and controversial issues in insurance law, this study will reexamine the consumer protection preference in the subtopic of misrepresentation, including innocent misrepresentation, materiality, reliance, remedy, contribute-to-the-loss approach and so on. In sum, this study will explore the continuing debates about the pro-insurer rule and pro-insured rule in the RLLI in the U.S., as well as substantive issues of insurance law in China, and try to find an optimal model for the rules of misrepresentation.

II. THE ALI RESTATEMENT OF THE LAW, LIABILITY INSURANCE ON THE RULE OF MISREPRESENTATION

A. DEVELOPMENT OF THE RLLI: PRO-INSURED OR PRO-INSURER RULE

Since insurance products usually involve consumers with less sophistication and bargaining power than insurers, standardized forms are generally used. Additionally, legal mechanisms for improving the status of the consumer are common in insurance law, such as *contra proferentem* and the reasonable expectation rule.[7] However, the mentioned rules may have

---

[5] *World Insurance: The Great Pivot East Continues*¸ SWISS RE INST. (2019), https://www.swissre.com/dam/jcr:b8010432-3697-4a97-ad8b-6cb6c0aece33/sigma3_2019_en.pdf.

[6] Siyi Lin, *Looking Back and Thinking Forward: The Current Round of Civil Law Codification in China*, 52 INT'L LAW. 439, 440 (2019).

[7] James M. Fischer, *Why Are Insurance Contracts Subject to Special Rules of Interpretation?: Text Versus Context*, 24 ARIZ. ST. L.J. 995, 1017 (1992). *But see* Hazel Glenn Beh, *Reassessing the Sophisticated Insured Exception*, 39 TORT TRIAL & INS. PRAC. L.J. 85, 86 (2003).

the issue of "pro-insured bias."[8] A similar situation happens in the substantial rules of insurance law. The American Law Institute ("ALI") began drafting Principles of the Law of Liability Insurance in 2010. In 2014, the ALI converted an existing PLLI into a Restatement of the Law of Liability Insurance, which "restates" rules from existing case law.[9] Substantial parts of the first three chapters were approved in the 2016 annual meeting. The final version of the RLLI was approved in 2018,[10] the contents of which are still subject to considerable debate, especially whether the proposed rules are excessively "pro-insured" or "pro-insurer."[11] Most of the concern is that the PLLI or RLLI are more improperly preferable towards insureds. They may be too strict on insurers, disrupt the fairness and efficiency of insurance contracts, and, in the end, let insurers raise insurance premiums to pass the cost to policyholders.[12] This also implies that the specific rules proposed in the RLLI may be a result of policy considerations, either for insureds, insurers, or both. Thus, it is worthy of more attention to clarify the "pro-insured" or "pro-insurer" ideas behind the RLLI, before attempting to justify them or exploring any other balancing alternatives.

---

[8] *E.g.*, Peter Nash Swisher, *A Realistic Consensus Approach to the Insurance Law Doctrine of Reasonable Expectations*, 35 TORT & INS. L.J. 729, 758 n.128 (2000) ("Even if insurance contracts involve standardized agreements provided in the proverbial 'take it or leave it' fashion, the pro-insured bias may amount to excessive correction if courts fail to accurately and precisely identify the danger that standardized agreements present."); Fischer, *supra* note 7, at 996-97.

[9] Victor E. Schwartz & Christopher E. Appel, *Encouraging Constructive Conduct by Policyholders in the Restatement of the Law of Liability Insurance*, 68 RUTGERS U. L. REV. 455, 456 (2015).

[10] Press Release, Am. Law. Inst., The American Law Institute Approves Restatement of the Law, Liability Insurance (May 22, 2018), https://www.ali.org/news/articles/american-law-institute-approves-liability-insurance/; *see also* Kenneth S. Abraham, *Plain Meaning, Extrinsic Evidence, and Ambiguity: Myth and Reality in Insurance Policy Interpretation*, 25 CONN. INS. L.J. 329, 331 (2018); Michael Menapace, *Going Beyond the Four Corners to Deny a Defense: A Critique of Section 13(3) of the Restatement of Liability Insurance*, 53 TORT TRIAL & INS. PRAC. L.J. 795, 799 (2018).

[11] Scott E. Harrington & Alan B. Miller, *Economic Perspectives on the Restatement of the Law on Liability Insurance Project* 2-3 (2017), https://ssrn.com/abstract=2941892; Jay M. Feinman, *The Restatement of the Law of Liability Insurance As A Restatement: An Introduction to the Issue*, 68 RUTGERS U. L. REV. 1, 19 (2015). As for the example of duty to settle, see Leo P. Martinez, *The Restatement of the Law of Liability Insurance and the Duty to Settle*, 68 RUTGERS U. L. REV. 155, 167 (2015).

[12] Schwartz & Appel, *supra* note 9, at 457–58. For more discussions, see Priest, *supra* note 3, at 662; Baker & Logue, *supra* note 4, at 783.

B. STRUCTURE AND REMEDY OF MISREPRESENTATION

Many of the proposed rules of misrepresentation are highly correlated to the theme of "pro-insured" or "pro-insurer." The first critical issue is the framework of misrepresentation, which relates to the subjective element, remedy issues, and the status of innocent misrepresentation. In the general rules of common law, an insurer may void an insurance contract if a policyholder supplies false and material information to the insurer.[13] However, in the earlier version of the PLLI, the draft had an innovation for misrepresentation rules.[14] First, the insurer could only rescind the policy when the misrepresentation was either intentional or reckless. Also, the misrepresentation had to satisfy the elements of materiality and reliance, and the insurer had to return all paid premiums.[15] In this way, for the policyholder's negligent or innocent misrepresentation, the insurer has no right to rescind the policy. Furthermore, if the policyholder satisfies the definition of large commercial policyholder, then the mentioned rule is not mandatory.[16]

The PLLI provides another novel remedy, quasi-reformation, for misrepresentation with no intention or recklessness:[17]

> If the insurer would have issued the same policy but at a higher premium if the correct information had been supplied at the time of the application or renewal, the insurer must pay the claim at issue but may collect from the policyholder or deduct from the claim payment the additional premium that would have been charged.[18]

If the insurer would not have issued the policy for any premium if the correct information had been supplied at the time of the application or renewal, the insurer must pay the claim at issue but may collect from the

---

[13] Schwartz & Appel, *supra* note 9, at 460.

[14] PRINCIPLES OF THE LAW OF LIAB. INS. § 7 cmt. b (AM. LAW. INST., Tentative Draft No. 1, 2013).

[15] *Id*. § 7(2) ("an insurer may decline to pay a claim on the basis of a false or misleading representation made by a policyholder during the application or renewal process for the insurance policy and may, after returning all premiums paid by the policyholder, rescind the policy only if all of the following conditions are met: (a) The misrepresentation was either intentional or reckless as defined in § 8; (b) The insurer reasonably relied on the misrepresentation in issuing or renewing the policy as specified in § 9; and (c) The misrepresentation was material as defined in § 10.").

[16] *Id*. § 7(5).

[17] *Id*. § 11 cmt. a.

[18] *Id*. § 11(1).

policyholder or deduct from the claim payment a reasonable additional premium for the increased risk.[19]

Thus, in the event that misrepresentation is neither intentional nor reckless, instead of rescission of the policy, the policyholder has the right to receive the proceeds minus the additional premiums. The mentioned rules are arguably more preferable for the policyholder.

