À LA CARTE COVERAGE. UNBUNDLING CAUSES OF LOSSES AND COVERAGE GRANTS TO ALLOW CONSUMER-INSURED SELECTION.*

Harold Weston

Clinical Assistant Professor of Risk Management and Insurance,

Georgia State University, J. Mack Robinson College of Business

ARE YOU BEING SERVED? 39

FRAGMENTED RISK OR INTEGRATED RISK? 42

FROM FIRE POLICY TO MULTI-PERIL POLICY 43

LIABILITY INSURANCE EMBRACES PREVIOUSLY SEPARATE EXPOSURES 51

REGULATIONS ALLOW INSURERS TO OFFER MULTI-LINE PACKAGE POLICIES 53

DEVELOPMENT OF COMBINATION AUTOMOBILE INSURANCE 56

THE PERILS OF THE AGENT/BROKER RELATIONSHIP WITH THE INSURED 57

AN AGENT'S DUTY TO PROCURE BUT NOT TO ADVISE 58

* This paper has been revised a little from what was presented at the Fragmented Risk Symposium, and has benefited from the thoughtful remarks of Steven Weisbart and Jeffrey Stempel, who were on the panel with me.

GETTING ADVICE REQUIRES A SPECIAL RELATIONSHIP 61
"FULL COVERAGE" IS . . . WHAT? 62
CAN WE DO BETTER? 66
À LA CARTE OR MODULES OF COVERAGE 66
WHAT À LA CARTE COVERAGE MIGHT LOOK LIKE 76
WILL IT WORK? EXPECTATIONS AND IMPLICATIONS 82
CONCLUSION 87

Would having insureds select each coverage for every peril and exposure available result in better insurance selection and better customer satisfaction? In theory, it should, because it will allow insureds to select the coverages they want at the total price they want to pay, and allow both parties to the insurance contract to be clear about what their intent is. That should also reduce errors and omissions claims against insurance agents and brokers. In practice, however, it will probably still be a task too much for most consumers and thus cause different dissatisfaction. More likely, regulations to set new minimum coverages for homeowners policies will be needed, and adjustments to the insurer-agent relationship will help further.

ARE YOU BEING SERVED?

When it comes to insurance, consumers want "full coverage" at the cheapest price without any effort to understand their own risk exposures and insurance needs. They also want the insurance contract to affirm their "reasonable expectations," but not have to read the contract and be bound by it.

Insurers want to provide "full coverage" for the things they are willing to insure, less coverage for other things, scant or no coverage for things for which they cannot charge much, and offer the right combination of coverages and limits for the segment of the market at a competitive price that will attract consumers–all the while operating in a 200-plus-years context of insurance principles, regulation, and litigation.

Problems ensue. For insureds, they ensue when losses are not covered due to exclusions and limitations in the policy, when insureds do not cooperate on losses and liability claims, when

agents fail to procure or misrepresent policy provisions, and when insurers fail to honor their contracts. For insurers they ensue–arise, actually–in the contracts themselves: contracts are by necessity complex and technical even when written in plain English and meeting, at a minimum, Flesch readability scores as required by many statutes.[1] But consumers have low reading levels–50% at the basic level, with an average reading level at the eighth-to-ninth grade level–so they are lost at comprehension for even the simplest agreement.[2] Thus, the fundamental premise to U.S. contract law, that there was a meeting of the minds to form the contract, is fundamentally flawed given that one party refuses to read the contract or even the declarations page. For agents and brokers, problems ensue in the subsequent errors and omissions claim when insureds, surprised at an uncovered loss, contend that they would have paid the additional premium for such coverage or higher limit had the agent informed them of the option, whereas agents know and can often document that the insured specified the least costly insurance or declined additional coverages.

This fragmented risk conference allows us to re-think the entire process of procuring insurance and meeting expectations, reasonable or unreasonable. To give consumers the insurance coverage they say they want and would pay for, we should

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[1] For insurance statutes setting Flesch readability standards, see, for example, ARK. CODE ANN. § 23-80-206 (West 2013); COLO. REV. STAT. ANN. § 10-16-107.3 (West, Westlaw through First Reg. Sess. 2013) (as to health insurance); CONN. GEN. STAT. ANN. § 38a-297 (West, Westlaw current with Public Acts through July 8, 2013); DEL. CODE ANN. tit. 18, § 2741 (West, Westlaw through 79 laws 2013); FLA. STAT. ANN. § 627.4145 (West, Westlaw through Ch. 272 of the 2013 1st Reg. Sess.); GA. CODE ANN. § 33-3-25 (West, Westlaw current through end of 2013 Reg. Sess.); HAW. REV. STAT. § 431:10-106 (West, Westlaw through Act 247 of the Reg. Sess.); KY. REV. STAT. ANN. § 304.24-611 (West, Westlaw through end of 2013 Reg. Sess.); MINN. STAT. ANN. § 72C.09 (West, Westlaw current with laws of 2013 Reg. Sess.); NEV. REV. STAT. ANN. § 687B.124 (West, Westlaw through the 2011 76th Reg. Sess.); N.Y. INS. LAW § 3102(c)(1)(D) (McKinney, Westlaw through 2013 Legis.); OR. REV. STAT. ANN. § 743.106 (West, Westlaw through ch. 787 of 2013 Reg. Sess.).

[2] IRWIN S. KIRSCH ET AL., U.S. DEP'T OF EDUC., ADULT LITERACY IN AMERICA: A FIRST LOOK AT THE RESULTS OF THE NATIONAL ADULT LITERACY SURVEY (3d ed. 2002), *available at* http://nces.ed.gov/pubs93/93275.pdf; *see also* John A. Cogan, Jr., *Readability, Contracts of Recurring Use, and the Problem of Ex Post Judicial Governance of Health Insurance Policies*, 15 ROGER WILLIAMS U. L. REV. 93, 97–98 (2010).

consider abandoning pre-packaged causes of loss forms and coverage grants, and see if check-the-box coverage selections with transparent prices per peril and exposure will serve the consumer better. I call it "à la carte coverage" and suggest that insureds see the price extension for each coverage, which includes currently limited coverages that could be extended to the fullest amount. This would give insureds the coverages they say they want, at the prices they say they are willing to pay, while matching their purchase actions with their expectations. If the total price is too high for the insured for the "full coverage," then the insured can de-select coverages and limits until the desired price is reached, with a sure record of the insured's choice of coverages chosen and rejected.

In risk terminology, this is all called risk identification and then risk financing through insurance, with insureds specifying the endorsements and coverage they need to fill out the policy to the coverages they want. This is the practice with commercial insureds, who have risk managers and skilled brokers to deal with complex exposures—and even they do not always get it right. This is not the practice with consumers, although the concept should be the same. On the insurer side, insurers decide their "risk appetite" as to what they want to take on, which results in their underwriting guidelines; some insurers have a bigger appetite than others, a distinction further reflected in the standard lines markets and the surplus lines markets. As Professor Jeffrey W. Stempel has written:

> Policyholders purchase insurance to accomplish particular goals of risk management and insurers sell particular products in order to profit through risk distribution (and investment of premium proceeds), designing product to attempt to cover certain profitable risks while avoiding unprofitable or unpredictable risks.[3]

Eighty-three years earlier, a lecturer on insurance said about the same thing: "The only basis on which permanency and profit can be attained for both parties to the contract is for the

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[3] Jeffrey W. Stempel, *An Inconsistently Sensitive Mind: Richard Posner's Cerebration of Insurance Law and Continuing Blind Spots of Econominalism,* 7 CONN. INS. L.J. 7, 17–18 (2000).

producer to furnish what meets the needs of the consumer at a reasonable price above cost. And for the consumer to get what serves his purpose at a price he can afford to pay."[4]

Calling the spread and mash of perils and exposures through coverage grants and exclusions and exceptions and sublimits "fragmented risk" seems helpful in one way: to reflect this spread and mash. But the phrase is misleading in another way: at some point, even "full coverage" of unified risk (if that is the opposite, and if it exists) falls into the hole of moral hazard and violates the principle of indemnity where everything that is a potential loss is transferred to insurers. The "fragemented risk" problem is in many lines of insurance, particularly for consumers due to their minimal knowledge and lack of sophistication with insurance. Small businesses have some of the same problems, albeit restricted because of the business owner's policy, which is a package designed for small businesses that is further crafted by insurers through endorsements for particular types of business. In this paper I focus on the homeowners insurance policy (comprised of the property policy historically known as the fire policy, and to a lesser extent the liability policy), on the personal automobile policy, and on commercial liability insurance. The issues discussed here can be extended to many other types of insurance, some of which I also touch upon here.

FRAGMENTED RISK OR INTEGRATED RISK?

A review of the history of the fire policy into the homeowners policy, other commercial property policies, and liability policies leads to the conclusion that the development of the homeowners package policy is mostly a process of accretion: ever expanding coverage for dwelling, new coverage for contents and other exposures to the homeowner, plus new casualty, all into the package policy. We have come a long way, but improvements remain needed. Even with the open perils/special perils policy, the list of exclusions makes clear that there are gaps in coverage.

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[4] William B. Medlicott, *Standard Clauses and Forms*, *in* FIRE INSURANCE LECTURES DELIVERED BEFORE THE INSURANCE INSTITUTE OF HARTFORD 70, 71 (Ins. Inst. of Hartford, Inc. ed., 1917) *available at* http://books.google.com/books?id=H_tCAAAAIAAJ&printsec=frontcover&source=gbs_ViewAPI#v=onepage&q&f=false.

A homeowner's package may look fragmentary today, but that is because it is a composite of many good fragments. A 1958 book ambitiously heralded the amalgamation of "fragmentary coverages" that were addressed by multiple policies before the package policy of recent times:

> Today, by the use of no more than one or two broad policies, the homeowner can obtain insurance which is far more complete than that which was once provided by the combination of a score of narrower forms. Gradually the use of comprehensive insurance has been displacing the piecemeal aggregation of fragmentary coverages as the accepted means of satisfying household insurance needs.[5]

Even so, it is fair to ask whether the current package is serving consumers–and insurers–as well as it could. Further, in asking that, we shall also have to ask whether some things need to be excluded due to moral hazard, the principle of indemnity, adverse selection, or other fundamental insurance principles.

FROM FIRE POLICY TO MULTI-PERIL POLICY

It is worth a moment to review the history of the homeowners policy to see why we have come to the present place of multi-peril policies with gaps and sub-limits.

The policy we call the standard fire policy was long ago solely that: a policy against the peril of fire, nothing else. Its basic form can be traced back to 1660 in London and a little later in Germany.[6] The form as we know it has its origins in the Massachusetts insurance statute in 1873, and then New York specified the form in 1887 known as the Standard Fire Policy, later modified a little in 1918. The 1887 form was drafted by the insurance companies, "but during its use it was found unfair to

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5 JOHN EUGENE PIERCE, DEVELOPMENT OF COMPREHENSIVE INSURANCE FOR THE HOUSEHOLD 3 (1958).

