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Misclassifying the Insurance Policy: The Unforced Errors of Unilateral Contract Characterization

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MISCLASSIFYING THE INSURANCE POLICY: THE UNFORCED ERRORS OF UNILATERAL CONTRACT CHARACTERIZATION

*Hazel Beh & Jeffrey W. Stempel**

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Once we commit ourselves to such big verbal creatures as “offers for bilateral contracts” or “offers for unilateral contracts,” instead of analyzing the transaction in terms of promises and consequences, the other mistakes follow almost naturally and inevitably.

—Samuel J. Stoljar¹

INTRODUCTION

Longstanding conventional wisdom has commonly characterized the insurance policy as a subspecies of unilateral contract,² although this classification of policies has been a relatively underdeveloped part of insurance law scholarship.³ Tradition also regarded unilateral contracts

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We are particularly appreciative of Professor Perillo's thoughtful comments on an earlier draft of this Article, as they helped us solidify our views. In an April 5, 2010 email, Professor Perillo asked whether our “quarrel is really with the law of the conditions” and challenged us to take on that “bigger project.” We agree that a rigid application of the law of conditions has often impeded justice, particularly because insurance contracts are already troubled by inherent inequalities between the parties. However, rather than upending the law of conditions or asking that insurance become more of an exception within contract law than it already is, we believe that insurance contracts can be liberated from the harsh effects of several contract doctrines, including conditions, by recognizing their bilateral nature.

Professor Perillo also questioned whether our characterization of forfeiture provisions in insurance policies as liquidated damage provisions in disguise was accurate. When a policyholder loses coverage for a seemingly trivial failure to provide notice or to cooperate with the insurer, conventional analysis is that the policyholder forfeits coverage for noncompliance with a condition. We view these provisions as an insurer's attempt to impose liquidated damages upon the policyholder—no coverage as a penalty for breach. To view it this way invites courts to evaluate these provisions under a test of reasonableness in light of actual damages.

¹ *The False Distinction Between Bilateral and Unilateral Contracts*, 64 YALE L.J. 515, 524 (1955).

² See JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACTS § 2.10, at 58 (6th ed. 2009); 1 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS §1.23, at 95 (Perillo rev. ed. 1993); accord MARK S. DORFMAN, INTRODUCTION TO RISK MANAGEMENT AND INSURANCE 151 (8th ed. 2005) (“Most insurance contracts are unilateral contracts.”); GEORGE E. REJDA, PRINCIPLES OF RISK MANAGEMENT AND INSURANCE 99 (9th ed. 2005) (“An insurance contract is a unilateral contract.”); EMMETT J. VAUGHAN & THERESA VAUGHAN, FUNDAMENTALS OF RISK AND INSURANCE 167 (8th ed. 1999) (same); see also, e.g., *Niagara Fire Ins. Co. v. Scammon*, 100 Ill. 644 (Ill. 1881); *Viele v. Germania Ins. Co.*, 26 Iowa 9 (Iowa 1868); *Gen. Credit Corp. v. Imperial Cas. & Indem. Co.*, 95 N.W.2d 145 (Neb. 1959); *Rittenhouse Found., Inc. v. Lloyds London*, 277 A.2d 785 (Pa. 1971).

³ See *infra* notes 66-72 and accompanying text. Unlike insurance texts designed for insurance and business curricula, legal texts on insurance frequently do not even mention the unilateral/bilateral contract distinction. The most commonly used one and two-volume treatises fit this mold. See, e.g., LORELIE S. MASTERS, JORDAN S. STANZLER & EUGENE R. ANDERSON, INSURANCE COVERAGE LITIGATION (2d ed. 2004) (no discussion of the unilateral/bilateral

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distinction as applied to insurance policies); PETER J. KALIS ET AL., POLICYHOLDER'S GUIDE TO INSURANCE COVERAGE (1997) (same); BARRY R. OSTRAGER & THOMAS R. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES (13th ed. 2006) (same); ALLAN D. WINDT, INSURANCE CLAIMS & DISPUTES (3d ed. 1995) (same). But see 3 ERIC MILLS HOLMES, HOLMES' APPLEMAN ON INSURANCE §§ 4.2, 11.2 (2d ed. 1998) (extensive multi-volume insurance law treatise touches on the unilateral/bilateral contract distinction). Of course, treatise writers in glass houses should not throw stones. See, e.g., JEFFREY W. STEMPER, STEMPER ON INSURANCE CONTRACTS (3d ed. 2006 & Supp. 2009) (no discussion of unilateral/bilateral distinction).