However, such special rules for misrepresentation about the policyholder's intent and quasi-reformation remedy are both removed in the following RLLI, because there is no legal support in common law.[20] Also, the RLLI disregards the distinction between small and large commercial policyholders. In the current RLLI, rescission of the insurance contract is not limited to intentional or reckless misrepresentation,[21] and no special rule like quasi-reformation remedy is available for innocent misrepresentation. The remedy will not be different because of the sophistication of the policyholder either.[22] In the end, there is no obvious classification of misrepresentation which leads to a different remedy.[23] Insurers may rescind the policy even for innocent misrepresentation. The reporter in the RLLI justifies that the misrepresentation rule in many common law jurisdictions is substantially one of strict liability.[24] Thus, this rule is obviously more preferable for insurers, in contrast to the rule in the PLLI, which is preferable for policyholders.

Essentially, the rules in the PLLI (intentional and reckless misrepresentation rule) and the RLLI (strict liability misrepresentation rule) have opposing pros and cons. The PLLI's rule is more lenient for policyholders because one can still get coverage in the case of innocent or negligent misrepresentation. In contrast to the RLLI, under this rule, the insurer assumes the substantial risk of compensating innocent misrepresentations and this thereby encourages better underwriting.[25]

---

[19] *Id*. § 11(2).

[20] Baker & Logue, *supra* note 4, at 784.

[21] RESTATEMENT OF THE LAW LIAB. INS. § 7(1) (AM. LAW INST., Proposed Final Draft No. 2, 2018).

[22] *See* Caroline Wood, *A Reformation Remedy for Educators Professional Liability Insurance Policies*, 65 EMORY L.J. 1411, 1416 (2016).

[23] RESTATEMENT OF THE LAW LIAB. INS. § 7(2) (AM. LAW INST., Proposed Final Draft No. 2, 2018) ("Subject to the rules governing defense obligations, an insurer may deny a claim or rescind the applicable liability insurance policy on the basis of an incorrect representation made by a policyholder in an application for an insurance policy only if the following requirements are met: (a) The misrepresentation was material as defined in § 8; and (b) The insurer reasonably relied on the misrepresentation in issuing or renewing the policy as specified in § 9.").

[24] *Id*. § 7 cmt. j

[25] Lorelie S. Masters, Amy R. Bach & Daniel R. Wade, *The American Law Institute Principles/Restatement of the Law of Liability Insurance: Part*

However, criticisms are that the policyholder is in the better position to avoid innocent misrepresentation [26] because of his knowledge of his own experience and facts about the loss.[27] The PLLI shifts the burden of the investigation of the history of the insurance applicant from himself to the insurer, ignoring cost effectiveness.[28] Furthermore, misrepresentation may influence the insurer's assessment, and the estimation of the reasonable premium for increased risk in quasi-reformation remedy may be difficult.[29]

As for the RLLI rule, innocent misrepresentation is still subject to the remedy of rescission. The powerful remedy of rescinding the contract may provide a stronger incentive for the policyholder to comply with the duty of disclosure.[30] But there are fairness concerns because a mere innocent misrepresentation will make a policy voidable. Such result may be too harsh and unfair for the policyholder.[31] Some jurisdictions have other mechanisms to alleviate fairness issues, such as requiring the insurer to introduce evidence that it would not have approved the application if accurate information had been supplied.[32] Also, innocent misrepresentation is one of the risks that risk-averse policyholders prefer to shift to insurers, and thus this rule may not be efficient.[33]

Theoretically, the intentional and reckless misrepresentation rule in the PLLI is more pro-insured, whereas the strict liability misrepresentation rule in the RLLI is pro-insurer. Even though the intentional and reckless misrepresentation rule was present in an earlier version of the PLLI, it has been abandoned in the RLLI. Some parts of the RLLI keep the intentional and reckless misrepresentation rule, but it is just an option for courts instead of a proposed rule. For example, to defend Professor Priest's criticism that the intentional and reckless misrepresentation rule has concerns of efficiency, Professor Tom Baker and Professor Kyle Logue clarify that this rule is not applied in the RLLI, and it is retained as a possible alternative to the contribute-to-the-loss approach.[34] In other words, since the RLLI rejects the contribute-to-the-loss approach, if a court would like to alleviate the issue that can be addressed by such rule, it is better off considering the intentional

---

III Selected Comments from a Policyholder Perspective 35 (LexisNexis July 2015).

[26] Schwartz & Appel, *supra* note 9, at 464-65; Chen, *supra* note 2, at 8.

[27] Priest, *supra* note 3, at 654.

[28] *Id.* at 655.

[29] Schwartz & Appel, *supra* note 9, at 465.

[30] *Id*. at 464.

[31] RESTATEMENT OF THE LAW LIAB. INS. § 7 cmt. j (AM. LAW INST., Proposed Final Draft No. 2 2018).

[32] Masters, Bach & Wade, *supra* note 25, at 33.

[33] RESTATEMENT OF THE LAW LIAB. INS. § 7 cmt. j (AM. LAW INST., Proposed Final Draft No. 2 2018).

[34] Baker & Logue, *supra* note 4, at 786-87.

and reckless misrepresentation rule.[35] Regardless of the argument of efficiency, the development from PLLI to RLLI shows a shift from pro-insured rule to pro-insurer.

C. MATERIALITY

The RLLI defines the Materiality Requirement as: "but for the misrepresentation, a reasonable insurer in this insurer's position would not have issued the policy or would have issued the policy only under substantially different terms."[36] In order to distinguish the reliance element, the RLLI emphasizes that materiality is a purely objective inquiry in that the insurer needs to demonstrate that there is an objectively reasonable basis for the judgment in regular underwriting.[37] The criteria of that judgment is a "reasonable insurer" instead of a particular or "ordinary or average" insurer, because this rule may better cover the scenario where an innovative insurer asks the questions that ordinary insurers would not.[38] In such a case, the question asked by an innovative insurer is generally not asked by an ordinary or average insurer. In this sense, an ordinary insurer is less likely to satisfy the reasonableness standard. Thus, it seems that the reasonable insurer standard is stricter for an insurer and more preferable for a policyholder.

D. RELIANCE

The RLLI defines the reasonable reliance requirement as: "[t]he reliance requirement of § 7(2)(b) is met only if: (1) but for the misrepresentation, the insurer would not have issued the policy or would have issued the policy only with substantially different terms; and (2) Such actions would have been reasonable under the circumstances."[39] In contrast to materiality, reliance in the RLLI is primarily defined as a subjective element, identifying "the impact of misrepresentation on the particular insurer."[40] The reasonableness element in reliance, an objective element, focuses on "whether the insurer reasonably failed to discover or act upon the truth." An insurer must prove that an objectively reasonable insurer in the insurer's position would not discover the misrepresentation.[41] Similar to the objective materiality issue, an insurer needs to prove reliance to the degree of a reasonable insurer. This may urge an insurer to conduct further and more

---

[35] RESTATEMENT OF THE LAW LIAB. INS. § 9 cmt. b. (AM. LAW. INST., Proposed Final Draft 2018).
[36] *Id.* § 8.
[37] *Id.* § 8 cmt. c.
[38] *Id*. § 8 cmt. d.
[39] *Id*. § 9.
[40] *Id*. § 9 cmt. a.
[41] *Id*. § 9 cmt. d.

serious investigation to satisfy this element.[42] Overall, it is harsher for an insurer and more advantageous for a policyholder.

As mentioned above, the RLLI clarifies objective elements in materiality and reliance. The insurer has the responsibility to prove that and assumes risk if he fails to do so. This also attracts some criticisms, such as: "these rules … will have the economic effect of reducing insurance availability to the society by increasing the costs and reducing the predictability of the underwriting process."[43] Generally, rules for materiality and reliance are more preferable for a policyholder than an insurer.