6 GEORGES GALEY ET AL., SWISS RE, FIRE INSURANCE 7 (2009); *see* THE BUSINESS OF INSURANCE: A TEXT BOOK AND REFERENCE WORK COVERING ALL LINES OF INSURANCE 331–32 (Howard P. Dunham ed., 1912).

policyholders in some respects and unworkable in others."[7] In 1943 National Association of Insurance Commissioners drafted the new form,[8] which became the New York Standard Fire Policy, codified in Section 3404 of the New York Insurance Law, and subsequently adopted in most states.[9] There were good reasons for the development of a standard policy: the early fire policies were often little more than fraud in their bulk of provisions to avoid paying a loss. A famous and often quoted New Hampshire court decision of 1873, *De Lancey v. Rockingham Farmers' Mutual Fire Insurance Co.*, trashed such a policy:

> The principal act of precaution was, to guard the company against liability for losses. Forms of applications and policies (like those used in this case), of a most complicated and elaborate structure, were prepared, and filled with covenants, exceptions, stipulations, provisos, rules, regulations, and conditions, rendering the policy void in a great number of contingencies. These provisions were of such bulk and character that they would not be understood by men in general, even if subjected to a careful and

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7 S.S. HUEBNER, KENNETH BLACK, JR. & BERNARD L. WEBB, PROPERTY AND LIABILITY INSURANCE 18 (4th ed. 1996). The form is sometimes known as the 1886 form probably because it was drafted in 1886, and the need for a standard form was introduced in the New York legislature in 1886. *Id*; *see* PIERCE, *supra* note 5, at 203–04; Mountain, *supra* note 9, at 59; MAGEE, *supra* note 37, at 129. New York State amended the statute and adopted the form into law in 1887. *See* HUEBNER, BLACK & WEBB, *supra* note 7, at 18.

8 *See* HUEBNER, BLACK & WEBB, *supra* note 7, at 18.

9 H.M. Mountain, *The Standard Fire Policy*, *in* PROPERTY AND LIABILITY INSURANCE HANDBOOK 59 (John D. Long & Davis W. Gregg eds. 1965). Mr. Mountain is listed as being the president of the Aetna Insurance Company. *Id.*

As for state adoption of the New York Standard Fire Policy, see, for example: ARIZ. REV. STAT. ANN. § 20-1503 (2013); CONN. GEN. STAT. § 38a-307 (West 2012); IOWA CODE § 515.109 (West 2012); LA. REV. STAT. ANN. §22:1311 (2009); MASS. GEN. LAWS ch. 175 § 99 (2011); N.J. STAT. ANN. § 17:36-5.20 (West 2013); N.Y. INS. LAWS § 3404 (McKinney 2010); WASH ADMIN. CODE § 284-20-010 (2013). *See also* THE BUSINESS OF INSURANCE, *supra* note 6, at 337–40, for the form as of 1917.

laborious study: by men in general, they were sure not to be studied at all. The study of them was rendered particularly unattractive, by a profuse intermixture of discourses on subjects in which a premium payer would have no interest. The compound, if read by him, would, unless he were an extraordinary man, be an inexplicable riddle, a mere flood of darkness and confusion. Some of the most material stipulations were concealed in a mass of rubbish, on the back side of the policy and the following page, where few would expect to find anything more than a dull appendix, and where scarcely any one would think of looking for information so important as that the company claimed a special exemption from the operation of the general law of the land relating to the only business in which the company professed to be engaged. As if it were feared that, notwithstanding these discouraging circumstances, some extremely eccentric person might attempt to examine and understand the meaning of the involved and intricate net in which he was to be entangled, it was printed in such small type, and in lines so long and so crowded, that the perusal of it was made physically difficult, painful, and injurious. Seldom has the art of typography been so successfully diverted from the diffusion of knowledge to the suppression of it.

. . . .

. . . When the premium payer complained that he had been defrauded, it was not, in the opinion of the legislature, a sufficient answer to say that, if he had been wise enough, taken time enough, had good eyes enough, and been reckless enough in the use of them to read the mass of fine print, and had been scholar, business man, and lawyer enough to understand its full force and effect, he would have

> been alarmed, and would not have been decoyed into the trap that was set for him.[10]

The perils insured in the New York Standard Fire Policy against were–and remain–fire and lightning. The New York Standard Fire Policy provides, "TO AN AMOUNT NOT EXCEEDING [-----] DOLLARS, BUT IN ANY EVENT FOR NO MORE THAN THE INTEREST OF THE INSURED, AGAINST ALL DIRECT LOSS BY FIRE, LIGHTNING AND BY REMOVAL FROM PREMISES ENDANGERED BY THE PERILS INSURED AGAINST IN THIS POLICY, EXCEPT AS HEREINAFTER PROVIDED[.]"[11] "The new policy as stated in the statute expanded and reduced some coverages. It expanded coverage by omitting the exclusion of loss caused directly or indirectly by riot or civil commotion, which had been found in prior fire insurance contracts," and which previously prevented coverage for fire loss caused by disturbance of the peace by three or more persons.[12] The new statute specified perils not insured, including insurrection, rebellion, and revolution, which replaced the narrower riot or civil commotion exclusion, and others reflecting the war-time menace[13]:

> (a) enemy attack by armed forces, including action taken by military, naval or air forces in resisting an actual or an immediately impending enemy attack; (b) invasion: (c) insurrection; (d) rebellion; (e) revolution; (f) civil war; (g) usurped power; (h) order of any civil authority except acts of destruction at the time of and for the purpose of preventing the spread of fire, provided that such fire did not originate from any of the perils excluded by this policy; (i) neglect of the insured to

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[10] Delancey v. Ins. Co, 52 N.H. 581, 587–88, 590 (1873). The case remains a popular one to quote. The last citation to the case was in *National Merchandise Co. v. United Service Automobile Association*, 400 So. 2d 526 (Fla. Dist. Ct. App. 1981).

[11] N.Y. INS. LAW § 3404(e).

[12] PIERCE, *supra* note 5, at 233.

[13] *Id.* at 234.

> use all reasonable means to save and preserve the property at and after a loss, or when the property is endangered by fire in neighboring premises; (j) nor shall this Company be liable for loss by theft.[14]

The statutory form also allowed the insurer to add other perils: "[A]ny other peril to be insured against or subject of insurance to be covered in this policy shall be by endorsement in writing hereon or added hereto."[15]

Thereafter, the conditions common to fire insurance are specified.

Other perils were not in the standard policy, and this is the peculiar part, because the statute allows insurers to abandon the form entirely if the policy provides insurance "solely against the peril of fire or which insures against the peril of fire in combination with other kinds of insurance, . . . provided: (A) the policy contains, with respect to the peril of fire, terms and provisions no less favorable to the insured that those contained in the standard fire policy[.]"[16] It might be said that the statute provides the minimum contract benefit to insureds for fire insurance, but insurers are free to provide further benefits in any other form. Other states' statutes provide similar exemptions from complying with the New York standard form– that is, only the fire coverage must be substantially the same as the New York standard, and everything else can be whatever the state insurance commissioner will allow.[17] A small book in 1930 entitled *Where Fire Insurance Leaves Off* dealt exactly with these omitted perils and exposures available by separate insurance: tornado and windstorm, blanket mortgage interest, explosion, riot and civil commotion, falling aircraft, sprinkler leakage, demolition, and others particular to commercial

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[14] N.Y. INS. LAW § 3404(e).

[15] PIERCE, *supra* note 5, at 232.

[16] N.Y. INS. LAW § 3404(f)(1).

[17] *See* CAL. INS. CODE §§ 2070, 2071 (West 2013); Fire Ins. Exch. v. Super. Ct., 10 Cal. Rptr. 3d 617, 627 (Cal. App. 4th 2004); GA. CODE ANN. § 33-32-1 (West 2013); 215 ILL. COMP. STAT. 5/397 (2013); ORE. REV. STAT. ANN. § 742.204(3) (2013).

accounts.[18] The author illustrated the absence of such coverage with an anecdote in the introduction: "Just as the author was completing this work an unprecedented hail storm swooped down on Hartford. Nothing like it had occurred for years. . . . Out of the hundreds of claims perhaps fifty were properly insured and Hartford is an insurance city!"[19] Windstorm policies developed in the Midwest during the 1860s and continued through the 1880s.[20] These could be either bought separately or in some states be added to the fire policy.[21] A standard windstorm policy was approved in 1905, and a rider for the peril of hail was also added.[22] The peril of explosion was offered as a rider to the fire policy starting in 1908, but not until 1914 had "this hazard seemed to have very much importance in this country," although the coverage was common in German fire insurance policies back to 1868.[23] Loss due to the fall of aircraft and airships became available in 1921 under a separate policy, under which the rates varied with proximity to airports.[24] By 1929, this coverage was expanded to include loss against motor-vehicle damage.[25] In 1930, New Jersey approved a supplemental contract to the fire policy to cover aircraft damage, explosion, hail, riot, civil commotion, and windstorm.[26] Later that same year, Pennsylvania approved a similar form that added damage by motor vehicles not owned by the insured.[27] New Jersey then modified its form to the Pennsylvania variety;

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[18] CLARENCE T. HUBBARD, WHERE FIRE INSURANCE LEAVES OFF (1930).

[19] *Id.* at 5.

[20] PIERCE, *supra* note 5, at 221.

[21] *Id.*

[22] PIERCE, *supra* note 5, at 221–22.

[23] *Id.* at 222.

[24] *Id.* at 223–24.

[25] PIERCE, *supra* note 5, at 223–25.

[26] *Id.* at 226–27.

[27] *Id.* at 228.

other states soon followed.[28] The result was that these three integrated policies were now available for less than half the premium of the cost of these three policies sold alone.[29]

Regulations reflected this fragmentation of risk. For example, the California statute of 1935, still in force, defines fire insurance as "fire, lightning, windstorm, tornado, or earthquake,"[30] though, of course, California then pulls out earthquake and offers it under the state-run California Earthquake Authority.[31] In fact, all these perils, and more, are classified as "miscellaneous insurance," which is what they were until added by the 1953 amendment to the California fire statute.[32]

The agglomeration of covered perils really began in 1937 with an "Extended Coverage Endorsement" that added these and others directly onto the fire insurance policy. This "extended coverage endorsement" added "perils of windstorm, hail, explosion, riot, riot attending a strike, civil commotion, aircraft, vehicles, and smoke, and may be further extended by choice of form or endorsement to include a number of additional perils such as vandalism and malicious mischief, earthquake, or the various 'Broad Form' or 'All Risk' perils."[33] The Extended Coverage Endorsement added extensions of coverage with sublimits such as appurtenant structures, property off-premises, "fair rental value" while the premises is being re-built, and debris removal.[34] The endorsement excluded "frost, ice, snow or sleet" and interior damage from "sonic boom, electrical arcing, water hammer, and rupture of water pipes, which are often confused with explosion."[35]

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[28] *Id.* at 229.

[29] *Id.* at 226–29.

[30] CAL. INS. CODE § 102 (Deering 2013).

[31] *Id.* §§ 10089.6(a) (2013). California implements regulations at CAL. CODE REGS. tit. 10, § 2697 (2013).

[32] *Id.* § 120 (2013).

[33] Edwin N. Searl, *Forms to Accompany the Fire Policy–Personal, in* PROPERTY AND LIABILITY INSURANCE HANDBOOK, *supra* note 9, at 73.

[34] *Id.* at 74–76.

[35] *Id.* at 77; *see also* PIERCE, *supra* note 5, at 237–44.

A second optional endorsement afforded more perils and filled some of the new gaps. The Additional Extended Coverage Endorsement, which became the Broad Form Endorsement, added: falling objects; weight of ice, snow or sleet; collapse; sudden and accidental tearing asunder, cracking, etc. of hot water equipment; breakage of glass, freezing of plumbing, heating and air condition systems, and sudden and accidental injury from artificially generated current in electrical appliances, and theft;[36] although, theft could be added separately without the Additional Extended Coverage Endorsement.[37] This is what we recognize as the modern HO-2 form for homeowners insurance.[38] In 1942, this extended coverage endorsement was widely used[39] and became known as the Dwelling and Contents form, which we recognize as an early modern homeowners policy–minus the liability coverage–we deal with today, and which continued to evolve with more coverages.[40]

The "Special Form" is the "all risk" form, first developed in the 1950s,[41] which for homeowners is the modern HO-3 form.[42]

Look at an all risks commercial form to see how broad all risks could be. The reinsurer Swiss Re, in a monograph on all risks policies, quoted an offer by a reinsurance broker to Swiss Re in 1985:

> All Risks of physical loss or damage including boiler explosion and machinery breakdown, blanket crime, fidelity, computer crime etc., third party liability, W.C.A., Jones Act 6, U.S.L. and H., FRA/FELA, EL/ELOD, Aircraft Liability, broad

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[36] Searl, *supra* note 9, at 78; PIERCE, *supra* note 5, at 245–46.