The same lack of interest in the unilateral/bilateral distinction pervades insurance law casebooks. See, e.g., KENNETH S. ABRAHAM, INSURANCE LAW AND REGULATION: CASES AND MATERIALS (4th ed. 2005) (no mention of unilateral/bilateral dichotomy); TOM BAKER, INSURANCE LAW AND POLICY (2d ed. 2008) (same); EMERIC FISCHER, PETER NASH SWISHER & JEFFREY W. STEMPER, PRINCIPLES OF INSURANCE LAW (Rev. 3d ed. 2006) (same); ROGER C. HENDERSON & ROBERT H. JERRY, II, INSURANCE LAW: CASES AND MATERIALS (3d ed. 2001) (same); ALAN I. WIDISS, INSURANCE: MATERIALS ON FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES, AND REGULATORY ACTS (1989).

It appears that one needs to go back half a century to find even modest discussion of the unilateral/bilateral distinction as applied to insurance policies. See, e.g., EDWIN W. PATTERSON, ESSENTIALS OF INSURANCE LAW § 11, at 65 (2d ed. 1957) (setting forth traditional view of insurance policy as unilateral contract and devoting one long paragraph to the matter). Only one modern casebook even touches on the issue and it does not use the word "unilateral" in its short discussion. See LEO P. MARTINEZ & JOHN W. WHELAN, CASES AND MATERIALS ON INSURANCE LAW 59 (5th ed. 2006).

With a typical bilateral contract, the parties exchange performances and receive the benefits of performance simultaneously, and a breach is generally easily identifiable. With insurance policies, on the other hand, the insured tenders performance in the form of payments of premiums and the insurer is obligated to perform only if some event identified in the policy triggers the performance—recall the concept of a condition precedent.

Id.

Examination of the unilateral or bilateral nature of insurance policies has been an underdeveloped aspect of general contracts scholarship as well. All contracts treatises and casebooks at least touch on the unilateral/bilateral dichotomy. However, many casebooks do so only through a case involving the issue and most treatises devote little attention to the distinction. See, e.g., E. ALLAN FARNSWORTH, CONTRACTS § 3.4 (4th ed. 2004) (dedicating two pages of 900-page treatise to the unilateral/bilateral distinction; noting that the *Restatement (Second) of Contracts* abandons the terminology). But see *id.* § 3.3, at 111 n.5 (noting existence of reverse-unilateral contracts that result "from an offer of a performance for a promise, rather than an offer of a promise for a performance" (citing RESTATEMENT (SECOND) OF CONTRACTS § 55 cmt. a (1981))). Few casebooks or treatises mention insurance policies as an example of a unilateral contract and only the Calamari and Perillo treatise gives the matter significant attention. See, e.g., IAN AYRES & RICHARD E. SPEIDEL, CONTRACT LAW 305 (7th ed. 2008) (setting forth a "unilateral contract sampler" of eight cases, none involving insurance policies); RANDY E. BARNETT, CONTRACTS: CASES AND DOCTRINE 342-68 (4th ed. 2008) (extensive focus on unilateral contract issues but no mention of insurance policies); BRIAN A. BLUM & AMY C. BUSHAW, CONTRACT: CASES, DISCUSSION, AND PROBLEMS 117-28 (2003) (covering unilateral/bilateral distinction without mention of insurance policies); STEVEN J. BURTON, PRINCIPLES OF CONTRACT LAW 52-58 (3d ed. 2006) (no mention of insurance as unilateral contract); MICHAEL L. CLOSEN ET AL., CONTRACTS: CONTEMPORARY CASES, COMMENTS, AND PROBLEMS 112-29 (1992) (discussing unilateral contracts at length but not mentioning insurance policies; includes *Peters v. Mut. Benefit Life Ins. Co.*, 420 N.W.2d 908 (Minn. App. 1988), an employment case where plaintiff was a terminated agent for the insurer rather than a policyholder); THOMAS D. CRANDALL & DOUGLAS J. WHALEY, CASES, PROBLEMS, AND MATERIALS ON CONTRACTS 59-66, 76 (4th ed. 2004) (setting forth traditional dichotomy without mentioning insurance policy); JOHN P. DAWSON ET AL., CONTRACTS 372-77 (8th ed. 2003)

as relatively rare.⁴ Karl Llewellyn viewed them as the equivalent of “bearded ladies” found in the “freak tent” of a circus.⁵ Commercial contracts that were not rewards or bonuses were viewed as rarer still, with brokerage arrangements traditionally standing as the leading example of commercial unilateral contracts.⁶ Moreover, the *Restatement (Second) of Contracts* implicitly abolished the terminology,⁷ although it was subsequently argued with some force that