E. CONTRIBUTE-TO-THE-LOSS APPROACH

Another important issue is that, unlike some jurisdictions, the RLLI rejects the contribute-to-the-loss rule, which is also referred to as the causal relation doctrine.[44] Under this rule, an insurer cannot reject a claim from a policyholder if there is no causal relation between the accident and the fact misrepresented. The RLLI does not follow this approach for the following reasons: first, the current RLLI rule is better off than the contribute-to-the-loss rule, because all kinds of misrepresentation will be penalized rather than only misrepresentations which contribute to the loss;[45] second, when the precise relationship between cause of loss and misrepresentation is hard to prove, an insurer will substantially suffer the cost. Unfair cross-subsidies occur here since a high-risk policyholder who has misrepresented without precise evidence of causation may be subsidized by a low-risk policyholder who does not misrepresent at all.[46] There is no sufficient common law authority to support this rule.[47] Finally, as mentioned above, the RLLI suggests that the benefit of the contribute-to-the-loss rule can be better addressed by applying the intentional/reckless approach, which limits rescission to the case where the policyholder misrepresentation is intentional or reckless.[48]

The current approach applies the increased-risk standard in materiality instead of the contribute-to-the-loss approach. However, this is still subject to some criticisms, such as the fact that the proposed rule and reason are lacking sufficient support and explanation. Also, as a suggested

---

[42] *Id.*

[43] Priest, *supra* note 3, at 655.

[44] *Compare* RESTATEMENT OF THE LAW LIAB. INS. § 9 cmt. b (AM. LAW INST., Proposed Final Draft No. 2, 2018), *with* Henrik Lando, *Optimal Rules of Negligent Misrepresentation in Insurance Contract Law*, 46 INT'L. REV. L. & ECON. 70, 71 (2016).

[45] RESTATEMENT OF THE LAW LIAB. INS. § 9 cmt. b (AM. LAW INST., Proposed Final Draft No. 2, 2018).

[46] *Id.*

[47] *Id.*

[48] *Id.*

alternative for the intentional/reckless approach, it may fail to clarify the insurer's burden of proof.[49] Generally, the RLLI rejects the contribute-to-the-loss rule, and thus an insurer can rescind the policy as long as misrepresentation occurs regardless of the relationship between cause of loss and misrepresentation. Across the spectrum of pro-insurer and pro-insured, the RLLI rule is obviously more pro-insurer.[50]

III. CHINESE INSURANCE LAW ON THE RULE OF MISREPRESENTATION

One of the greatest achievements or efforts of the RLLI is conceptualizing insurance law as a unique field.[51] The Sino-American comparative research is motivated by the debate whether the particular proposed rules of both the RLLI in the U.S. and the Insurance Act in China (as well as the Supreme People's Court Judicial Interpretations on Certain Questions Concerning the Application of the Insurance Act)[52] might be construed as either "pro-insured" or "pro-insurer" when facing legal action.[53] The theoretical argument behind the "pro-insured" or "pro-insurer" debate is the controversy that exists between insurance contract law, business law, and consumer law. Comparative thinking is, therefore, best informed by highlighting a few of the distinctions between American and Chinese insurance law and litigation. We explore and argue that the proposed insurance rules, whether "pro-insured" or "pro-insurer," should be "in the long-term interest of policyholders with respect to maximizing the availability of insurance to society."[54] And we will apply this benchmark to test Chinese rules in the area of misrepresentation.

---

[49] Masters, Bach & Wade, *supra* note 25, at 34.

[50] Baker & Logue, *supra* note 4, at 782-83.

[51] *Tom Baker works to define the field of liability insurance law*, PENN LAW (June 20, 2016), https://www.law.upenn.edu/live/news/6274-tom-baker-works-to-define-the-field-of-liability#.V2lC3qIsAwd.

[52] According to the Stipulation of the Supreme People's Court on the Judicial Explanation (2007 No. 12), the Supreme People's Court judicial interpretation has legal effect. And it is worth to state the role of the Supreme People's Court and its Judicial Interpretation. Since China is not the case law system, it means that insurance law principles are largely uniform law developments built up from predominantly the Judicial Interpretations (not all the decisions) of Supreme People's Court of China that are binding on the entire country. *See The Stipulation of the Supreme People's Court on the Judicial Explanation*, 13 New Laws and Regulations 45, 45-48 (2007).

[53] Harrington & Miller, *supra* note 11.

[54] Priest, *supra* note 3, at 653

A. A BRIEF OVERVIEW OF CHINESE INSURANCE LEGISLATION AND ITS GUIDING PRINCIPLES

The first statute on insurance was enacted in 1995 and included provisions on both insurance contracts and insurance regulation.[55] The Insurance Act of 1995 was then amended in 2002, 2009, and 2015. The Insurance Act of 1995 adopted de facto more pro-insurer rules than its amendments in order to enhance the development of insurance business, and thus provided more incentives for insurers while paying less attention to consumer protection.[56] The good thing is that China's insurance industry has developed dramatically since 1995. The data shows that in less than 20 years, the annual premium income has risen *2800%* through 2017, making China the second largest insurance market in the world.[57] Unfortunately, the insurance business earned a bad reputation due to the difficulty of getting compensation for the insured.[58] And that is why the consumers often view the insurers as liars. Over time, the fast growth of the insurance market and an increasing number of consumers created a demand for more regulation to protect consumers.[59]

The long-awaited 2009 amendment expressly expanded consumer rights and provided more protection provisions for the insured by replacing major articles of the original act. This transition reflects the legislator's shift in attitude from emphasizing the development of the insurance industry to embracing consumer protection, and from emphasizing freedom of contract to accepting contractual justice.[60] In addition, since 2009, the Supreme People's Courts ("SPC") has published four judicial interpretations of the Insurance Act: in 2009 (the SPC Interpretation I), 2013 (the SPC Interpretation II), 2015 (the SPC Interpretation III) and 2018 (the SPC

---

[55] ZHEN JING, CHINESE INSURANCE CONTRACTS LAW AND PRACTICE 32-43 (2017).

[56] WEI ZHENG, GAIGE KAIFANG SISHINIAN DE BAOXIAN JIANGUAG [THE 40 YEARS INSURANCE REGULATION IN THE AFTERMATH OF REFORM AND OPENING UP] 73-77 (China Acad. Journal Elec. Publ'g House 2019).

[57] Editorial, *China's Awakening Sends Shockwaves Around the World*, ATLAS MAG., 1 (Oct. 2018), https://www.atlas-mag.net/en/issue/china-s-awakening-sends-shockwaves-around-the-world.

[58] CHRISTIAN NOTHHAFT, MADE FOR CHINA: SUCCESS STRATEGIES FROM CHINA'S BUSINESS ICONS 151 (Springer Int'l Publ'g 2018).

[59] Kaun-Chun Chang, *Commentaries on the Recent Amendment of the Insurance Law of the People's Republic of China Regarding Insurance Contracts from the Perspective of Comparative Law*, 10 WASH. U. GLOBAL STUD. L. REV. 749, 752-53 (2011).

[60] XU CHONGMIAO & LI LI, ZUI XIN BAO XIAN FA SHI YONG YU AN LI [NEWLY AMENDED INSURANCE LAW—APPLICATION & CASES] 14 (2009).

Interpretation IV), [61] and aims to clarify the ambiguous articles of the Insurance Act in order to strengthen the protection of the insured.