[37] JOHN H. MAGEE, PROPERTY INSURANCE 236–37 (3d ed. 1955).

[38] DIANE W. RICHARDSON, HOMEOWNERS COVERAGE GUIDE 2 (4th ed. 2011).

[39] PIERCE, *supra* note 5, at 231–34.

[40] *See* PIERCE, *supra* note 5, at 242–44.

[41] Searl, *supra* note 9, at 83; PIERCE, *supra* note 5, at 271–81.

[42] *See* RICHARDSON, *supra* note 38, at 2.

> form liability, marine liability, characters liability, fiduciary liability, errors and omissions, control of well etc., contract frustration and/or expropriation and or in convertibility and or as may be more fully defined in the policy wording.[43]

As the monograph later notes, the concept of "all risk" coverage presented innumerable difficulties around the world where such insurance was offered, and was often marketed to suggest no limitations. "The underwriter is well aware that no property policy in the world can cover literally 'all' risks; the layman, however, may be misled."[44]

LIABILITY INSURANCE EMBRACES PREVIOUSLY SEPARATE EXPOSURES

Liability insurance has also moved from many different liability insurance contracts to a few. Here, it is easier to trace this in the commercial lines, and then to the personal lines. Single liability coverage, such as existed for employers' liability (worker's compensation) and team liability insurance for operations on the roads, was expanded.[45] New policies were then developed for Owners, Landlords, and Tenants (O. L. & T.) to cover premises and related exposures, as well as for Manufacturers and Contractors (M. & C.) for the risks of these types of firms, which could also include premises exposures.[46] Separate policies were also developed for elevator, construction and alteration, "protective" (for independent contractors), and products-completed operations.[47] An insured with several exposures like these needed the several insurance contracts.[48]

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[43] PETER BÜTLKOFER & GEORGES GALEY, SWISS RE, "ALL RISKS" IN PROPERTY INSURANCE: AN ATTEMPT TO REMOVE AMBIGUITIES 6 (2005), *available at* http://media.swissre.com/documents/all_risks_in_property_en.pdf.

[44] *Id.* at 9–13.

[45] *See* Roy C. McCullough, *General Liability Insurance*, *in* PROPERTY AND LIABILITY INSURANCE HANDBOOK, *supra* note 9, 461–63.

[46] *Id.*

[47] *Id.*

We might presume that the need for insurance coverage expanded with judicial expansion of tort liabilities, such as products-completed operations cover for the product liability developed in *MacPherson v. Buick Motor Co.*[49] and many cases thereafter, and leading to strict liability in *Greenman v. Yuba Power Products, Inc.*[50] However, graphing these two lines is not necessary for this discussion.[51]

An integrated approach for the general liability exposures began in the 1930's leading to a "comprehensive liability insurance" policy in 1939 for the bodily injury and property damage exposures[52] (what is now Coverage A of the CGL form). Personal injury exposures for libel, slander, invasion of privacy, etc. (Coverage B of the CGL form) were separately rated and selected.[53]

Exclusions have proliferated under the CGL, but many can be bought by back endorsement. Separate specialty insurance is for other exposures such as professional liability, employment practices liability, directors and officers liability, aircraft indemnity, etc., which is often provided by different insurers. Newer policies, often developed in the surplus lines market (e.g. employment practices and environmental impairment, and more recently for cyber and media exposures), have shifted to the standard lines market as experience develops with costs, rates, and underwriting.

For personal lines, consumers had to purchase separate insurance for their exposures of small watercraft, mobile

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48 *Id.*

49 MacPherson v. Buick Motor Co., 111 N.E. 1050, 1053 (N.Y. 1916).

50 Greenman v. Yuba Power Prods, Inc., 377 P.2d 897, 900 (Cal. 1963).

46 Huebner et al. put the first products liability insurance as 1910, which would be appropriate for manufacturers and retailers who sold directly to the consumer. *See* S. S. HUEBNER, KENNETH BLACK JR. & ROBERT S. CLINE, PROPERTY AND LIABILITY INSURANCE 375 (1968). The MacPherson case famously pushed the tort liability back to the manufacturer even when there was a chain of wholesalers between the manufacturer and the ultimate consumer buyer. *Id.*

52 *See* Edgar E. Isaacs, *Comprehensive Liability Insurance*, *in* PROPERTY AND LIABILITY INSURANCE HANDBOOK, *supra* note 9, at 492–501, for a general discussion of the evolution of these coverages.

53 *Id.* at 501.

equipment on the premises, premises liability, animals, etc.[54] Because these separate policies were purchased only when the insured actually had the specific exposure, there was a higher risk of adverse selection, and the premiums were higher due also to the smaller volume of policies written.[55] These exposures—including basic bodily injury and property damage coverage—were made standard on liability coverage that became part of the homeowners policy, and an insured can obtain the personal liability cover for libel, etc., by adding it to the policy or with an umbrella policy.

REGULATIONS ALLOW INSURERS TO OFFER MULTI-LINE PACKAGE POLICIES

Another reason for fragmented coverages was insurance statutes and regulations. For a long time, property insurers could write only property coverage; casualty insurers could write only casualty coverage; and life insurers could write only life insurance. An insured who wanted to buy fire and casualty coverage had to buy them from two different insurers. This continued until the 1920's, when state regulations changed to allow insurers to either own subsidiaries of the other line or, in some states, to write them all in one carrier.[56] The change had little impact until New York –– the lead regulator among the states –– allowed carriers to write multiple lines in 1949, and that freed up carriers that were still segregated to become full multi-line insurers.[57]

Allowing insurers to be multi-line facilitated package homeowners insurance. Some early combination dwelling policies, which provided liability insurance with coverage for dwelling and other risk, can be found back to 1913, but these were rare.[58] Liability coverages that we today consider essential

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54 *Id.* at 505–07.

55 G. WILLIAM GLENDENNING & ROBERT B. HOLTOM, PERSONAL LINES UNDERWRITING 453 (1982).

56 Life insurance remains separate.

57 David L. Bickelhaupt, *Evolution of Multiple Line Insurance*, *in* PROPERTY AND LIABILITY INSURANCE HANDBOOK, *supra* note 9, at 731–38.

58 PIERCE, *supra* note 5, at 291–93.

were not bought because the insurance agent could not afford to sell them; the small premium for each such coverage was inadequate to justify the expense of soliciting, policymaking, and premium collecting.[59] The first homeowners policy was offered in the fall of 1950 by the Insurance Company of North America –– later known as INA –– according to H.R. Heilman.[60] Homeowners policies were filed for use in four states by the fall of 1952, and nineteen states the following year.[61] A standard policy form came into being in 1954.[62] The package provided "integrated coverage" "on the dwelling and its contents, protection against loss by theft, and personal liability coverage.[63] "The insured is not permitted to select only those coverages where he may consider his exposure greatest."[64] This naturally increases spread of risk and reduces adverse selection, such as by people who lived close to airports who would add falling aircraft coverage[65] or those living in neighborhoods more susceptible to crime to buy theft coverage,[66] and similarly for the liability coverage.[67] Coverage limits also became bigger and fixed. Homeowners typically carried fire insurance only to the amount of the mortgage, and "personal property was even less adequately covered and relatively few individuals bought

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59 H.R. Heilman, *Homeowners and Other Personal Packages*, *in* PROPERTY AND LIABILITY INSURANCE HANDBOOK, *supra* note 9, at 744–46.

60 *Id.* at 745.

61 *Id.* at 746.

62 PIERCE, *supra* note 5, at 312.

63 H.R. Heilman, *supra* note 59, at 747–48.

64 *Id.* at 748.

65 PIERCE, *supra* note 5, at 226–29.

66 ROBERT B. HOLTOM, UNDERWRITING, PRINCIPLES & PRACTICES 509 (3d ed. 1987).

67 *Id.* Today we see underwriting for particular risks has been added back in the past 10 years or so to address dog and swimming pool liability, for example. *Id.*

personal liability or theft protection."[68] The insured value rose to the replacement cost of the dwelling with sublimits as a percentage of the dwelling, not broken down by peril or line.[69] Besides spreading risk and reducing adverse selection, packaged policies also eliminated the need for profitability in each line because the profit was now to the whole package.[70] Another treatise in 1965 described the development this way:

> The trend toward multiple-line and all-lines policies has offered the insuring public more convenient protection by covering many risks in a single policy. It also has led to improved protection by minimizing gaps and overlaps in coverage.
>
> From the standpoint of the insurers, multiple-line legislation has provided the opportunity to increase lines and volume of business as well as to improve spread of risk, counterbalancing a bad year in one line with a good year in others. In theory, at least, administrative costs could be reduced to the advantage of both the insurer and the insured. Adverse selection also was minimized, since the insured had less opportunity to purchase coverage selectively . . . .[71]

The homeowners package policy as described in this article looks a lot like the current HO forms, with the further coverages and sublimits, as well as exclusions for cash, securities, boats, and stamp and coin collections, and optional coverages of home office, secondary dwellings, and personal articles floaters.[72]

The thick trend line that emerges from this history of homeowners insurance — policy development and multi-line

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[68] Heilman, *supra* note 59, at 745.

[69] *See id.* at 748.

[70] HOLTOM, *supra* note 66, at 510.

[71] HUEBNER, BLACK & WEBB, *supra* at note 7, at 10.

[72] Heilman, *supra* note 59, at 751–53.

carrier — is aggregation of separate policies into the homeowners policy that provides comprehensive, albeit not universal, coverage. Insurance for the peril of fire has long been regulated, using the 1943 New York standard fire insurance policy. New perils were added by separate policies, followed by endorsements and the later budding of personal liability added by separate casualty companies. Both lines were combined as insurance regulations allowed. The insurance for the peril of fire is what has been regulated; everything else has been added only subject to rate and form approval.

DEVELOPMENT OF COMBINATION AUTOMOBILE INSURANCE

In looking at the history of coverage fragments and aggregation, we see a similar evolution in automobile insurance. With few roads, few automobiles, slow speeds, and imperfect protection against dangers of gasoline, the property exposure was greater than the liability exposure at first.[73] Coverages for expanding risks of loss to the vehicle itself collision, comprehensive, theft, etc, developed from 1898 through the 1950s.[74] Automobile liability insurance was developed separately by the casualty companies, based on the "teams liability policies" for horses and carriages.[75] Automobile insurance began in 1901, as indemnity policy, rather than the liability policy it later became around 1918.[76] The restrictions and exclusions of the early policies, egregious as they were, are not important here. Here, too, coverages continued to be added over the decades. This is in line with, and even ahead of, compulsory financial responsibility laws for public vehicles carrying passengers for hire, the first of which was enacted in

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[73] *See* PIERCE, *supra* note 5, at 122–52.

[74] *See id.*

[75] *Id.* at 153–64; Calvin Brainard, *Family Automobile Insurance*, *in* PROPERTY AND LIABILITY INSURANCE HANDBOOK, *supra* note 9, at 546–57.

[76] *See* PIERCE, *supra* note 5, at 153–64.