(covering unilateral/bilateral distinction without mention of insurance policies); DAVID G. EPSTEIN ET AL., *MAKING AND DOING DEALS: CONTRACTS IN CONTEXT* 109-29 (2d ed. 2006) (addressing unilateral contracts and acceptance by performance but not using insurance policies as example); E. ALLAN FARNSWORTH, *CONTRACTS* § 3.4 (4th ed. 2004) (setting forth traditional dichotomy without mentioning insurance policy); *id.* §§ 67-69, at 152-58 (no mention of insurance as type of unilateral contract); JEFF FERRIELL, *UNDERSTANDING CONTRACTS* § 1.02[C] (2d ed. 2009) (outlining unilateral/bilateral dichotomy but making no mention of insurance); LON L. FULLER & MELVIN ARON EISENBERG, *BASIC CONTRACT LAW* 86-88, 504-35 (8th ed. 2006) (same); JAMES F. HOGG ET AL., *CONTRACTS: CASES AND THEORY OF CONTRACTUAL OBLIGATION* 223-48 (2008) (extensive discussion of unilateral/bilateral distinction but no mention of insurance policies); CHARLES L. KNAPP, ET AL., *PROBLEMS IN CONTRACT LAW: CASES AND MATERIALS* 33-63 (6th ed. 2007) (no mention of insurance policies in discussion of dichotomy); GEORGE W. KUNEY & ROBERT M. LLOYD, *CONTRACTS: TRANSACTIONS AND LITIGATION* 75-93 (2d ed. 2008) (no mention of insurance as type of unilateral contract); JOHN EDWARD MURRAY, JR., *CONTRACTS: CASES AND MATERIALS* 125-32 (6th ed. 2006) (discussing concept with no mention of insurance policies); JOHN EDWARD MURRAY, JR., *MURRAY ON CONTRACTS* § 17 (4th ed. 2001) (same); SAMUEL WILLISTON, *A TREATISE ON THE LAW OF CONTRACTS* § 1:17 (Richard A. Lord ed., 4th ed. 2007) (covering unilateral and bilateral concepts with no express mention of insurance policies and citing to only two cases, amongst the scores cited in the section, where an insurer is party: *Nat'l Sur. Co. v. City of Atlanta*, 106 S.E. 179 (Ga. 1921), and *Schoff v. Combined Ins. Co. of Am.*, 604 N.W.2d 43 (Iowa 1999)).

⁴ See Mark Pettit, Jr., *Modern Unilateral Contracts*, 63 B.U. L. REV. 551, 551 (1983) (“[L]ack of support for the unilateral contract idea in the cases required [legal scholars] to illustrate the concept with ridiculous hypotheticals about climbing greased flagpoles and crossing the Brooklyn Bridge.”); accord FARNSWORTH, *CONTRACTS*, *supra* note 3, § 3.24, at 183 (“The popularity of the Brooklyn Bridge hypothetical has been due in part to the lack of more practical illustrations.”); see also *infra* Part I regarding the development of the unilateral/bilateral distinction and the origin of the now-famous Brooklyn Bridge hypothetical.

⁵ K. N. Llewellyn, *On Our Case-Law of Contract: Offer and Acceptance*, I, 48 YALE L.J. 1, 36 (1938) [hereinafter Llewellyn, *On Our Case-Law of Contract* (Part I)].