In contrast, in the U.S., the transition of the Principles Project to a Restatement raised vigorous opposition from the insurance industry concerning many pro-insured provisions, with the rule of misrepresentation being one of the most contentious provisions. [62] China made major modifications regarding insurance misrepresentation, and the guiding principle of the 2009 Amendment, the subsequent Amendments, and the SPC Interpretations is to enhance consumer protection and mitigate the insured's responsibility.[63]

B. STRUCTURE AND REMEDY OF MISREPRESENTATION

In the RLLI, misrepresentation is defined as an incorrect statement of fact made by a policyholder in an application for an insurance policy, and there are two requirements (materiality and reasonable-reliance) for which an insurer may deny a claim or rescind the applicable insurance policy.[64] In Chinese insurance law, misrepresentation falls under the insured's duty of disclosure, since it was originally introduced to protect the interest of insurers due to information asymmetry.[65] The general rule of the insured's misrepresentation is Article 16 of the Insurance Act (2015). This rule has been modified several times, especially by the Insurance Act (2009) and SPC Interpretation II (2013), focusing on the protection for insurance consumers. It provides that:

> Article 16
>
> (1) Where the insurer makes any inquiry about the subject matter insured or about the insurant when entering into an insurance contract, the insurance applicant shall tell the truth.
>
> (2) The insurance applicant fails to perform the obligation of telling the truth as prescribed in the preceding paragraph intentionally or for gross negligence, which is enough to affect the insurer's decision on whether to underwrite the insurance or raise the insurance premium, and thus the insurer shall have the right to rescind the contract.

---

[61] The Interpretation I 2009 focuses on the application of the Insurance Act 2009 amendment. The Interpretation II 2013 is mainly on general rules of insurance contracts. The Interpretation III 2015 focuses on life insurance, while the Interpretation IV 2018 focuses on property and liability insurance.

[62] Schwartz & Appel, *supra* note 9, at 460-65.

[63] Chang, *supra* note 59, at 767.

[64] RESTATEMENT OF THE LAW LIAB. INS. §§ 7-9 (AM. LAW INST. 2019).

[65] HAILIN ZOU, INSURANCE LAW 126 (2017).

> (3) The right to rescind as stated in the preceding paragraph shall be extinguished if not exercised within 30 days of the time the insurer knows of the cause for rescission. Once 2 years have elapsed after the contract is entered into, the contract may not be rescinded even if cause for rescission exists; where an insured incident occurs, the insurer shall be liable for paying indemnity or insurance benefit.
>
> (4) Where the insurance applicant intentionally fails to perform the obligation of telling the truth, the insurer shall not be liable for paying indemnity or insurance money for an insured incident that occurs before the contract is rescinded, and shall not refund the insurance premium.
>
> (5) Where an assured in gross negligence fails to make truthful disclosure so as to contribute materially to the occurrence of an insured event, the insurer shall not be liable for paying indemnity or insurance money for an insured incident which occurs before the contract is rescinded, but shall refund the insurance premium.
>
> (6) Where the insurer knowing the truth which the insurance applicant fails to tell enters into an insurance contract with the insurance applicant, the insurer shall not rescind the contract and, if an insured incident occurs, shall be liable for paying indemnity or insurance money.[66]

Section 1 proclaims the insured's duty of disclosure. Section 2 defines the meaning and elements of failure to meet the duty of disclosure. That includes: (a) subject fault ("intentionally or gross negligence"); (b) materiality ("affect the insurer's decision on whether to underwrite the insurance or raise the insurance premium"); and (c) remedy for breach of the duty ("the insurer shall have the right to rescind the contract"). Section 3 and 6 stipulate the limitations of the insurer's remedies, which is also called the incontestability clause and the waiver clause. Section 4 and 5 discuss the consequences due to the insured's intentional failure to disclose a material fact or by gross negligence respectively.

The Insurance Act provides different legal remedies depending on the type of breach. If the insured intentionally misrepresents material facts in applying for insurance, the insurer is entitled to rescind the contract, is not responsible for the loss, and does not have to refund the premium. If the insured misrepresents material facts by gross negligence, the insurer is entitled to rescind the contract, is not responsible for the loss, but has to

---

[66] Insurance Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Congr., June 30, 1995, effective April 24, 2015), art. 16.

refund the premium.[67] If the insured only negligently or innocently misrepresents material facts, the insurer is not entitled to rescind the contract, and is liable for the loss caused by the insured occurrence.[68] Unlike the RLLI rule, where innocent misrepresentation is still subject to the remedy of rescission, China has adopted and maintained a pro-insured rule since its 2009 Amendment.

For intentional misrepresentation there is little debate, but not for gross negligence. It could be justified to punish the policyholder for intentionally violating the duty of disclosure. It might not be justified for instances of gross negligence considering the non-sophistication of the insured in risk assessment. The insured could only get the refund premium due to gross negligence, however, he or she has no right to ask for insurance compensation. This "all-or-nothing" legal consequence seems too harsh for the insured, since it is the same result if he or she intentionally breaches the duty. As for the alternative and more pro-insured choice, it is suggested that the insurer may reduce the compensation amount "to be paid proportionately to the ratio of premium he received and the premium he should have received."[69]

As remedies for the insurer, he enjoys the right of contract rescission (Rücktritt) and the right of nonpayment of claims. In order to protect the insured, the insurer shall rescind the contract at first and then declare for the right of nonpayment of claims.[70] In other words, the insurer could not refuse to pay the claims directly without contract rescission.

C. THE SCOPE OF THE DUTY OF DISCLOSURE: INQUIRY-BASED DISCLOSURE

There are two types of disclosure: inquiry-based disclosure and voluntary disclosure. Originally, the insured voluntarily disclosed the material information to assist the insurer in risk assessment, since the

---

[67] *Id.*

[68] Insurance Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Congr., June 30, 1995, effective Oct. 1, 2009), art. 16; Insurance Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Congr., June 30, 1995, effective Oct. 28, 2002), art. 17.

[69] Zhen Jing, *Remedies for Breach of the Pre-Contract Duty of Disclosure in Chinese Insurance Law*, 23 CONN. INS. L.J. 327, 346-47 (2017).

[70] Zuìgāo Rénmín Fǎyuàn Guānyú Shìyòng "Zhōnghuá Rénmín Gònghé guó Bǎoxiǎnfǎ" Ruògān Wèntí De Jiěshì (Er) (最高人民法院关于适用《中华人民共和国保险法》若干问题的解释(二)) [Interpretation of the Supreme People's Court on Several Issues Concerning the Application of the Insurance Law of the People's Republic of China (2)] (Sup. People's Ct. 2013).

insurance contract is traditionally regarded as the utmost good faith contract.[71] The Maritime Code of China includes the provisions on marine insurance that adopts voluntary disclosure.[72] It reads in pertinent part:

> Article 222
>
> [B]efore the contract is concluded, the insured shall disclose to the insurer material circumstances which the insured has knowledge of or ought to have knowledge of in his ordinary business practice and which would influence the insurer in deciding the premium or whether he agrees to insure or not.[73]

However, the voluntary disclosure approach means that the insured's duty of disclosure is not limited to the scope of the insurer's inquiry, and the adverse consequences that the insured fails to inform will be imposed on the insured.[74] It puts a pretty heavy burden on the insured, and seems neither reasonable nor fair for the unsophisticated insured. Therefore, the Insurance Act of 1995 disregarded voluntary disclosure and directly adopted the inquiry-based disclosure. Article 16 (1) of the Insurance Law, as amended in 2009 and 2015 follows the same approach. This approach is clearly the pro-insured rule, which encourages the regulatory and constructive conduct of the insurer. The regulatory function of the insurer, which reflects the socioeconomic role of insurance, is a valuable lens for supporting the pro insured rules and adjudicating the insurers' operation.[75]

From voluntary and active disclosure to inquiry-based passive notification, the insured will only provide information to the extent that the insurer asks. It raises two disputed questions. The first question is whether the insured should inform the insurer of the information outside the scope of the insurer's inquiry, if the information is material. The China Insurance Regulatory Commission (CIRC) once affirmed the recognition that if the insurer does not ask, the insured need not inform.[76] However, one year later,

---

[71] Chang, *supra* note 59, at 764.