1916 in New Jersey; by 1922 ten states had such laws.[77] The first financial responsibility law for individual motorists was enacted in 1925 in Connecticut, Vermont, Maine, Rhode Island, and Minnesota soon followed.[78] Standardized policies developed in the mid-1930s.[79]

Because liability arising from the use of the vehicle also resulted in damage to the vehicle, the need for coverage to both the motorist and the vehicle became evident earlier than it did the dual need with homes. Therefore, as early as 1913, the fire insurers and the casualty insurers cooperated to provide both coverages to the vehicle owner.[80]

THE PERILS OF THE AGENT/BROKER RELATIONSHIP WITH THE INSURED

Why do insureds not get the full coverages they later claim they wanted? Most insurance is sold through intermediaries; even direct writers have contact with insureds through licensed staff; and only a little insurance is sold on the web without any human contact by the insurer with the consumer. We might therefore expect that knowledgeable agents should put together the necessary coverages to de-fragment the risk that remains with homeowners policies and automobiles policies. This brings us to the area of agent/broker liability for procuring insurance and the legal relationship between agents/brokers and insureds. Agents and brokers are referred to generically as intermediaries or producers. Typically, agents represent the insurer, and brokers represent the insured. Both can become dual agents. The relationship is complex and the duties are variable. We need to see how this relationship has its own fragmentation and thus how it impacts fragmented risk. The current practice of procuring insurance has problems and troublesome inconsistencies. The attention here is on the duty to procure, the special

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[77] Thomas C. Morrill, *Motorists' Financial Responsibility Laws*, *in* PROPERTY AND LIABILITY INSURANCE HANDBOOK, *supra* note 9, at 579.

[78] *Id.* at 580.

[79] *See* PIERCE, *supra* note 5, at 122–97.

[80] 3 COUCH ON INSURANCE § 46:46 (Lee R. Russ & Thomas F. Segalla, eds., 3d ed. 2009).

relationship, the request for "full coverage," and how these fail to address fragmented risk.

AN AGENT'S DUTY TO PROCURE BUT NOT TO ADVISE

Insureds ask agents for insurance, sometimes for the vague "full coverage," sometimes for a bid to match their existing coverage whether that coverage is suitable or not, and sometimes for lowest cost available. Agents have a duty to procure the coverage requested, and like any agent for a principal to report back what they could and could not do, in this case to say they found the coverage at certain prices or were unable to obtain that specific coverage.[81] Failure to procure or report is a breach of duty to procure, or more generally stated, negligence.[82] This is easy enough to resolve. The problem that ensnares the parties is when the agent does as requested but the loss turns out uncovered: here the insured claims he or she relied upon the agent for advice but got none, and would have paid more if informed of the availability of broader coverage but did not know of the optional coverage. This common assertion was specifically rejected in a North Carolina case, *Pinney v. State Farm Mutual Insurance Co.,*[83] typical of the scenario, where the insured claimed he would have increased his automobile liability limits above the minimum in order to obtain higher uninsured motorist limits[84]; the court upheld a motion to dismiss saying there was no duty to advise, and it was "entirely speculative" that the insured would have raised his liability limits.[85]

Courts almost uniformly hold that insurance agents have no duty to advise absent a "special relationship" that imposes such

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[81] *Id.*

[82] *Id.*

[83] Pinney v. State Farm Mut. Ins. Co., 552 S.E.2d 186 (N.C. Ct. App. 2001).

[84] *Id.* at 190–91.

[85] *Id.* at 191.

a duty.[86] A California case, *Paper Savers, Inc. v. Nacsa*, citing to several earlier cases is representative of this nearly-nationwide position:

> In the absence of an express agreement to ensure adequate coverage or a holding out by the agent to assume greater duties otherwise implied in the agency relationship, the onus is thus squarely on the insured to inform the agent of the insurance he requires. (*Ibid.; see also Gibson v. Government Employees Ins. Co.* (1984) 162 Cal. App. 3d 441, 452, 208 Cal. Rptr. 511 [not part of general duty to advise on optimum coverage amounts or types of insurance available on the general market or to warn when coverage is too low]; *Shultz Steel Co. v. Hartford Accident & Indemnity Co.* (1986) 187 Cal. App. 3d 513, 522–23, 231 Cal. Rptr. 715 [public policy militates against imposing duty on insurer to advise of availability of coverage beyond that requested by insured]; *Ahern v. Dillenback* (1991) 1 Cal. App. 4th 36, 42–43, 1 Cal. Rptr. 2d 339 [agent has no duty to procure more or different insurance coverage than insured requested]; *Malcom v. Farmers New World Life Ins. Co.* (1992) 4 Cal. App. 4th 296, 303–04, 5 Cal. Rptr. 2d 584 [insurer had no affirmative duty to advise insured specifically about suicide exclusion and its effect on coverage].)[87]

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86 *See, e.g.,* Paper Savers, Inc. v. Nacsa, 51 Cal. App. 4th 1090 (1996)*;* Buelow v. Madlock, 206 S.W.3d 890 (Ark. Ct. App. 2005).

87 *Paper Savers, Inc.*, 51 Cal. App. 4th at 1096. A few cases from other jurisdictions to this point are: Murphy v. Kuhn, 682 N.E.2d 972, 974 (N.Y. 1997) ("insurance agents have a common-law duty to obtain requested coverage for their clients within a reasonable time or inform the client of the inability to do so; however, they have no continuing duty to advise, guide or direct a client to obtain additional coverage"); Herdendorf v. GEICO Ins. Co., 77 A.D.3d 1461, 1463 (N.Y. App. Div. 2010) ("[A] general request for coverage does not trigger a duty to recommend coverage for every scenario"); City Blueprint & Supply Co., Inc. v. Boggio, et al., 2008-1093, p. 66 (La. App. 4 Cir. 12/17/08); 3 So. 3d 62, 66 (no duty to identify the insured's coverage needs and advise him accordingly); Tornado Techs., Inc. v. Quality Control Inspection, Inc., 977

An Arkansas court in *Buelow v. Madlock* said about the same thing:

> Our supreme court has ruled that an insurance agent has no duty to advise or inform an insured as to insurance coverages; instead, our law places the responsibility on the policy holder to educate himself concerning matters of insurance. *Scott–Huff Ins. Agency v. Sandusky*, 318 Ark. 613, 887 S.W.2d 516 (1994); *Howell v. Bullock*, 297 Ark. 552, 764 S.W.2d 422 (1989); *Stokes v. Harrell*, 289 Ark. 179, 711 S.W.2d 755 (1986). The court adopted this position in *Stokes v. Harrell, supra*, and in doing so, it recognized an exception where there is a special relationship between the agent and the insured, as evidenced by an established and ongoing relationship over a period of time, with the agent being actively involved in the client's business affairs and regularly giving advice and assistance in maintaining proper coverage for the client.[88]

Consider this interesting case from Minnesota –– *Paul v. Holmgren* ––[89] that pushes the question of what the insured wanted for coverage and what the agent knew, to a very unusual loss exposure. The parents, the Pauls, bought a house for their daughter and son-in-law; everyone knew the house needed foundation work; the daughter went to an insurance agent to

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N.E.2d 122, 127 (Ohio. Ct. App. 2012) ("We conclude that FAC's exercise of good faith and reasonable diligence was satisfied in obtaining the insurance as requested by QCI over the years, but there was no duty to advise QCI, without them furnishing additional and pertinent information, that additional coverage was needed."); Emerson Elec. Co. v. Marsh & McLennan Cos., 362 S.W.3d 7, 9 (Mo. 2012); Am. Family Mut. Ins. Co. v. Dye, 634 N.E.2d 844,848 (Ind. Ct. App., 1994) (no duty to advise absent special relationship); 735 ILL. COMP. STAT. ANN. 5/2-2201(West 2013) (Illinois statute specifying ordinary care for insurance agents).

[88] *Buelow*, 206 S.W.3d at 893.

[89] Paul v. Holmgren, No. 60-CV-10-1789, 2012 WL 2368878 (Minn. Ct. App. June 25, 2012).

obtain insurance and asked for a homeowners policy, but the agent said that was not available because she was not the homeowner but a tenant; and so the insurance agent provided a renter's policy to the daughter and the husband and a "named perils" dwelling-owners' policy for the Pauls.[90] Then the Pauls' hired a contractor to move the house to a new foundation, but the house fell from the dolly, and the house was a total loss.[91] The contractor had insufficient insurance, and the Pauls then typically went after the insurance agent, alleging "negligence and breach-of-contract claims against Noah for failing to procure insurance to cover the house move."[92] The appellate court said it was a question of fact whether the agent knew of the plan to move the house and the need for specific coverage for that risk; otherwise the agent had no duty to inquire as to the insured's needs.[93]

GETTING ADVICE REQUIRES A SPECIAL RELATIONSHIP

For an agent to be obligated to do more than merely procure requires an affirmative request by the insured to the agent to provide advice, which creates the legal "special relationship" or "special circumstances" that imposes the duty, which turns the agent into an advisor if not risk manager.[94] Leave aside the reality that often the insured does not want advice but instead wants the least expensive insurance and tells the agent exactly that, and the agent so notates his or her file. Leave that aside. For the insured who really would have taken advice from a

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90 *Id.* at *1.

91 *Id.*

92 *Id.* at *1. Noah was the insurance agent in the case. *Id.*

93 *Id.* at *3.

94 *See, e.g.,* Gust K. Newberg Constr. Co. v. E. H. Crump & Co., No. 84 C 3257, 1986 WL 4152, at *16 (N.D. Ill. Mar. 31, 1986) *aff'd,* 818 F.2d 1363 (7th Cir. 1987); *see also* 3 COUCH ON INSURANCE, *supra* note 80, at §§ 46:59–61 (explaining no duty to advise absent special relationship, and cases collected therein). An excellent account of this topic is by Douglas Richmond, *Insurance Agent and Broker Liability*, 40 TORT TRIAL & INS. PRAC. L.J. 1 (2004); *see also* cases cited in *supra* note 87.

knowledge and reliable agent, the nastiness is that the insured does not know the law requires him or her to say to the agent:

> You are the expert in this. I need insurance. I don't want you only to procure quotes for insurance. I want you to advise me. I intend for us to have a 'special relationship' under the law so you will give me advice. Evaluate my exposures and my coverage needs. I rely upon you for advice.

If only the insured knew more about insurance agents and special relationships under the law, the insured would not have to know much about insurance.

As Douglas Richmond, an authority on insurance intermediary law, says,

> If an intermediary and an insured are not a good fit because the insured needs the protection attending a special relationship and the intermediary is unwilling to accept the duties that inhere in such a relationship, the insured must look elsewhere for assistance with its insurance needs because the intermediary will not be held liable for failing to advise the insured in the way the insured would have wished, given hindsight.[95]

None of this agency stuff matters if the insured buys on-line directly from the insurer, where the insured is largely price-driven in his or her selections.

Whether the roles of intermediaries should change is a topic to be addressed another time.

"FULL COVERAGE" IS . . . WHAT?

Insureds often contend they told the agent they wanted "full coverage," seeming to follow their father's advice, and their father's father's advice, to ask for "full coverage." Asking for "full coverage" should solve the fragmented risk problem by

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95 Douglas R. Richmond, *Agents and Brokers*, *in* 1 NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION 2-1, 2-53 (Jeffrey E. Thomas & Francis J. Mootz, III eds., 2d ed. 2009).

getting the agent to put together the package with appropriate endorsements to patch up the exclusions and limitations that later leave the insured uncovered. Except no one knows what "full coverage" means, and so the request is unenforceable as a matter of law.