⁶ See *infra* Part I; see also contracts treatises and casebooks cited *supra* note 2. The vast bulk of unilateral contract cases cited, reproduced, or discussed in these sources involve efforts by plaintiffs to collect a reward or prize, or the attempt of a broker (usually real estate) to recover a commission. See FARNSWORTH, *CONTRACTS*, *supra* note 3, § 3.24. Certain cases in the reward genre are perennially popular. See, e.g., *Carlill v. Carbolic Smoke Ball Co.*, [1893] 1 Q.B. 256 (Ct. App.) (U.K.) (payment of reward/penalty where user of purported influenza prevention device contracts the flu); see also *Leonard v. Pepsico*, 88 F. Supp. 2d 116 (S.D.N.Y. 1999) (collector of millions of “Pepsi points” not entitled to collect reward of military plane from television advertisement because advertisement was an obvious farce and it contained insufficient detail to constitute an offer rather than an invitation to make an offer); *Lefkowitz v. Great Minneapolis Surplus Store, Inc.*, 86 N.W.2d 689 (Minn. 1957) (first customer in line claims reward of free fur coat). Another commonly included case, *Petterson v. Pattberg*, 161 N.E.2d 428 (N.Y. 1928), involves a mortgagor’s thwarted attempt to pay off the mortgage early in response to the mortgagee’s offer because the mortgagee sold the mortgage to a third party and managed to blurt out that fact to the mortgagor before the mortgagor tendered payment.

⁷ See RESTATEMENT (SECOND) OF CONTRACTS §§ 32, 62 (1981); see also *infra* Part I. The *Restatement (First) of Contracts* stated “[a] unilateral contract is one in which no promisor

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courts never abandoned the distinction⁸ and that the concept served a perhaps surprising modern function in protecting weaker parties to arrangements that did not quite qualify as traditional contracts.⁹

One can argue that the unilateral or bilateral status of the insurance policy is something like Holmes's clavicle of the cat: a vestige from another era with little or no modern relevance.¹⁰ We contend that in the case of insurance, the distinction is unhelpful and that the unilateral characterization is less persuasive than deeming insurance policies bilateral contracts. But, whether correct or incorrect, helpful or distracting, concepts and classifications are important. The characterizations and labels affixed to objects and activities understandably affect their use and perceptions about them. To name something is to know it.¹¹ Conceptualizing the insurance policy as unilateral (or reverse-unilateral)¹² enshrines an incorrect understanding of the nature of insurance contracting, the insurance policy, and the

receives a promise as consideration for his promise. A bilateral contract is one in which there are mutual promises between two parties to the contract; each party being both a promisor and a promisee." RESTATEMENT (FIRST) OF CONTRACTS § 12 (1932).

⁸ See Pettit, *supra* note 4, at 551 (suggesting that, based on analysis of its appearance in reported cases, "[the] unilateral contract never died, but is alive and thriving as never before").

⁹ See *id.* at 552 ("Of particular importance is the use of unilateral contract to establish one-way obligations of such institutions as employers, governments, and schools toward individuals with whom they deal. Unilateral contract has become an important concept in defining relationships that arise in our increasingly organized society."); *id.* at 594 ("In the modern cases judges generally use unilateral contract to impose liability" on employers, governments, schools and other defendants against whom plaintiffs are seeking to enforce purported rights.); see also David G. Epstein & Yvette Joy Liebesman, *Bearded Ladies Walking on the Brooklyn Bridge*, 59 ARK. L. REV. 267, 296 (2006) (noting Pettit's research and finding 435 reported decisions issued between 2000 and 2006 that used the term "unilateral contract" although it was "less clear" how the concept was being deployed and to what result).

¹⁰ See O.W. Holmes, Jr., *Common Carriers and the Common Law*, 13 AM. L. REV. 609, 630-31 (1879) ("[E]ach new decision follows syllogistically from existing precedents. But as precedents survive like the clavicle in the cat, long after the use they once served is at an end, and the reason for them has been forgotten, the result of following them must often be failure and confusion from the merely logical point of view.").

¹¹ Actually, Dewey made the observation with the aid of a less prominent coauthor. See JOHN DEWEY & ARTHUR F. BENTLEY, *KNOWING AND THE KNOWN* 147 (1949) ("[N]aming is seen as itself directly a form of knowing . . ."). More expansively, Dewey and Bentley asserted that the labels or signposts used to characterize thinking or conduct themselves became important factors in the construction of thought and analysis. See *id.* ch. 5, at 147 ("In a natural factual cosmos in course of knowing by men who are themselves among its constituents, naming processes are examined as the most readily observable and most easily and practicably studied of all processes of knowing.").