[72] *See* Maritime Code of the People's Republic of China (promulgated by the Standing Comm. People's Cong., Nov. 7, 1992, effective Nov. 7, 1992), art. 222, http://www.ilo.org/dyn/natlex/natlex4.detail?p_lang=en&p_isn=31944&p_country=CHN&p_count=1097 (China).

[73] *Id.*

[74] ZOU, *supra* note 65, at 125.

[75] Jeffrey W. Stempel, *Enhancing the Socially Instrumental Role of Insurance: The Opportunity and Challenge Presented by the ALI Restatement Position on Breach of the Duty to Defend*, 5 U.C. IRVINE L. REV. 587, 590 (2015).

[76] Notice on Problems in Rectifying Life Insurance Clauses (promulgated by the China Ins. Regulatory Comm'n, 2006, effective 2006),

the CIRC restated that if the insured knows or should know that certain material matters involve the determination of the insurability, which affects the insurer's decision whether to underwrite or increase the insurance premium, even if the insurer has not made a clear inquiry, the insured should inform the insurer of the information.[77] To restrict the insured's obligation, the SPC Interpretation clarified that for the information outside the inquiry form, the insured is obligated to disclose only what he actually knows, not what he should know.[78]

The second question is whether all the questions the insurer asked fall into the scope that the insured has to answer, especially for the general clauses listed in the insurance policy inquiry form. This question is not addressed in the Insurance Act, but the SPC Interpretation II clarifies that not all the questions asked by the insurer should be truthfully informed.[79] If the insurer is not asking about important facts, the insured does not breach the duty even by concealing or misrepresenting.[80] In other words, the insurer's inquiry needs to be material facts which could restrict the insured. The next issue is to explore how to decide the materiality of the facts, which is also one element of the breach of the duty of disclosure.

D. MATERIALITY

Among the questions asked by the insurer, the facts that involve the assessment of the underwritten risks should be material facts. A material fact is defined as one "[which] is enough to affect the insurer's decision on whether to underwrite the insurance or raise the insurance premium."[81] There are two questions left to be addressed for the definition. First, it is still unsettled that the term "insurer" mentioned in Art. 16(2) should be understood as either the insurer in the specific case ("the subjective standard") or a reasonable insurer ("the objective standard"). Considering the protection

---

no. 318 (This Notice has been abolished).

[77] Reply on Issues Related to Insurance Contract Disputes (promulgated by the China Ins. Regulatory Comm'n, Feb. 21, 2006, effective Feb. 21, 2006).

[78] Interpretation of Supreme People's Court on Several Issues pertaining to Application of the Insurance Law of the People's Republic of China (II) (promulgated by the Sup. People's Ct., May 31, 2013), art. 5; s*ee also* Jing, *supra* note 69, at 331.

[79] Interpretation of Supreme People's Court on Several Issues pertaining to Application of the Insurance Law of the People's Republic of China (II) (promulgated by the Sup. People's Ct., May 31, 2013), art. 6.

[80] Min Chang, *Study on Insurance Contract Incontestability System*, 2 GLOBAL L. REV. 76-91 (2012).

[81] Insurance Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., June 30, 1995, effective Apr. 24, 2015), art. 16.

of the insured, especially the non-sophistication and reasonable expectations of the insured, many courts have adopted the "objective standards" and treated the insurer as the prudent insurer.[82]

Second, in contrast to the RLLI, Chinese insurance law has not proscribed what approach could be used to evaluate materiality. In judicial practices, different courts adopted different judgment standards, which ultimately led to far-reaching judgment results. Previously, as a general rule, all the questions specifically asked by the insurer are important facts.[83] However, the SPC Interpretation denied this approach, but adopted a more pro-insured attitude: "not all the questions asked by the insurer should be truthfully informed."[84] It indicates that if the question asked by the insurer is not a material fact, the insured could reject information or misrepresent without adverse consequence.

For this issue, the RLLI adopts the pro-insurer rule "increased-risk standard in materiality" and rejects the "contribute-to-the-loss" approach.[85] However, following the central philosophy of consumer protection, China adopts the pro-insured "contribute-to-the-loss" approach, and puts the burden on the insurer in misrepresentation, at least for misrepresentation made by the "gross negligence" of the insured.[86]

E. SUBJECT FAULT: INTENTIONALLY OR GROSS NEGLIGENCE

The subject fault of the duty of disclosure matters not only in evaluating materiality, as discussed above, but also causes different legal consequences which we will discuss in the next section. The subjective fault in the Insurance Act 2009 Amendment was changed from "negligence" to "gross negligence," and thus it only distinguishes misrepresentation that can

---

[82] Zhen Jing, *Insured's Duty of Disclosure and Test of Materiality in Marine and Non-Marine Insurance Laws in China*, J. BUS. L. 681, 686-87 (2006).

[83] XIN CHEN, INSURANCE LAW 64 (2010).

[84] Interpretation of Supreme People's Court on Several Issues pertaining to Application of the Insurance Law of the People's Republic of China (II) (promulgated by the Sup. People's Ct., May 31, 2013), art. 6.

[85] Baker & Logue, *supra* note 4, at 782-83. For a discussion of the contribution to the loss rule in relation to materiality, see generally Kathryn H. Vratil & Stacy M. Andreas, *The Misrepresentation Defense in Causal Relation States: A Primer*, 26 TORT & INS. L.J. 832, 835 (1990).

[86] Insurance Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., June 30, 1995, effective Apr. 24, 2015), art. 16 ("Where a policyholder failed to perform the obligation to provide truthful information due to gross negligence which has a serious impact on the occurrence of an insured event, the insurer shall not be liable to make compensation or payment . . .").

be made intentionally or by gross negligence.[87] In other words, the subjective fault of the insured is limited to "intentionally or [through] gross negligence," and thus increases the protection for the insured. The significance of China's insurance law adopting the "gross negligence" instead of "negligence" of the policyholder as the subject fault, may not only expand the degree of insured's fault, but also provide a more operational path to limit the insurer's right of rescission of the contract.[88] However, the problem is that there is no definition of "gross negligence" in the Act, and this creates confusion in deciding to what extent the insured's misrepresentation can be attributed to "gross negligence" rather than "negligence."[89]

The Insurance Act of 1995 provided a similar rule to that of the RLLI, "[i]f the assured fails to make such a disclosure as provided in the preceding paragraph in negligence, and such breach of disclosure duty is material for an insured event, insurer could rescind the contract and return the premium."[90] However, the Insurance Act of 2009 Amendment protects "innocent misrepresentation" only if the insured made the misrepresentation with intent to deceive or gross negligence. In those instances, the insurer could rescind the contract.[91] The Insurance Act of 2009 Amendment adopts a similar pro-insured rule to that in the PLLI.[92]

F. A SHORT SUMMARY

As for the nature of insurance law, in the U.S., it "is neither a branch of private contract law nor of public commercial law, but is its own field that

---

[87] *Id.*

[88] ZOU, *supra* note 65, at 130.