It is probably from the automobile insurance side that we see the vague and unenforceable request for "full coverage," meaning *property insurance* for the vehicle itself, in addition to the required liability insurance to meet the financial responsibility laws. This is illustrated by a 1924 Texas case, *Merchants' & Manufacturers' Inter-Insurance Alliance v. Hansen*, in which the court said "full coverage" was understood to include liability, fire, theft, and collision insurance.[96] A 1928 Texas case did not even mention liability coverage within its definition of "full coverage," despite citing to *Merchants v. Hansen*, but instead limited the coverage to the vehicle itself.[97] Even a 1987 decision cited *Merchants v. Hansen* for the point.[98] A 1947 Virginia decision referred to "full coverage" as meaning both property and casualty on the vehicle.[99] Property insurance on the vehicle had its own complications if there was a secured interest on the car and the lender had the vehicle insured against collision and theft loss, because then the owner, as in *Merchants v. Hansen*, could not also procure the property insurance, there being no remaining insurable interest to protect.

Though financial responsibility laws still require only liability coverage, and collision/comprehensive coverage remains elective, most people buy both, except for people who own old cars with low market values. Today, a request for "full

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96 Merchants' & Mfrs. Inter-Insurance Alliance v Hansen, 258 S.W. 257, 261 (Tex. Civ. App. 1924).

97 Am. Auto. Ins. Co. v. Baker, 5 S.W.2d 252, 253 (Tex. Civ. App. 1928). Likewise, an Ohio court referred to "full coverage" as meaning the collision endorsement to the fire coverage. *See* Union Ins. Soc. of Canton v. De Salvo, 17 Ohio App. 477, 477 (1923).

98 Soliz v. S. Farm Bureau Cas. Co. (*In re* Soliz), 77 B.R. 93, 95 (Bankr. N.D. Tex. 1987).

99 Va. Ins. Rating Bureau v. Commonwealth *ex rel.* State Farm Mut. Auto. Ins. Co., 42 S.E.2d 419, 424 (Va. 1947).

coverage" in automobile insurance is often interpreted to mean uninsured motorist coverage, although this often requires only inquiry by the insurance agent as to what the insured really wants for his automobile insurance.[100] Full coverage can mean many other ancillary vehicle coverages as well, said a Kentucky court, giving numerous examples[101] Other examples where full coverage was asserted and rejected are property coverage beyond the assigned risk limit;[102] some unlimited, unspecified coverage limit beyond a "typical" $50,000 or $100,000 per person limit;[103] workers' compensation when excluded in a commercial automobile insurance policy;[104] or trailer coverage.[105]

Full coverage can also be requested for any other types of insurance, even though the courts reject vague intent as a basis for imposing liability on insurance agents.[106] "An agent's duty to

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[100] *See, e.g.,* Johnson v. Urie, 405 N.W.2d 887, 892 (Minn. 1987); Parker v. Amica Mut. Ins. Co., 395 A.2d 507, 510 (N.H. 1978); Miller v. Liberty Mut. Ins. Co., 438 So. 2d 939, 940 (Fla. Dist. Ct. App. 1983); McDonald v. Keystone Ins. Co., 459 A.2d 1292, 1294–95 (Pa. Super. Ct. 1983); Wiley v. Osmun, No. 10-000209-NI, 2012 WL 2948576, at *6 (Mich. Ct. App. July 19, 2012); Broderick v. Dairyland Ins. Co., 2012 WY 22, 270 P.3d 684, 692 (Wyo. 2012). *But see* Jones v. Kennedy, 108 S.W.3d 203, 208 (Mo. Ct. App. 2003).

[101] Flowers v. Wells, 602 S.W.2d 179, 181 (Ky. Ct. App. 1980).

[102] Madhvani v. Sheehan, 234 A.D.2d 652, 653–54 (N.Y. App. Div. 1996).

[103] Michael Schag, *The Case for Expanded Illinois Insurance Producer Duties,* 16 N. ILL. U. L. REV. 433, 438–39 (1996).

[104] Trotter v. State Farm Mut. Auto. Ins. Co., 377 S.E.2d 343, 347–48 (S.C. Ct. App. 1988) ("A request for 'full coverage' . . . does not place an insurance agent under a duty to determine the insured's full insurance needs. . . . Trotter himself was admittedly aware of workers' compensation insurance . . . .").

[105] *See, e.g.*, Conner v. Union Auto. Ins. Co., 9 P.2d 863, 865 (Cal. Ct. App. 1932) (holding that coverage did not extend to a trailer that was attached to the insured's vehicle).

[106] *See, e.g.*, Turner, Wood & Smith, Inc. v. Reed, 311 S.E.2d 859, 860 (Ga. Ct. App. 1983) (discussing homeowners insurance); Stillwell v. Allstate Ins. Co., 663 F.3d 1329, 1333 (11th Cir. 2011) (applying Georgia law to landlord's insurance); Rotan v. Farmers Ins. Group of Cos., 2003 OK CIV APP 11, 83 P.3d 894, 895 (discussing gap coverage on vehicle); Small v. King, 915 P.2d 1192, 1194 (Wyo. 1996) (discussing event coverage); Barns v. McCarty, 893 N.E.2d 325, 328 (Ind. Ct. App. 2008) (discussing third-party drivers on automobile

provide correct coverage cannot be triggered by a client's request for 'full coverage' because the request is not a specific inquiry about a specific type of coverage," is a common judicial statement, here from a 1996 Wyoming decision.[107] In a recent Massachusetts case, the insured requested "full coverage" for a vacant building to be re-built into a single-family home for re-sale, and the agent "explained that no policy covers every possible risk"; the agent then set about to find a specified perils policy to cover the building, instead of an all risk policy, because the agent could not procure such a policy on a vacant building; and the court held that "fully insured" could not mean an all risk policy.[108]

Sometimes insureds do not seem to understand the term "full coverage," and, as a result, they misrepresent that

policy); Beauty Craft Supply & Equip. Co. v. State Farm Fire & Cas. Ins. Co., 479 N.W.2d 99, 101 (Minn. Ct. App. 1992) (discussing employee dishonesty coverage where insured requested agent to provide coverage same as existing policy); Catalanotto v. Commercial Mut. Ins. Co., 285 A.D.2d 788, 790 (N.Y. App. Div. 2001) ("[I]t is undisputed that plaintiffs made no request for coverage protecting against damage caused by the weight of snow or ice. At best, plaintiffs made a generalized request that defendant 'cover [them] on everything,' the very kind of request that has been repeatedly held to be insufficient . . . "); Dewyngaerdt v. Bean Ins. Agency, Inc., 855 A.2d 1267, 1270 (N.H. 2004) (holding that a tree trimmer's request for full coverage was too vague to put agent on notice of need for wrongful cutting coverage); Bos. Camping Distrib. Co. v. Lumbermens Mut. Cas. Co., 282 N.E.2d 374, 376 (Mass. 1972) ("The president of the plaintiff corporation was expressing his intention to procure a good insurance contract. Any reply made by the broker was expressive of present intention but was not in its effect a contract."); 12 ERIC MILLS HOLMES, HOLMES' APPLEMAN ON INSURANCE 224–28 (2d ed. 1999). *But see, e.g.*, Shelter Mut. Ins. Co. v. Davis, 753 N.W.2d 18 (Iowa Ct. App. 2008) (holding that an off-premises exclusion should be voided under the reasonable expectations doctrine where an insured had contacted his agent with the express request of "full coverage" on his ATVs); Stamps v. Consol. Underwriters, 468 P.2d 84, 89 (Kan. 1970) (requesting full coverage to include sons on vehicles not met where sons were excluded on the vehicles).

[107] Small v. King, 915 P.2d 1192, 1194 (Wyo. 1996); *see also* Myers v. Yoder, 921 N.E.2d 880 (Ind. Ct. App. 2010) (rejecting insured's contention that a request for full coverage imposed a duty on the agent to provide advice).

[108] Barrett Fin. Corp. v. Pine Ins. Agency, Inc., No. CV99-02371C, 2000 WL 1273357, at *1–3 (Mass. Supp. Apr. 20, 2000).

information to the police officer when they are in a vehicular accident.[109]

CAN WE DO BETTER?

The insured-agent practice does not patch up fragmented risk. There is, however, much more to be said about that practice and how it might be improved, but the focus here is on fragmented risk in the coverage itself, and whether this can be remedied.

From the current perspective, insurance coverage can look badly fragmented. However, from the historical perspective, insurance is a story of integrating coverages from separate forms and separate companies into more comprehensive coverage, thus showing a de-fragmenting of perils and insurance coverage. This is a better perspective, but not enough, and it still puts the insured in situations without sufficient coverage because gaps and splits remain. Moreover, there are new hazards not addressed by the existing insurance or opened up by carved out exclusions. Some gaps could have been filled had the insured known what to buy, but the better insurance providers are quick to add these fillers to distinguish their superior products.

This symposium is supposed to see if we can do better, instead of justifying the status quo. Can we try some new ways to provide more coverage options to the insured, help the insured make better decisions, and give the agent a less defensive position to be in? If we take the insured at his or her word that he or she would have bought additional coverage had they been offered the coverage, then "*à la carte* insurance" or "modules of coverage," which the insured selects with transparent prices, could solve some problems. I conclude it should, in theory, work, but in practice it will create new problems.

"À LA CARTE" OR "MODULES OF COVERAGE"

The proposal is to let—or make—the insured select the coverage he/she actually wants, enabling the insured to see the

[109] Vonault v. O'Rourke, 33 P.2d 535, 543 (Mont. 1934); *see also* Schlenker v. Egloff, 24 P.2d 224, 227 (Cal. Ct. App. 1933).

price for each additional coverage or removal of exclusion. I also propose to make the choices more extensive by including what is now separate warranty coverage.

My original idea has historical precedent and is currently used in some commercial coverage. John Magee, in his 1955 book, describes an "optional-perils policy," where perils are listed by line including extensions to the right for the amount of coverage, rate, and premium.[110] The form states "insurance is provided only against those perils and for only those coverages indicated below by a premium charge."[111] One industry publication, *Property Insurance Report*, proposed a "cafeteria plan" for homeowners coverages in 2003, but concluded that the insurers did not have the data to actually price the particular separate coverages.[112]

This *à la carte* coverage pricing is now done at varying degrees with some forms of insurance. For example, homeowners insurance under California law, *California Insurance Code* § 10102, requires something similar to this for replacement cost options showing the available expansions of coverage from the actual cash value, to "replacement cost coverage," to "extended replacement cost" coverage that adds 25% above the limit, to "guaranteed replacement cost coverage" that has no limit.[113] The mandatory disclosure looks like this:

> NOTICE TO CONSUMERS -- CALIFORNIA RESIDENTIAL INSURANCE DISCLOSURE
>
> This disclosure is required by Section 10102 of the California Insurance Code. This form provides general information related to residential property insurance and is not part of your residential property insurance policy. Only the specific provisions of your policy will determine whether a

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110 MAGEE, *supra* note 37, at 218.

111 *Id.*

112 DOES HOMEOWNERS INSURANCE FINALLY HAVE A PROFITABLE FUTURE?, PROPERTY INSURANCE REPORT 5–6 (2003). The April 22, 2013 issue noted that its prediction had not come to be. Thanks to Steven Weisbart for alerting me to this.

113 CAL. INS. CODE § 10102 (West 2013).

particular loss is covered and the amount payable. The information provided does not preempt existing California law.

PRIMARY FORMS OF RESIDENTIAL DWELLING COVERAGE

You have purchased the coverage(s) checked below. NOTE: Actual Cash Value Coverage is the most limited level of coverage listed. Guaranteed Replacement Cost is the broadest level of coverage.