¹² See *infra* notes 75-79 and accompanying text (explaining the characterization of insurance policies as a type of "reverse-unilateral" contract on the theory that the performance by the policyholder, through payment of the premium, antedates performance by the insurer); see also PERILLO, *supra* note 2, § 2.10, at 58 ("In the usual unilateral contract, the promise is made by the offeror. However, there exists an unusual kind of contract called a reverse-unilateral contract. In a reverse unilateral contract the offeree makes the only promise."); *id.* (using insurance policy as express example of reverse-unilateral contract); Epstein & Liebesman, *supra* note 9, at 285 (reiterating concept generally without consideration of application to insurance).

insurer-policyholder relationship. It is, in our view, more wrong than right¹³ and distracts rather than illuminates or assists. More importantly, it fails to appreciate the degree to which insurance policies differ from most contracts,¹⁴ the harms caused by the characterization, and the degree to which insurance policy construction needs liberation from this archaic dichotomy even more than contract law generally.¹⁵

Treating insurance policies as unilateral contracts appears to be both conceptually wrong and largely pointless in that insurance disputes are less often about contract formation and more often about the scope and availability of coverage provided under the policy.¹⁶ More important, use of the unilateral construct produces inconsistent, incorrect, and unfair results in application.¹⁷ One might defend the characterization as one that permits the policyholder (as the purportedly non-promising party) to terminate the policy at will without penalty.¹⁸ But this freedom is a bit like Anatole France's biting witticism that under law, both rich and poor alike are free to sleep under a bridge.¹⁹ Policyholders²⁰ generally will benefit much more from fair application of the insurance protection they have purchased (a goal undermined by the unilateral characterization) than from somewhat greater freedom to switch or drop insurance policies. On balance, the unilateral characterization of insurance policies, to the extent it possesses continued force, hurts policyholders and undermines the operation of insurance more than it protects either party or promotes the economic and social goals of insurance.²¹ Any legal rule or categorization that does more harm than good deserves to be interred.

Part I of our exploration addresses the history, theory, and doctrine of unilateral contracts, while Part II notes the degree to which the insurance policy—as a “reverse-unilateral” contract—is a particularly

¹³ See *infra* Part III.A.

¹⁴ See *infra* Part II.

¹⁵ See *infra* Part III.

¹⁶ See *infra* Part III.A.

¹⁷ See *infra* Part III.C.

¹⁸ See *infra* notes 124-27 and accompanying text.

¹⁹ See ANATOLE FRANCE, *THE RED LILLY: IMMORTALS CROWNED BY THE FRENCH ACADEMY* (1894) (“The law, in its majestic equality, forbids the rich as well as the poor to sleep under the bridges, to beg in the streets, and to steal bread.”).

²⁰ For clarity and ease of reference, this article uses the term “policyholder” rather than “insured” whenever possible. Technically, of course, there is a distinction in that a person or entity can be “an insured” under the policy even if it is not the person or entity that procured the insurance, paid the premiums, or is named in the policy. See FISCHER ET AL., *supra* note 3, apps. A-G (reproducing representative policies with a definition of who is “an insured” that is broader than the named policyholder or purchaser). For example, the employees of a commercial policyholder, when acting within the scope of their employment, are usually “insureds” for purposes of liability policy protection. See, e.g., Insurance Services Office (ISO), CG 00 01 10 01 (2000), sec. II, *reprinted in* FISCHER ET AL., *supra* note 3, app. E, at 11.

²¹ See *infra* Part III.C.

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rare bird even within the ornithology of traditional contract characterization.²² Part III addresses the problems presented by a unilateral categorization of insurance policies, including not only its questionable utility and shaky conceptual foundations that fail to appreciate the special sphere of insurance, but also the largely deleterious practical problems presented by the unilateral model of insurance policies.²³ We conclude that common law should characterize insurance policies as bilateral agreements and should evaluate their terms and conditions under this model. Courts should abandon the presumption that insurance contracts are unilateral and instead should remain faithful to contract law's preferences for bilateralism and promises over unilateralism and conditions.