[89] *See, e.g.*, Ergang Chen v. China Life Luliang County Branch, YunNan Luniang District People's Court, No. 1233 (2018); Yingchun Huo v. China Pingan Insurance Chifeng Branc, Inner Mongolia Hongshan District People's Court, No. 474 (2015).

[90] Insurance Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., June 30, 1995, effective June 30, 1995), art. 16.

[91] Changyin Han, *A Comparative Review on Mainland and Taiwan Insurance Contract Law: Focus on Mainland Insurance Act 2009 Amendment*, 7 INS. STUD. 3, 7-8 (2009).

[92] Schwartz & Appel, *supra* note 9, at 462-63 ("Where a policyholder negligently provided information to obtain an insurance policy, the Principles project established a novel 'quasi-reformation remedy.'"). Under this approach, the insurer was required to pay the claim of the negligent policyholder in full but could recoup some higher premium for the increased risk the insurer would have undertaken had the policyholder supplied the correct information when asked. *See* PRINCIPLES OF THE LAW OF LIAB. INS. § 7 cmt. b (AM. LAW INST., Tentative Draft No. 1, 2013).

includes aspects of both public and private law."[93] In China, under the background of the drafting Civil Code, insurance law is not seriously governed by the forthcoming Civil Code. There are only a few articles related to auto compulsory liability insurance (with Traffic Accident Social Assistance Fund) in the section of tort liabilities, for the purpose of providing compensation to the insureds and the third-party victims.[94] Insurance contracts were originally considered to be commercial contracts since their oldest form is marine insurance. From this perspective, insurance law should be regarded as part of commercial law. However, there is no General Principles of Commercial Law, let alone the Commercial Code in China. Insurance law constitutes the subject of special legislation as its own field in China.

Similar to the RLLI, China has no special rules or acts excluding the application of insurance law to business insurance. Thus, the current laws regarding the duty of disclosure shall be applied for all insureds. Moreover, China does not distinguish "sophisticated commercial insureds"[95] from "individual insureds," which resembles the difference between "business insurance" and "consumer insurance."

It is also worth using the developments in behavioral science to determine what consumers understand and why pro-insured rules are credited.[96] In addition, insurance technologies have enabled the insurer to better evaluate risk and underwrite the policy. On the contrary, behavioral economists explain consumers' anomalies as intuitive thinking bias in risk assessment.[97] What's more, the insured may conduct myopic loss aversion.[98] He or she may simply ignore the adverse consequences of misrepresentation and will not disclose all information voluntarily in fear of a higher premium,

---

[93] Jeffrey E. Thomas, *Insurance Law Between Business Law and Consumer Law*, 58 AM. J. COMP. L., 353, 353 (2010).

[94] Zhōnghuá Rénmín Gònghéguó Mínfǎ Diǎn Caoan (中华人民共和国民法典草案)[Civil Code of the People's Republic of China (draft)] (promulgated by Nat'l People's Cong., March 2020), art. 1213, 1215, 1216, https://npcobserver.files.wordpress.com/2019/12/civil-code-draft.pdf, 232-33, *translated in* google translate.

[95] The sophisticated insured doctrine is often regarded as one pro-insured rule since it is a common law rule that distinguishes (to some extent) between commercial and individual insurance consumers in the U.S. Since there is no uniform definition as to what constitutes a sophisticated insured, and it has not gained universal acceptance, this doctrine is not adopted in the RLLI. *See* Thomas, *supra* note 93, at 362-63.

[96] James Davey, *Fracturing and Bundling Risks: The Coverage Expectations of the "Real" Reasonable Policyholder*, 11 RUTGERS J. L. & PUB. POL'Y 118, 167 (2013).

[97] DANIEL KAHNEMAN, THINKING, FAST AND SLOW 20–21 (2011).

[98] *See* Shlomo Benartzi & Richard H. Thaler, *Myopic Loss Aversion and the Equity Premium Puzzle*, 110 Q.J. ECON. 73 (1995).

and this attitude makes consumers underestimate the risks of being exposed to harsh consequences.

IV. COMPARATIVE COMMENTS AND IMPLICATIONS

A. STRUCTURE AND REMEDY OF MISREPRESENTATION

1. Clarification of the RLLI

The RLLI in the U.S. and insurance law in China share important differences as well as similarities. One of the most critical differences will be the structure and remedy of misrepresentation. China differentiates rescission of contract according to the accountability of the policyholder. Insurers may rescind an insurance contract for a policyholder's intentional and reckless misrepresentation, but not for an innocent one. This model is similar to the rules in the United Kingdom, Germany, and the intentional/reckless approach in the PLLI. In the U.S., the RLLI changes the rule in the PLLI and does not categorize misrepresentation according to the accountability of the policyholder. Any misrepresentation may cause rescission of the insurance contract by the insurer, and this is in fact a strict liability rule. The structure and remedy of misrepresentation in the RLLI and China are likely in different positions on the spectrum, but their development may have implications for each other.

Even though the current rule in the RLLI is the strict liability misrepresentation rule, it is worth scrutinizing the reason why it abandons the intentional and reckless misrepresentation rule and its justification for doing so.[99] In the early version, the PLLI adopted an intentional and reckless misrepresentation rule as an "innovation," because the strict liability misrepresentation rule is unfair and inefficient. The loss caused by an unintentional mistake shall be one of the risks that the policyholder purchases liability insurance for.[100] Policyholders also purchase liability insurance for the purpose of "shifting the financial risks of their negligent conduct to insurers."[101] In other words, it is more likely justified to punish intentional misrepresentation, since this is correlated to adverse selection from policyholder. This will let the honest members of the insurance pool cross-subsidize dishonest members. However, an honest mistake would be less likely to cause this concern, and to cover such loss is generally the purpose of purchasing liability insurance.[102] Thus, "the strict liability version of the misrepresentation defense is also inefficient, insofar as it

---

[99] Baker & Logue, *supra* note 4, at 786.

[100] PRINCIPLES OF THE LAW OF LIAB. INS. § 7 cmt. b (AM. LAW INST., Tentative Draft No. 1 2013).

[101] *Id.*

[102] Baker & Logue, *supra* note 4, at 784.

results in a misallocation of risk."[103]

Interestingly, the later version of the RLLI abandons the intentional and reckless misrepresentation rule and replaces it with the strict liability misrepresentation rule. However, it seems that there are no further and theoretical reasons for this change, except the explanation that there is no sufficient common law authority to support the intentional and reckless misrepresentation rule.[104] In later debates between the Reporters and Professor Priest at Yale Law School, they emphasize and clarify that the intentional and reckless misrepresentation rule is no longer adopted in the RLLI, but they still once again explain the possible unfairness and inefficiency of the strict liability misrepresentation rule.[105] But for the reason that the restatement is to "restate the common law governing all such liability insurance contracts" rather than create a new rule,[106] Reporters do not theoretically reject the intentional and reckless misrepresentation rule. More likely, the Reporters reluctantly accepted the strict liability misrepresentation rule for the RLLI. Regardless of the nature of the restatement and policy considerations, it should be fair to say that the RLLI does not theoretically reject the intentional and reckless misrepresentation rule. In this sense, it may be too quick to say the RLLI prefers the current strict liability misrepresentation rule and negates the intentional and reckless misrepresentation rule.