___ ACTUAL CASH VALUE COVERAGE pays the costs to repair the damaged dwelling minus a deduction for physical depreciation. If the dwelling is completely destroyed, this coverage pays the fair market value of the dwelling at time of loss. In either case, coverage only pays for costs up to the limits specified in your policy.

___ REPLACEMENT COST COVERAGE is intended to provide for the cost to repair or replace the damaged or destroyed dwelling, without a deduction for physical depreciation. Many policies pay only the dwelling's actual cash value until the insured has actually begun or completed repairs or reconstruction on the dwelling. Coverage only pays for replacement costs up to the limits specified in your policy.

___ EXTENDED REPLACEMENT COST COVERAGE is intended to provide for the cost to repair or replace the damaged or destroyed dwelling without a deduction for physical depreciation. Many policies pay only the dwelling's actual cash value until the insured has actually begun or completed repairs or reconstruction on the dwelling. Extended Replacement Cost provides additional coverage above the dwelling limits up to a stated percentage or specific dollar amount. See your policy for the additional coverage that applies.

___ GUARANTEED REPLACEMENT COST COVERAGE covers the full cost to repair or replace the damaged or destroyed dwelling for a covered peril regardless of the dwelling limits shown on the policy declarations page.

___ BUILDING CODE UPGRADE COVERAGE, also called Ordinance and Law coverage, is an important option that covers additional costs to repair or replace a dwelling to comply with the building codes and zoning laws in effect at the time of loss or rebuilding. These costs may otherwise be excluded by your policy. Meeting current building code requirements can add significant costs to rebuilding your home. Refer to your policy or endorsement for the specific coverage provided and coverage limits that apply.

READ YOUR POLICY AND POLICY DECLARATIONS PAGE CAREFULLY: The policy declarations page shows the specific coverage limits you have purchased for your dwelling, personal property, separate structures such as detached garages, and additional living expenses. The actual policy and endorsements provide the details on extensions of coverage, limitations of coverage, and coverage conditions and exclusions. The amount of any claim payment made to you will be reduced by any applicable deductibles shown on your policy declarations page. It is important to take the time to consider whether the limits and limitations of your policy meet your needs. Contact your agent, broker, or insurance company if you have questions about what is covered or if you want to discuss your coverage options.

INFORMATION YOU SHOULD KNOW ABOUT RESIDENTIAL DWELLING INSURANCE

AVOID BEING UNDERINSURED: Insuring your home for less than its replacement cost may result

in your having to pay thousands of dollars out of your own pocket to rebuild your home if it is completely destroyed. Contact your agent, broker, or insurance company immediately if you believe your policy limits may be inadequate.

THE RESIDENTIAL DWELLING COVERAGE LIMIT: The coverage limit on the dwelling structure should be high enough so you can rebuild your home if it is completely destroyed. Please note:

• The cost to rebuild your home is almost always different from the market value.

• Dwelling coverage limits do not cover the value of your land.

• The estimate to rebuild your home should be based on construction costs in your area and should be adjusted to account for the features of your home. These features include but are not limited to the square footage, type of foundation, number of stories, and the quality of the materials used for items such as flooring, countertops, windows, cabinetry, lighting and plumbing.

• The cost to rebuild your home should be adjusted each year to account for inflation.

• Coverage limits for contents, separate structures, additional living expenses and debris removal are usually based on a percentage of the limit for the dwelling. If your dwelling limit is too low, these coverage limits may also be too low.

You are encouraged to obtain a current estimate of the cost to rebuild your home from your insurance agent, broker, or insurance company or an independent appraisal from a local contractor, architect, or real estate appraiser. If you do obtain an estimate of replacement value, and wish to change your policy limits, contact your insurance

company. While not a guarantee, a current estimate can help protect you against being underinsured.

DEMAND SURGE: After a widespread disaster, the cost of construction can increase dramatically as a result of the unusually high demand for contractors, building supplies and construction labor. This effect is known as demand surge. Demand surge can increase the cost of rebuilding your home. Consider increasing your coverage limits or purchasing Extended Replacement Cost coverage to prepare for this possibility.

CHANGES TO PROPERTY: Changes to your property may increase its replacement cost. These changes may include the building of additions, customizing your kitchen or bathrooms, or otherwise remodeling your home. Failure to advise your insurance company of any significant changes to your property may result in your home being underinsured.

EXCLUSIONS: Not all causes of damage are covered by common homeowners or residential fire policies. You need to read your policy to see what causes of loss or perils are not covered. Coverage for landslide is typically excluded. Some excluded perils such as earthquake or flood can be purchased as an endorsement to your policy or as a separate policy. Contact your agent, broker, or insurance company if you have a concern about any of the exclusions in your policy.

CONTENTS (PERSONAL PROPERTY) COVERAGE DISCLOSURE:

This disclosure form does not explain the types of contents coverage provided by your policy for items such as your furniture or clothing. Contents may be covered on either an actual cash value or replacement cost basis depending on the contract.

Almost all policies include specific dollar limitations on certain property that is particularly valuable, such as jewelry, art, or silverware. Contact your agent, broker or insurance company if you have any questions about your contents coverage. You should create a list of all personal property in and around your home. Pictures and video recordings also help you document your property. The list, photos, and video should be stored away from your home.

CONSUMER ASSISTANCE

If you have any concerns or questions, contact your agent, broker, or insurance company. You are also encouraged to contact the California Department of Insurance consumer information line at (800) 927-HELP (4357) or at www.insurance.ca.gov for free insurance assistance."

(b) The agent or insurer shall indicate on the disclosure form which coverages the applicant or insured has selected or purchased.

(c) The disclosure statement may contain additional provisions not conflicting with, annulling, or detracting from the foregoing.

(d) Following the issuance of the policy of residential property insurance, the insurer shall provide the disclosure statement to the insured on an every-other-year basis at the time of renewal. The disclosure required by this section may be transmitted with the material required by Section 10086.1.

(e) No policy of residential property insurance may be initially issued on and after January 1, 1993, as guaranteed replacement cost coverage if it contains any maximum limitation of coverage based on any set dollar limits, percentage

amounts, construction cost limits, indexing, or any other preset maximum limitation for covered damage to the insured dwelling. The limitations referred to in this section are solely applicable to dwelling structure coverages. Endorsements covering additional risks to the insurer's dwelling structure coverage may have internal limits as long as those endorsements are not called guaranteed replacement cost coverage.

(f) On and after July 1, 1993, no policy of residential property insurance may be renewed as guaranteed replacement cost coverage if it contains any maximum limitation of coverage based on any set dollar limits, percentage amounts, construction cost limits, indexing, or any other preset maximum limitation for covered damage to the insured dwelling. The limitations referred to in this section are solely applicable to dwelling structure coverages. Endorsements covering additional risks to the insurer's dwelling structure coverage may have internal limits as long as those endorsements are not called guaranteed replacement cost coverage.

(g) Coverage provided for building code upgrades by a policy of residential property insurance shall be applicable to building codes, ordinances, standards, or laws only to the extent that those codes, ordinances, standards, or laws do not impose stricter standards on the property on the basis of the level of insurance coverage applicable to the property.

(h) The disclosure required by Section 10101 shall also be provided to the mortgagor in the event that a policy is forced placed by an insurer at the request of a mortgagee. In those cases, neither the insurer nor the mortgagee shall be required to obtain a signature from the mortgagor. No disclosure shall be required to be provided with respect to blanket policies issued to a mortgagee,

> and designed to provide interim coverage for losses occurring prior to the mortgagee obtaining knowledge of the lapse of the policy and prior to placement of a policy on behalf of the mortgagor.
>
> (i) This section shall become operative on July 1, 2011.[114]

This California disclosure form is a start towards what I have in mind for showing the consumer the optional coverages available. There are, however, many problems with the form: it is long; it is confusing in some respects; and it leaves the insured still wondering whether "replacement cost coverage" is really replacement cost coverage, unless the consumer has the insurance expert's knowledge of the distinctions between replacement cost coverage, extended replacement cost coverage, and guaranteed replacement cost coverage—even with the information provided. Another flaw is that it is a disclosure rather than a selection form. Extensive studies have established that disclosures do not work with consumers because of information overload, cognitive bias, and lack of financial literacy, and because consumers do not read them.[115]

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[114] *Id.*

[115] *See, e.g.*, Omri Ben-Shahar and Carl. E. Schneider, *The Failure of Mandated Disclosure*, 159 U. PA. L. REV. 647, 686–89 (2011) (overload and accumulation effects); Matthew A. Edwards, *Empirical And Behavioral Critiques Of Mandatory Disclosure: Socio-Economics And The Quest For Truth In Lending*, 14 CORNELL J.L. & PUB. POL'Y 199, 221–22 (2005) (information overload and cognitive and behavioral limitations); ARCHON FUNG, MARY GRAHAM & DAVID WEIL, FULL DISCLOSURE: THE PERILS AND PROMISE OF TRANSPARENCY 33–34 (2007) (bounded rationality); MARK FURLETTI, FEDERAL RESERVE BANK OF PHILADELPHIA, FEDERAL CONSUMER PROTECTION REGULATION: DISCLOSURES AND BEYOND, 7–10 (2005) (disclosures must be simple and information must be provided at the right time); Roman Inderst, *Consumer Protection and the Role of Advice in the Market for Retail Financial Services*, 167 J. INST. & THEOR. ECON. 4, 6–7 (2011) (low financial literacy and behavioral biases); Florencia Marotta-Wurgler, *Does Disclosure Matter?* N.Y.U. L. & ECON. RESEARCH PAPER SERIES No. 10-54 1, 30 (2010), *available at* http://ssrn.com/abstract=1713860 ("[S]hoppers in our setting simply don't react to what they read, as they either don't pay much attention to the contract terms or don't understand them well enough to affect their purchase decision."); Florencia Marotta-Wurgler, *Will Increased Disclosure Help? Evaluating the Recommendations of the Ali's "Principles of the Law of Software Contracts,"* 78 U. CHI. L. REV. 165, 168, 178 (2011) (requiring click through on click-wrap

For automobile insurance, a simple disclosure and option selection form has long been in effect for uninsured motorist coverage, for which most states disclosure of the option for higher or lower limits is shown and requires the insured's signature to reject or reduce uninsured motorist insurance equal to the liability limit.