II. THE UNILATERAL/BILATERAL DISTINCTION: HISTORY, THEORY, AND DOCTRINE

According to classical contract doctrine, a traditional unilateral contract is different from a bilateral contract because it always and necessarily contains a promise on only one side.²⁴ In exchange for that promise, the promisor seeks a performance and only a performance from the other party—no promise of performance will do. It is at the instant of completion of performance that the contract is formed, and fully executed on one side.²⁵ On the other hand, in a bilateral contract, an offer may be accepted by a return promise or by the beginning of performance.²⁶ At the moment the promise is made or promised

²² For example, Professor Perillo, discussing the reverse-unilateral concept, found that the “most common reverse unilateral contract arises where the offeree silently accepts services that are rendered with the expectation of payment.” *See* PERILLO, *supra* note 2, § 2.10, at 58. Without naming it as such, Professor Williston described the reverse-unilateral contract in his 1924 treatise. WILLISTON, *supra* note 3, at 31 (“If the offer contemplates the formation of a unilateral contract, it may be that the offeror proposes to exchange his own promise for an act of the offeree or, *conceivably, that the offeror proposes to exchange an act on his part for a promise which he requests from the offeree.*” (emphasis added)).

²³ *See infra* Part III.

²⁴ As Professor Perillo explains: “Every contract involves at least two contracting parties. In some contracts, however, only one party has made a promise and therefore only this party is subject to a legal obligation. Such a contract is said to be unilateral. In contrast, a contract where both parties have promises is bilateral.” PERILLO, *supra* note 2, § 2.10(a), at 56-57; *see also* contracts casebooks and treatises cited *supra* note 3 (expressing a similar concept of unilateral and bilateral contracts).

²⁵ *See* RESTATEMENT (FIRST) OF CONTRACTS § 57 (1932); PERILLO, *supra* note 2, § 2.10; FARNSWORTH, CONTRACTS, *supra* note 3, § 3.4; I. Maurice Wormser, *The True Conception of Unilateral Contracts*, 26 YALE L.J. 136, 136 (1916) [hereinafter Wormser, *True Conception*] (“When an act is thus wanted in return for a promise, a unilateral contract is created when the act is done.”).

²⁶ *See* RESTATEMENT (FIRST) OF CONTRACTS § 53 cmt. a (1932); PERILLO, *supra* note 2, § 2.10; FARNSWORTH, CONTRACTS, *supra* note 3, § 3.4.

performance begins, a bilateral contract is formed and each party is bound.²⁷

The unilateral/bilateral distinction, although a staple of twentieth century contract law, particularly as taught in law schools, was of little or no import until well into the late nineteenth century.²⁸ Harvard Law School Dean and case method inventor Christopher Columbus Langdell²⁹ is generally credited with elevating the unilateral/bilateral distinction to contract law's great dichotomy,³⁰ which was embraced as the conventional wisdom, even though the distinction was familiar enough to have been used in opinions issued prior to or contemporaneous with Langdell's casebook.³¹ Although it was not a

²⁷ See RESTATEMENT (FIRST) OF CONTRACTS § 52 cmt. a. (1932); PERILLO, *supra* note 2, § 2.10; FARNSWORTH, CONTRACTS, *supra* note 3, § 3.4.

²⁸ See C.C. LANGDELL, A SUMMARY OF THE LAW OF CONTRACTS, § 183, at 248 (2d ed. 1880) [hereinafter LANGDELL, A SUMMARY OF THE LAW OF CONTRACTS]; WILLISTON, *supra* note 3, § 13, at 11 n.42 (using dichotomy and ascribing to Langdell); Epstein & Liebesman, *supra* note 9, at 271-77 (noting that the unilateral/bilateral classification of contracts arose during the nineteenth century and is generally credited to Langdell); see also C.C. Langdell, *Mutual Promises as a Consideration for Each Other*, 14 HARV. L. REV. 496, 498 (1901) (responding to Williston's implicit criticism regarding the utility of the dichotomy).

²⁹ At least Langdell is commonly credited with establishing the case method. *But see* Epstein & Liebesman, *supra* note 9, at 271 n.9 (noting that legal historian James Willard Hurst viewed John Norton Pomeroy as the father of case method while contracts scholar Williston saw Harvard Professor James Barr Ames as the initiator of case method at Harvard (citing JAMES WILLARD HURST, THE GROWTH OF AMERICAN LAW: THE LAW MAKERS 261 (1950) and SAMUEL WILLISTON, LIFE AND LAW: AN AUTOBIOGRAPHY 205 (1941) (also stating that Langdell was primarily a lecturer during much of his career because of poor eyesight))).