2. Efficiency issue

As discussed, the U.S. changed from the more pro-insured PLLI to the more pro-insurer RLLI. Conversely, China changed the Insurance Act from preferring insurers to preferring policyholders. It is also worth considering other possible justifications for the current or alternative rule for misrepresentation, including efficiency of society. Even though the policyholder's risk of innocent misrepresentations would be better off transferred to the insurer, the insurer is substantially less likely to prevent such misrepresentations. In contrast, the policyholder is more likely to possess the necessary information for the insurance application and better control the possibility of mistake.[107] In the intentional and reckless misrepresentation rule, the policyholder may have less incentive to prevent innocent misrepresentation, because the insurer has to pay for insurance proceeds. From this viewpoint, the strict liability misrepresentation rule,

---

[103] PRINCIPLES OF THE LAW OF LIAB. INS. § 7 cmt. b (AM. LAW INST., Tentative Draft No. 1 2013); *See also* Lando, *supra* note 44, at 77.

[104] RESTATEMENT OF THE LAW LIAB. INS. § 9 cmt. b (AM. LAW INST., Proposed Final Draft 2018).

[105] Baker & Logue, *supra* note 4, at 784.

[106] *Id.* at 767.

[107] Chen, *supra* note 2, at 8; Priest, *supra* note 3, at 655.

while perhaps harsher for the policyholder, alternatively provides more incentive to decrease misrepresentation. This would possibly be better for society, if the harshness of the strict liability misrepresentation rule can be clarified to a certain extent. This will be further discussed in the summary and recommendation.

Second, for the intentional and reckless misrepresentation rule, the determination and benchmark for applying the rule may not be as easy as it appears. All categories may have the issue of over-inclusion or under-inclusion. The intentional and reckless misrepresentation rule constrains the rescission of a contract to intentional and reckless misrepresentation, but it is not always that critical for an insurer to satisfy the element of materiality. In contrast, an insurer is not allowed to rescind an insurance contract for innocent misrepresentation, even though such a mistake could be very critical for underwriting.[108] Why do we use the accountability of the policyholder as a threshold for rescission of contract, rather than the other elements of misrepresentation? This may require more justification.

3. Benchmark issue

The determination of the misrepresentation issue is also happening in China. Even though China applies the intentional and reckless misrepresentation rule, it is highly controversial to define the intentional, gross negligent, and innocent conduct of misrepresentation. As aforementioned, China modified the Insurance Act from "negligence" to "gross negligence" in rules of misrepresentation, but the definitions are unclear and thus many controversies appear. Actually, there are no definitions for the terms "intentional" or "gross negligence" which has created judicial uncertainty.[109]

The earlier version of the PLLI not only adopted the intentional and reckless misrepresentation rule but also provided definitions for them.[110] However, similar to the rejection of the intentional and reckless misrepresentation rule because there is not sufficient common law to support such a rule, there are few cases to support the determination of the categories of misrepresentation. Even if there were definitions of intentional and reckless misrepresentation, there would be problems in application and more time would be necessary to accumulate relevant case law and rules.[111] Since

---

[108] Chen, *supra* note 2, at 16.

[109] Jing, *supra* note 69, at 348.

[110] A misrepresentation by a policyholder is intentional if at the time it is made the policyholder knows or believes that the statement is false. For reckless, it means that the policyholder is willfully indifferent to whether the statement is true or false. PRINCIPLES OF THE LAW OF LIAB. INS. § 8 (AM. LAW INST., Tentative Draft No. 1 2013).

[111] However, the rule in PLLI at least provides some clues and possible benchmark for determining the categories of misrepresentation. Thus, if

the category of misrepresentation is a critical determining element for remedy, this issue will inevitably be hotly contested in misrepresentation litigation. The possible increase in litigation cost should be considered for the intentional and reckless misrepresentation rule.

B. REFORMATION

Apart from the aforementioned structure and remedy of misrepresentation, China and the RLLI have more similarity for the reformation of contract in innocent misrepresentation. Like the struggle between the PLLI and the RLLI, the common law general rule of strict liability in misrepresentation has been argued for a long time. In the case of innocent misrepresentation, the strict liability rule is usually criticized for problems such as harshness for insureds, market-distorting subsidy for non-misrepresenting insureds, over-compensation for insurers, and causing an incentive to engage in bad-faith underwriting.[112] Instead of the extreme consequence of rescission, reformation of a contract is usually the suggested remedy for innocent misrepresentation to avoid the mentioned problems of the strict liability rule.[113] The earlier version of the PLLI adopted reformation as a remedy for innocent misrepresentation to replace rescission. But this was abandoned for the traditional strict liability rule, because there were not sufficient common law cases to support it. In China, the current Insurance Act has no specific reformation remedy for innocent misrepresentation. Thus, even though reformation of contract is usually recommended and applied in other jurisdictions, China and the RLLI have not yet adopted this rule.

Even with the legal and economic justifications for reformation of contract, the approach still has some issues to be addressed. Like the German Insurance Contract Act in 2008, it uses the rule of proportionality to replace the old all-or-nothing principle.[114] However, the new proportionality rule is

---

China would like to keep the intentional and reckless misrepresentation rule, some definitions like the PLLI are necessary.

[112] Brian Barnes, *Against Insurance Rescission*, 120 YALE L.J. 328, 338-42 (2010); *See also* Genia Lindsey, *Why the Rescission of Health Insurance Policies Is Not an "Equitable" Remedy*, 40 N.M. L. REV. 363, 385 (2010).

[113] Barnes, *supra* note 112, at 358-65; Wood, *supra* note 22, at 1418.

[114] *See* Versicherungsvertragsgesetz [VVG] [Insurance Contract Act 2008], Nov. 23 2007, BGBL I at 2631, last amended by BGBL I at 3214 (Ger.), https://www.gesetze-im-internet.de/englisch_vvg/englisch_vvg.html#p0160 ("(4) … in accordance with subsection (3), second sentence, shall be ruled out if he would also have concluded the contract in the knowledge of the facts which were not disclosed, albeit with other conditions. The other conditions shall become an integral part of the contract with retroactive effect upon the request of the insurer; in the case of a breach of duty for which the policyholder does not

subject to many criticisms. For example, the proportionality rule is more lenient for policyholders than the strict liability rule, and reversely deters the effects of sanctions. Also, the new rule gives more privilege to the careless policyholder at the cost of the careful policyholder. And apparently, the new system may be too complex, flexible, and uncertain.[115] Such legal uncertainty makes the application even more difficult and may increase disputes and cost. For the U.S., the uncertainty issues may remain. For example, according to the PLLI, if the insurer would not have issued the policy for any premium if the correct information had been supplied at the time of the application or renewal, the insurer must pay the claim at issue but may collect from the policyholder or deduct from the claim payment a reasonable additional premium for the increased risk.[116] But it may need more specific rules and experience to decide a "reasonable additional premium" for the case where the insurer would not approve the insurance application if he had received the correct information.

Also, like the development of the intentional and reckless misrepresentation rule, the RLLI does not keep the reformation remedy of the PLLI because this is not a general common law rule. If we consider the cost of the reformation remedy, such as its uncertainty and the corresponding litigation cost, it may be even higher because the U.S. lacks the experience of applying this rule. The U.S. may need more time and cost to clarify the application and benchmark of this rule in specific cases. All such concerns can justify why the RLLI does not keep this rule at this moment. For China, the current law has no mechanism like reformation of contract for misrepresentation. Even though this approach looks less lenient for the policyholder, it may not be necessary to change it if China can fix the concerns of the RLLI.