Cyber insurance is closer to what I have in mind. Cyber insurance has first and third-party coverage and is offered in modules, which includes coverage offered by insurers and selected by the insured. Typical modules, such as those listed by the Chubb Group of Insurance Companies, are cyber liability, privacy notification expense, crisis management expenses, e-

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agreements led to readership of between 0.1 and 1.0%, which "suggests that increased disclosure may simply be unable to induce shoppers to study terms, even when they are being required to confirm their assent"); Robert A. Prentice, *Moral Equilibrium: Stockbrokers and the Limits of Disclosure,* 2011 WIS. L. REV. 1059, 1069–72 (2011) (bounded rationality, rational ignorance, irrational optimism); Shmuel I. Becher & Esther Unger-Aviram, *The Law of Standard Form Contracts: Misguided Intuitions and Suggestions for Reconstruction*, 8 DEPAUL BUS. & COMM. L.J. 199, 213 (2010) (81% of surveyed consumers do not read standard form contracts); Brenda J. Cude, *Insurance Disclosures: An Effective Mechanism to increase Consumers' Insurance Market Power?*, 24 J. INS. REG. 57, 69 (2006) ("The evidence from the focus groups suggests that many consumers do not read and understand insurance disclosures, and misinterpretations are likely among at least some consumers who do read disclosures. However, without a stated, specific objective it was difficult to know how to evaluate consumer understanding of the disclosures. It is surprising how often information disclosures are required when there is so little evidence that they have an impact on consumer behavior and that any impact they do have is the one intended."); Steven L. Schwarcz, *Rethinking the Disclosure Paradigm in A World of Complexity*, 2004 U. ILL. L. REV. 1, 16 (2004) (focusing on investors) ("In a world of complexity, disclosure alone will sometimes be insufficient to remedy the information asymmetry between the originator and its investors."); Melissa T. Lonegrass, *Finding Room for Fairness in Formalism - The Sliding Scale Approach to Unconscionability*, 44 LOY. U. CHI. L.J. 1, 29–30 (2012) ("consumers suffer from a variety of practical, cognitive, and behavioral limitations that, working together, render them ignorant of standardized terms and largely incapable of assessing their associated risks"); Samuel Issacharoff, *Disclosure, Agents and Consumer Protection*, 167 J. INST. & THEOR. ECON. 56, 61 (2011) ("The behavioral analysis of consumer behavior starts with the insight that for reasons of neurology, costs of information, and the sheer complexity of the decisions that have to be made in everyday life, all individuals rely on decisional heuristics for guidance. Sometimes, these heuristics serve us well; at other times they lead us predictably astray.").

business interruption and extra expenses, e-theft loss, e-communication loss, e-threat expenses, e-vandalism expenses, and reward expenses.[116] Philadelphia Insurance Companies lists loss of digital assets, non-physical business interruption and extra expense, cyber extortion, cyber terrorism, security event costs, network security and privacy liability coverage, employee privacy liability coverage, and electronic media liability coverage.[117] Other companies, such as Ace, offer cyber modules that look like these, but, because cyber insurance is still an evolving type of policy, uniformity across insurers is not the norm. Cyber insurance is for businesses and is chosen and crafted by risk managers and specialized brokers; thus, it usually involves a sophisticated buyer.[118]

WHAT À LA CARTE COVERAGE MIGHT LOOK LIKE

Let us consider the homeowners policy for *à la carte* coverage. The first question is, do we start with the 1943 standard fire and lightning policy and offer individual coverages up from there? If so, we wind up re-creating the 1937 Extended Coverage Endorsement and the Additional Extended Coverage Endorsement. That does not move us very far towards solving the problem of de-fragmenting coverage. In fact, it seems to move us backwards by about sixty years. All these perils are in the HO-2 form,[119] which seems a good place to start looking at *à la carte* choices, or "price fixe with choices," as Professor

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116 CHUBB GROUP OF INSURANCE COMPANIES, CYBERSECURITY BY CHUBB NEW BUSINESS APPLICATION, FORM #14-03-1007 (2012).

117 PHILADELPHIA INSURANCE COMPANIES, CYBER SECURITY LIABILITY RENEWAL APPLICATION (2010).

118 Sometimes the buyers are unsophisticated and merely demand any type of cyber insurance to be able to claim coverage in their cyber disclosures required by the SEC. *See* Susanne Sclafane, *"Just Get Me Coverage" Requests Come In To Cyber Brokers*, ADVISEN NEWS (June 3, 2012), http://fpn.advisen.com/articles/article176787335170070 1889.html?elq_mid=18493&elq_cid=1440352; SEC. AND EXCH. COMM'N, CF DISCLOSURE GUIDANCE: TOPIC NO. 2 - CYBERSECURITY (2011), *available at* http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm.

119 *See* RICHARDSON, *supra* note 38, at 2.

Stempel prefers to call them.[120] Related to that, we should abandon the 1943 form, which was crafted as a fire policy only, and which is useless as a standard anymore.[121]

Another thing to consider: maybe we should also scotch sublimits and percentages for other structures, instead adding it to total available value, like blanket coverage. And maybe we should scotch some of the sublimits where this can be done without incurring moral hazard or fraud.

As a concept, then, a homeowners insurance application for the property exposures, set up for à *la carte* selections and based loosely on the specified perils HO-2 form, might look like the following. I include some things that the current forms make optional such as ordinance and law coverage, sewer backup, and foundations, because I believe that these should be included in standard coverages. I also include a few things that I think should be available, such as no limits to rebuild following a catastrophe, because one cannot insure to value for a loss *and* insure to value for a catastrophe loss without then being over-insured. Thus, the insured who gets the replacement cost right on the policy can find himself short by hundreds of thousands of dollars in cases of catastrophic losses, such as wildfire and tornadoes. In those cases, the costs to rebuild mounts enormously due to supply and demand mismatch when thousands of homes and businesses have to be re-built at the same time.[122] This should be a risk borne by the insurers, not the individual insureds, who have enough trouble getting the replacement cost right without having to also estimate shifting supply and demand curves on the graph. A few other items listed here are my own suggestions of what might be appropriate to offer. For this paper and conference, I am less interested in

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[120] Jeffrey W. Stempel, Doris S. and Theodore B. Lee Professor of Law, William S. Boyd School of Law, Univ. of Nev., Las Vegas, Rediscovering the Sawyer Solution: Bundling Risk for Profit and Protection, Address at the Fragmented Risk Symposium at the Rutgers Center for Risk and Responsibility (Mar. 1, 2013), *in* 11 RUTGERS J.L. & PUB. POL'Y __ (2013).

[121] This conference has elicited agreement on the need for a new standard policy. A later article will take up that idea.

[122] Joshua Fox, *Softening the Short Shrift: Regulating Homeowners Insurance Limits as Causes of Underinsurance*, 46 CAL. W. L. REV. 369, 389 (2010) (suggesting a solution of "enterprise liability" based on the product liability theory of insurance).

finding agreement on what the coverages and sublimits should be than examining what it looks like to have choices for coverages and sublimits.

By the way, let us quickly abandon any thought to do this on paper for insureds; doing it on paper would be too unwieldy, too retro, and too unlikely to get the consumer to read it. Instead, it should be done with technology—desktop computer, tablet, mobile, whatever the future might bring—at an agent's office, sent to the insured, or on-line for direct writers, and it should be done in an appealing format while building an electronic record.

THINGS WE COVER FOR LOSS				
Property for homeowners who own and live in their house	**Description**	**Maximum Value**	**Mark If Selected**	**Price**
Buildings	Your house, including things attached within, and other structures on the property including stand-alone garage or carport, shed, pool equipment building, gazebo. We also cover foundations.	Total value available for all structures is $_____	included	
All personal property while in your house, or in other structures on the property, or on your property		$________	included	
Grave markers for relatives who previously lived in your house and other structures on your property		As necessary	included	
Silverware		$________		
Jewelry, watches, furs		$________		
Firearms and guns		$________		
Business property		$________		
Money and securities		$________		
Trees and shrubs growing on the property		$________		
All of your personal property off of the premises, including at		$________		

THINGS WE COVER FOR LOSS				
Property for homeowners who own and live in their house	**Description**	**Maximum Value**	**Mark If Selected**	**Price**
storage units				
Property of people other than your relatives who live with you		$________		
Food spoilage		$________		
Off-road vehicles you can ride not that are required to be registered		$________		
Domestic animals		$________		

Perils We Insure Against, If You Choose			
Perils (causes of loss that can be insured against)	Description	Mark If Selected	Price
Fire, lightning, windstorm, hail, falling objects from outside the building, explosion, riot or civil commotion, aircraft, vehicles, smoke, vandalism and malicious mischief, theft, weight of ice snow or sleet, sudden and accidental damage due to tearing apart or due to electrical current, volcanic eruption, sinkhole collapse, sewer back-up.		included	
Sudden and accidental discharge of water, if you have taken reasonable precautions to prevent these from developing			
Mold, fungus, wet rot, if you have taken reasonable precautions to prevent these from developing			
Complete collapse of at least ½ of the building, if you have taken reasonable precautions to prevent this from developing			
Animals			

Perils We Insure Against, If You Choose			
Perils (causes of loss that can be insured against)	Description	Mark If Selected	Price
Pollution, if you have taken reasonable precautions to prevent this from occurring			
Losses caused by lack of maintenance to your house or equipment or appliances			
Earth movement including landslides and earthquakes			
Power failure from the electric utility provider, unless the provider cut off service due to your failure to pay the bill			
Construction defects discovered within 5 years of the construction,			
Construction or repairs that cause a loss, within 2 years of the construction			
Combined perils(concurrent causation) – ½ or full coverage	If a peril you choose and a peril you did not choose both cause a loss in some combination or sequence, we will pay half the total loss. We will pay the full loss if you choose this option.	½ loss included	

Expenses We Pay If A Peril You Choose Causes a Loss to Property You Choose			
Expense	**Description**	**Mark if Selected**	**Price**
Debris removal	Cost to remove the damaged property	included	
Upgrades required by law and regulations	Additional cost to repair and rebuild where laws and regulations require upgrades in building materials and methods from what your house was before the loss.	included	
Extra living expenses	Following a peril that causes a loss, we pay the reasonable extra expenses you incur while your home is damaged and then being repaired within a reasonable time	included	
Fire department and first responder assessments and charges		$750 included	
Homeowner association assessments following loss to the association property by a peril we insure			
Data and collections stored electronically	Valued at the cost you paid for it, or the cost to replace or restore, whichever is less, subject to the limit selected		
Additional 25% rebuilding costs	Up to 25% times the property value will be available to rebuild if necessary		
Additional unlimited rebuilding costs for catastrophe	The policy will pay whatever the cost required to rebuild if the cost exceeds the value due to a declared catastrophe		

If we start instead with an all-risk––open perils––*à la carte* menu, we work backwards, so to speak, and remove some of the exclusions stated in the coverage grant of the HO-3 and in the exclusions section.[123]

We would still need conditions and other provisions, of course. We also need some exclusions, too, which we might put in a menu, depending on whether they could be "de-selected," *i.e.*, city-ordered condemnation and demolition, government confiscation, intentional acts, etc. Moral hazard remains a problem for intentional acts and failure to maintain. I have tried to address failure to maintain by allowing coverage "if you have taken reasonable precautions to prevent these from

[123] The HO-3 has problems of its own as a standard for reasons not relevant to this paper.

developing." Here, a home warranty can be added to coverage selections. If we include coverage for domestic animals, we then wind up adding a bit of animal mortality insurance to the policy, an interesting addition for a homeowners policy, but standard on farm and ranch policies; including coverage for domestic animals will require specification of the cause of loss for that exposure and a specified value.

But does the *à la carte* menu provide sufficient information for a person to make a decision? Absent an expected exposure, like moving a house such as *Paul v. Holmgren* discussed earlier, how could a person decide on the need for coverage for any peril? How likely is it for trees and other objects to fall on one's house, or smoke damage to occur, or rebuilding foundations? This issue suggests we need to modify the above form to add probability weightings to each exposure, knowing that the probability of loss would help make for better-informed decisions. But we should be very skeptical that consumers will actually make better decisions with that much information, given the limits of consumers—indeed any individual—to perfectly understand all information and make perfectly rational decisions.