³⁰ See C.C. LANGDELL, A SELECTION OF CASES ON THE LAW OF CONTRACTS 985-1094 (2d ed. 1879); see also CHRISTOPHER COLUMBUS LANGDELL, A SELECTION OF CASES ON THE LAW OF CONTRACTS (1st ed. 1871); LANGDELL, A SUMMARY OF THE LAW OF CONTRACTS, *supra* note 28 (slightly revised version of Langdell's Second Edition). As Epstein and Liebesman note, Langdell's original casebook "had none of Langdell's words" and contained "only a few hundred cases, without commentary." Epstein & Liebesman, *supra* note 9, at 271. The second edition, however, also contained a "250-page summary at the end of the casebook, like an early version of Gilbert's" and "was obviously written primarily to help students learn contract law from the casebook." *Id.* at 271-72. It was in this summary that Langdell used the terms unilateral and bilateral. *Id.* at 272.

³¹ See, e.g., *Fid. & Deposit Co. v. Burden*, 30 F.2d 610, 613 (2d Cir. 1929) (Hand, J., dissenting) (applying New York law, surety arrangement "became a unilateral contract when the surety performed"); *London Assurance Corp. v. Thompson*, 62 N.E. 1066, 1067 (N.Y. 1902) ("insurance policies are unilateral contracts") (in context, however, it may be that the court used the term "unilateral" to mean a contract of adhesion); *Cont'l Ins. Co. v. Wickham*, 35 S.E. 287, 289 (Ga. 1900) (insurance policy is a unilateral contract); *Niagara Fire Ins. Co. v. Scammon*, 100 Ill. 644 (Ill. 1881) (same); *Douglas v. Knickerbocker Life Ins. Co.*, 83 N.Y. 492, 503 (N.Y. 1881) (characterizing insurance policy as a unilateral contract); *Cobb v. Ins. Co. of N. Am.*, 11 Kan. 93, 98 (Kan. 1873) (insurance policy is "wholly a unilateral contract"); *Viele v. Germania Ins. Co.*, 26 Iowa 9 (Iowa 1868) (insurance policy unilateral).

English courts appear to have embraced the unilateral/bilateral distinction by the mid-nineteenth century. See, e.g., *Fishmonger's Co. v. Robertson*, (1843) 134 Eng. Rep. 510, 523 (noting that there are "a great number of cases of contract not binding on both sides at the time when made, and in which the whole duty to be performed rests with one of the contracting parties" (quoting *Kennaway v. Treleavan*, (1839) 151 Eng. Rep. 211, 213)); *id.* at 524 n.3 (labeling such arrangements as "perfect unilateral contracts"); *Phillips v. Aflalo*, (1842) 134 Eng.

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common feature of case law, the unilateral/bilateral dichotomy feature appears to have become established contracts orthodoxy by the early twentieth century,³² as reflected in the Williston treatise,³³ the Corbin treatise,³⁴ and other authorities of the era.³⁵ There was, however, debate about the accuracy of the unilateral/bilateral terminology and its utility.³⁶

The unilateral/bilateral dichotomy was driven home (and arguably made starker) in a prominent law review article by Professor I. Maurice Wormser,³⁷ who created one of law's most famous illustrations: the Brooklyn Bridge hypothetical. In the oft-told hypothetical, one party offers \$100 to a second party if he will walk across the Bridge, thereby creating and completing a contract that is unilateral because the promise

Rep. 348, 352 ("There may be a contract binding on one party and not on the other; as in the case of a guarantee, which is of this nature: 'if you will supply goods to a third person, I will see that you are paid.' In such a case it is optional whether the party will supply the goods."); see also M. POTHIER, A TREATISE ON THE LAW OF OBLIGATIONS OR CONTRACTS 89 (1826) (labeling contracts as reciprocal and unilateral, using a loan with a promise to repay as an example, a transaction that would now be viewed as a reverse-unilateral contract). Although Pothier was French, his translated work was highly influential in England and elsewhere. Certainly by the twentieth century, classic English law treatises embraced the unilateral contract concept. See, e.g., 1 FREDERICK POLLOCK ET AL., PRINCIPLES OF CONTRACT AT LAW AND IN EQUITY: A TREATISE OF THE GENERAL PRINCIPLES CONCERNING THE VALIDITY OF AGREEMENTS IN THE LAW OF ENGLAND AND AMERICA 22 (7th ed. 1906) (citing early cases and noting that "[a]n offer proposing a unilateral contract becomes a binding promise immediately upon the performance of the act or acts requested").