---

bear responsibility they shall become an integral part of the contract as of the current period of insurance. (5) The insurer shall only be entitled to the rights under subsections (2) to (4) if he has instructed the policyholder in writing in separate correspondence of the consequences of any breach of the duty of disclosure. These rights shall not exist if the insurer was aware of the disclosed risk factors or the incorrectness of the disclosure. (6) In the case of subsection (4), second sentence, leading to an increase in the insurance premium of more than 10 per cent on account of an alteration of the contract, or if the insurer refuses to cover the risk for the undisclosed circumstance, the policyholder may terminate the contract without prior notice within one month of receipt of the insurer's communication. The insurer shall notify the policyholder of this right in the communication.").

[115] Helmut Heiss, *Proportionality in the New German Insurance Contract Act 2008*, 5 ERASMUS L. REV. 105, 107 (2012).

[116] PRINCIPLES OF THE LAW OF LIAB. INS. § 11(2) (AM. LAW INST., Tentative Draft No. 1, 2013).

C. MATERIALITY, RELIANCE, AND CONTRIBUTE-TO-THE-LOSS APPROACH

The PLLI and RLLI use materiality and reliance to capture the significance and influence of misrepresentation. They are approximately equivalent to materiality in China's Insurance Act. The RLLI adopts the "objective standards" and treats the insurer as the prudent insurer. Even though some cases and literature also adopt this approach in China, it is worth clarifying this issue in the Insurance Act. Furthermore, the RLLI adopts the "increased-risk standard" in materiality but rejects the "contribute-to-the-loss" approach. This is believed to be more pro-insurer rather than pro-insured. However, the causation or contribute-to-the-loss approach, which requires causation between misrepresentation and loss, is more pro-insured. As mentioned before, China at least applies this rule for misrepresentations made by the "gross negligence" of the insured. Even though the contribute-to-the-loss approach is more favorable for the insured, it lacks theoretical and economic justification. This approach stints the remedy of an insurer according to an unexpected and uncertain causation issue. This may decrease the incentive for policyholders to present correct information, and thus deter the efficiency of the market. Therefore, it is better off for China to follow the approach of the RLLI and reject the contribute-to-the-loss approach.

D. A SHORT SUMMARY

The U.S. and China share differences and similarities in their development of misrepresentation rules. This also demonstrates both countries' consideration and struggle between preference for insurer or insured. We now realize that the final and current rules do not justify themselves. More understanding about their background is necessary. Also, in addition to the perspective on either party of the insurance contract, the overall efficiency of the insurance market and society needs to be considered. Regarding the structure and remedy of insurance misrepresentation, which are the most fundamental issues, the rules in the RLLI are worth more merit, if with one more clarification.

Generally, the strength of the strict liability rule is flexibility. A court has more room to decide the proper remedy for misrepresentation without any preset constraint. On the opposing side, one of the weaknesses of the strict liability rule is its harshness for the policyholder. This implies that the insurer is allowed to rescind the contract for a misrepresentation which is material but not deserving rescission. As long as a court is able to properly assess the severity of the misrepresentation and find a reasonable remedy, it may not be necessary to preset the remedy for a specific misrepresentation in statue or restatement. In order words, we recommend a reasonable rule, which allows rescission for any kind of misrepresentation, but this is not the equivalent to a rule that an insurer can rescind a contract for any mistake of

the policyholder. Rather than presetting remedies for misrepresentations, this rule asks a court to decide the proper remedy according to any important circumstances of the case, including the severity of the misrepresentation, the accountability of the policyholder, factual causation and so on.[117] Considering all possible costs of the preset intentional and reckless misrepresentation rule, including efficiency issues, benchmark issues, and relevant litigation costs, it would be another alternative worth considering, to allow a court to make decisions on a case-by-case basis and thus accumulate experience and rules.

V. CONCLUSION

This article has reconsidered the insurance misrepresentation rule under the RLLI as compared to China which is stated as the insured's duty of disclosure. By comparing Chinese law and American law, we find some similarities but differences as well. After the 2008 financial crisis, China joined the world trend to enhance the protection of insurance consumers. The 2009 Amendment and the following SPC Interpretations are vivid examples and have replaced many provisions of the Insurance Act of 1995 that were more pro-insurer. In the U.S., the PLLI adopts many innovations but is criticized as pro-insured without common law justification. And thus, the current RLLI does not exhibit a pro-insured approach.

Since there will be continuing debates over pro-insurer and pro-insured rules, we have tried to assess the insurance misrepresentation rules from the perspective of societal efficiency rather than the perspective of any one individual party to an insurance contract. Thus, we apply an agreed upon benchmark which is "in the long-term interest of policyholders with respect to maximizing the availability of insurance to the society."[118]

For the structure and remedy of misrepresentation, China and the U.S. are in different positions. China moved to the pro-insured rule, allowing the insurer to rescind an insurance contract only for the policyholder's intentional and reckless misrepresentation. In the U.S., the RLLI adopts a strict liability rule allowing the insurer to rescind the policy for all kinds of misrepresentations. The strict liability rule seems to be harsher for policyholders than the intentional and reckless misrepresentation rules, but it provides more incentive to decrease misrepresentation, and would possibly be better for society.

Even though reformation of contract is usually recommended and applied in other jurisdictions, China and the RLLI are similar for not adopting reformation of contract in cases of innocent misrepresentation yet. We disagree with applying the rule of proportionality to replace the old all-or-nothing principle, which is subject to many criticisms, especially from the law and economic

---

[117] Chen, *supra* note 2, at 16-17.

[118] Priest, *supra* note 3, at 653.

perspective of reformation of contract.

For the materiality issue, if we follow the above benchmark, it is suggested that China should reject the contribute-to-the-loss approach, which requires causation between misrepresentation and loss, since it decreases the incentive of the policyholder to present correct information, and thus deters the efficiency of the market.

Based on the above benchmark and analysis, the RLLI does provide several inspirations for China in insurance misrepresentation and indicates how to protect the long-term interest of policyholders and enhance the efficiency of the whole society. Of course, a determination of whether China's insurance misrepresentation rules function well or not might require further empirical studies.

CONNECTICUT INSURANCE
LAW JOURNAL

The Connecticut Insurance Law Journal is published at least twice per year. Domestic subscriptions are $28.00 per year, international subscriptions are $32.00 per year. Back issues and back volumes are available (for any volume up to and including Volume 12) for $15.00 per issue or $25.00 per volume; international orders add $3.00 per issue or $5.00 per volume.

Absent timely notice of termination, subscriptions are renewed automatically. To subscribe to the Insurance Journal or order back issues online, please visit our website located at https://cilj.law.uconn.edu, or you may fill out the form below and mail to:

Connecticut Insurance Law Journal
Attention: Administrative Editor
55 Elizabeth Street,
Hartford, CT 06105;
cilj.eic@uconn.edu

Please Print below and complete reverse:

Contact Name: _____

Contact Title: _____

Organization: _____

Department: _____

Address: _____

_____

City: _____ State: _____ Zip Code: _____

Phone: _____ Fax: _____

E-Mail: _____

Additional Comments: _____

Check all that apply:

☐ I would like to order (number) _____ subscriptions at $28.00 per subscription ($32.00 for international orders).

☐ I would like to order (number) _____ complete set(s) of back issues (Volumes 12-25) at $325.00 per set ($390.00 for international orders).

☐ I would like to order the following back volumes or back issues at $15.00 per issue, $25.00 per volume (international orders are $18.00 per issue and $30.00 per volume). Please list volume, issue and quantity for each.

Examples: 4 copies, Volume 3, Issue 2
2 copies - Volume 6

_____
_____
_____
_____