WILL IT WORK? EXPECTATIONS AND IMPLICATIONS

One positive result with *à la carte* coverage selections would be for consumers to pay more attention to their financial options. An application that forces consumers to choose what they want to cover at what limits and against what exposures would seem to do some good. Consumers have low financial literacy in addition to their low literacy levels,[124] which means that getting them to pay some attention to the insurance that protects their major investments and exposures is surely a good thing. As it is, consumers probably spend more time selecting and comparing features on their home appliances and electronics than they do on the insurance that protects their half-million dollar house or their $40,000 car, even though they

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[124] Richard H. Thaler, *Financial Literacy, Beyond the Classroom*, N.Y. TIMES, Oct. 6, 2013, at B6.

will pay the premium for decades to come.[125] It is not necessary that consumers come to find insurance interesting, or even learn much about it, but, since most people are risk averse and losses would hit them hard, consumers should pay a little attention to how insurance can protect them.[126]

A second positive result of *à la carte* selections would be a reduction in disappointment, and consequentially a reduction in claims against agents and insurers for not informing consumers of the limits of coverages and the availability of other coverage that consumers might need. Agents can recommend coverages, and perhaps they should, but the insured must select from the coverage menu where they can see the price for the coverage selected. Requiring selection of each peril beyond fire and lightning does create a very good record that the insured affirmatively selected or rejected particular coverages, and thus provides a very good defense for insurance agents against claims by insureds for not having procured or recommended coverage.[127]

A third positive result should be a re-work of the reasonable expectations theory of contracts. The merits of the reasonable expectations theory in contract interpretation, particularly as to form contracts, and the limitations of contract adjudication for insurance contracts, is a widely-debated topic in legal literature.[128] As it stands now in insurance contract

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125 Issacharof, *supra* note 115, at 59 (remarking that consumers shop for the best price on washing machines but never question the closing costs on a house purchase). Of course, to the consumer the appliance and car at least do something right away as a product, unlike insurance, which is only a promise and a document until the loss occurs, which might never happen. *See* Michelle Boardman, *infra* note 125, at 1081.

126 HAROLD D. SKIPPER & W. JEAN KWON, RISK MANAGEMENT AND INSURANCE 31–39 (2007) (summarizing how consumers view their risk exposure and make decisions under utility theory and prospect theory); *see also* Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decisions Under Risk,* 47 ECONOMETRICA 263 (1979).

127 *See generally* Russell Korobkin, *The Borat Problem in Negotiation: Fraud, Assent, and the Behavioral Law and Economics of Standard Form Contracts*, 101 CAL. L. REV. 51 (2013).

128 For some articles that discuss reasonable expectations and alternative doctrines that deal with interpretation and application of insurance contracts, *see, e.g.*, Stephen J. Ware, *A Critique of the Reasonable Expectations Doctrine*,

interpretation, insureds who never read their contracts and disclose little to the agent other than a general request for insurance, nevertheless claim *post*-loss to have had reasonable expectations of coverage *pre*-loss about what their expectations would have been had they thought of them, even though most consumers never read their contracts even after the loss.[129] A California court held that an expectation of coverage cannot *create* an ambiguity; rather, it is merely an interpretive tool used to resolve an ambiguity once it is found to exist.[130] Or even more removed, courts imagine what a reasonable consumer now faced with *this* loss would have expected had some reasonable consumer formed some reasonable expectation at a reasonable time earlier. As Michelle Boardman has written on the question of reasonable expectations with her proposal for "tested language":

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56 U. CHI. L. REV. 1461, 1488–89 (1989); Susan Randall, *Freedom of Contract in Insurance*, 14 Conn. Ins. L. J. 107, 111–18 (2008); Jeffrey E. Thomas, *An Interdisciplinary Critique of the Reasonable Expectations Doctrine*, 5 CONN. INS. L. J. 295, 316–19 (1998); David C. Knieriem, *Towards a Unified Theory of Insurance Law*, 67 J. MO. B. 96 (2011); Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconsionability*, 70 U. CHI. L. REV. 1203, 1270-73 (2003); Peter Nash Swisher, *A Realistic Consensus Approach to the Insurance Law Doctrine of Reasonable Expectations*, 35 TORT & INS. L. J. 729 (2000) (explaining reasonable expectations as a type of unconscionability); Kenneth S. Abraham, *Four Conceptions of Insurance*, 161 U. PA. L. REV. 653, 674 (2013).

Professors Schwarcz sand Stempel favor a products liability theory for insurance contracts to deal with contract terms. *See generally* Daniel Schwarcz, *A Products* Liability *Theory for the Judicial Regulation of Insurance Policies*, 48 WM. & MARY L. REV. 1389 (2007); Jeffrey W. Stempel, *The Insurance Policy As Thing*, 44 TORT & INS. L.J. 813 (2009). To my mind, the idea is fanciful and appealing, but when contract forms are regulated, as they are for financial service products, and especially for insurance where the contract is subject to regulatory approval, I prefer setting higher regulatory standards for coverage as the primary solution. *See, e.g.*, Korobkin, *supra* note 127; Lonegrass, *supra* note 115 (favoring unconscionability as the standard for judicial review); *see also* Abraham, *supra* note 128, at 675–76 (disfavoring the concept).

[129] Shmuel I. Becher & Esther Unger-Aviram, *The Law of Standard Form Contracts: Misguided Intuitions and Suggestions for Reconstruction,* 8 DEPAUL BUS. & COMM. L. J. 199, 227 (2010); Knieriem, *supra* note128, at 99.

[130] Fire Ins. Exch. v. Super. Ct., 10 Cal. Rptr. 3d 617, 624–26 (Cal. Ct. App. 2004).

> [c]onsumer evidence would inform the doctrine's central question: Would a reading of the policy language have refuted the consumer's a priori expectation? If so, that pre-policy expectation is no longer 'reasonable' and the court will not construe the policy to provide coverage.[131]

On the negative side, there are several problems. First, an *à la carte* coverage menu looks something like an on-line underwriting manual. This would probably be bad for customer relations; however, it would be good if we call it transparency and consider that many other companies, like the airline reservation systems and many other consumer goods and services, now require consumers to choose goods and services on-line, turning us all into data entry clerks. Second, it also looks a lot like the very annoying unbundled services that airlines and other vendors provide, where everything that seems to make the service better costs extra. Consumers hate paying separately for luggage transport, ticket changes, seats with cushions, and oxygen masks; yet the airlines make billions from these related charges.[132] Electronics and consumer goods companies shove warranty contracts on every product. These *à la carte* choices infuriate consumers by giving them too many choices and making them feel as if the price they see for the ticket or item is more like bait and switch to a pricier deal.

Third, we must be mindful of the erroneous ideal of the rational consumer, who in theory makes perfect decisions with perfect information to maximize utility, against the real bounded rational consumer, who uses limits, shortcuts, and heuristics to make decisions with imperfect information or even misinterpretation of perfect information. An extensive body of research under the heading of behavioral economics addresses this issue, and more detailed studies concern the question of decision making under uncertainty. "Bounded rationality," probably the most important concept under behavioral economics, shows that people are not perfectly rational and have

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[131] Michelle Boardman, *Insuring Understanding: The Tested Language Defense*, 95 IOWA L. REV. 1075, 1079 (2010).

[132] Joe Sharkey*, Fees on Top of Fees Obscure Cost of Flying*, N.Y.TIMES, July 23, 2012, at B5. ($12.4 billion last year from the top six domestic airlines alone).

neither perfect information nor an endless capacity to evaluate best outcomes. Instead, the term "bounded rationality" is used to reflect more realistic decision-making, which in strict terminology can mean rational choice under computational constraints and available information, or more broadly to include heuristics and intuitions.[133] "Even in the presence of seemingly objective information, individuals are prone to a host of cognitive distortions that may lead them to make decisions far different from those predicted in a world of perfect rationality."[134] In short, consumers simply are not up to the task of making complex decisions.

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133 Cassey Lee, *Bounded Rationality and the Emergence of Simplicity Amidst Complexity*, 25 J. ECON. SURVEYS 507, 511–12 (2011). *See generally* John Conlisk, *Why Bounded Rationality?*, 34 J. ECON. LIT. 669 (1996); Daniel Kahneman, *Maps of Bounded Rationality: Psychology for Behavioral Economics*, 93 AM. ECON. REV. 1449 (2003); Amy J. Schmitz, *Pizza-Box Contracts: True Tales of Consumer Contracting Culture*, 45 WAKE FOREST L. REV. 863 (2010); Alan M. White, *Behavior and Contract*, 27 LAW & INEQ. 135 (2009); Susan Block-Lieb & Edward J. Janger, *The Myth of the Rational Borrower: Rationality, Behaviorism, and the Misguided "Reform" of Bankruptcy Law*, 84 TEX. L. REV. 1481 (2006); Russell Korobkin, *Symposium: Law and Economics Conference to Honor Thomas S. Ulen: What Comes After Victory for Behavioral Law and Economics*, 2011 U. ILL. L. REV. 1653 (2011); Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051 (2000); BEHAVIORAL LAW AND ECONOMICS (Cass R. Sunstein ed., 2000); Danielle Kie Hart, *Contract Law Now - Reality Meets Legal Fictions*, 41 U. BALT. L. REV. 1 (2011) (discussing the implication of underlying assumptions of contract law).

134 ARCHON FUNG, *supra* note 115, at 33; *see also* Shmuel I. Becher, *Behavioral Science and Consumer Standard Form Contracts*, 68 LA. L. REV. 117, 120 (2007) ("Nonetheless, the application of behavioral economics insights to consumer contracts calls this fundamental notion into question. Given the cognitive limitations of ordinary people, consumers as a class frequently violate the rational-maximizing-expected-utility function that contract law theory ordinarily attributes to contracting parties. In other words, presuming the efficiency of form contract terms might be misguided due to fundamental behavioral failures on the part of consumers."); Korobkin, *supra* note 127, at 1656 ("To the extent that legal scholars wish to premise their conclusions on the assumption that the relevant actors are perfect optimizers of their material self-interest, they bear the burden of persuasion that this assumption is realistic in the particular context that interests them.")

CONCLUSION

À la carte coverage should solve the identified problem in theory, but in practice it will have major problems. Perhaps if the on-line application for *à la carte* insurance could be made interactive enough to entice the consumer and get the consumer to sit in the agent's office or be on-line with a direct carrier to go through this process, we could anticipate some improvement in customer knowledge, expectations, and satisfaction. We should also expect a reduction of claims against agents and brokers for failure to procure and failure to advise because of the record developed of the consumer's actual choices. These are certainly good things, if we can achieve them.

But I am reluctant to think *à la carte* coverage will actually work. However good and transparent the process may be, consumers are not up to the task, nor will they undertake the task, regardless of all the advice, notices, and warnings we might give them. There is a need for improved regulations; as Korobkin says, "Once the airtight bond between observed and individual welfare maximization is broken, there is no longer a syllogistic relationship between the goal of welfare maximization and a bias against regulation."[135] Improved regulations should include an update of the New York standard fire insurance contract to reflect current minimal levels of coverage such as the HO-2, if not higher levels. There is an opportunity for intermediaries to do more for consumers to help them work through the complexity of insurance, if consumers will let them. And as I noted earlier, we should work to restructure the agency relationship to raise the standard of care, a complex problem in itself that this paper does not take up, and a problem that applies to all financial intermediaries.[136] Towards this, the remarks of a Wisconsin court in 1922 about a health insurance

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[135] Korobkin, *supra* note 127, at 1658.

[136] David J. Cummins & Neil A. Doherty, *The Economics of Insurance Intermediaries*, 73 J. RISK AND INS. 359, 362 (2006). Some of the present limitations of the intermediary relationship are discussed in Hazel Beh & Amanda M. Willis, *Insurance Intermediaries*, 15 CONN. INS. L. J. 571, 588–90 (2009) and Chapter 86 of HOLMES, *supra* note 106. The Securities and Exchange Commission studied the question of standard of care for broker dealers and for financial advisors, pursuant to the mandate of the Dodd-Frank Act. *See generally* U.S. SEC. & EXCH. COMM'N, STUDY OF INVESTMENT ADVISORS AND BROKER DEALERS (2011).

policy remain salient for insurance contracting: "Insurance that does not insure may easily become a delusion and a snare to the unwary. It is well for both parties to the contract that it be made plain, simple, and easy to understand."[137]

137 Fehrer v. Midland Cas. Co., 190 N.W. 910, 913 (Wis. 1923).