³² See, e.g., SIR WILLIAM R. ANSON, PRINCIPLES OF THE LAW OF CONTRACT 26 n.1 (Arthur L. Corbin ed., 3d ed. 1919); POLLOCK, *supra* note 31 (stating that the unilateral/bilateral contract distinction was well-established by the end of the nineteenth century or the early twentieth century).

³³ See WILLISTON, *supra* note 3, § 13, at 11 n.42.

³⁴ See ANSON, *supra* note 32, at 26 n.1; ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 21 (1950).

³⁵ See, e.g., 1 ADDISON, C. G., ADDISON ON CONTRACTS: BEING A TREATISE ON THE LAW OF CONTRACTS 7 (Horace Smith ed., 8th ed. 1888) ("When the contract binds one person to another without any engagement being made by the latter, it is unilateral.").

³⁶ See Epstein & Liebesman, *supra* note 9, at 273-75 (noting and citing criticism).

³⁷ See Wormser, *True Conception*, *supra* note 25. Notwithstanding that the Wormser article is cited in only twenty-two law review articles (as of December 1, 2009), it is mentioned in nearly every contracts treatise or casebook that gives significant attention to the unilateral/bilateral distinction which is, as noted *supra* note 2, nearly every contracts treatise or casebook.

Wormser's view of unilateral contracting was stark in the sense, as discussed below, that he viewed the offeror as having unfettered rights to withdraw or modify the offer until the last instant before completion of performance, regardless of the seeming unfairness this posed for an offeree who had completed ninety-nine percent of the task without gaining any benefit of the bargain. As Epstein and Liebesman note, however, Langdell's casebook "distinguishes bilateral contracts from unilateral contracts on the basis of what the offeree does or says rather than on the basis of what the offeror said." See Epstein & Liebesman, *supra* note 9, at 272. As a result, Langdell would have found enforceable unilateral contracts created in situations involving partial performance or substantial (but imperfect) performance, thus expressing a considerably kinder and gentler vision of unilateral contracting than that advanced by Wormser in his 1916 *Yale Law Journal* article. See *id.* (referring to hypotheticals involving offer of compensation for painting fence earlier in article).

of payment is accepted, not by the promise of trekking over the Bridge, but by completion of the trek itself.³⁸ In addition, “only one party is bound”—the offeror—hence classification of the arrangement as unilateral rather than bilateral.³⁹

[I]n unilateral contracts, on one side we find merely an act, on the other side a promise. On the other hand, in bilateral contracts, [a party] barter[s] away his volition in return for another promise. . . . [T]here is an exchange of promises or assurances . . . [and] both parties . . . are bound from the moment that their promises are exchanged.⁴⁰

However, although the offeror is bound to pay upon completion of the walk across the Bridge, in Wormser’s view, he retains the power to withdraw the offer without penalty until the last second prior to completion of the crossing.⁴¹ This view, even though apparently largely accepted at the time, came under consistent fire from contract scholars because of its inherent unfairness. The hapless offeree could get ninety-nine percent of the way across the Bridge and end up with nothing, not even *quantum meruit* compensation for his time and effort. Similarly, the imaginary offeree of perhaps the second most famous unilateral contract hypothetical—someone climbing up a flagpole to obtain a prize—could be thwarted inches from the top of the pole by a cruel and cackling offeror.⁴²

Professor Wormser was aware of, but undaunted by, such displays of bleeding heart empathy:

The objection is made, however, that it is very “hard” upon B that he should have walked half-way across the Brooklyn Bridge and should get no compensation Critics of the doctrine of unilateral

³⁸ As outlined by Professor Wormser:

Suppose A says to B, “I will give you \$100 if you walk across the Brooklyn Bridge,” and B walks—is there a contract? It is clear that A is not asking B for B’s *promise* to walk across the Brooklyn Bridge. What A wants from B is the *act* of walking across the bridge. When B has walked across the bridge there is a contract, and A is then bound to pay to B \$100. At that moment there arises a unilateral contract. A has bartered away his volition for B’s act of walking across the Brooklyn Bridge.

See Wormser, *True Conception*, *supra* note 25, at 136.

³⁹ See *id.* (“When an act is thus wanted in return for a promise, a unilateral contract is created when the act is done. It is clear that only one party is bound. B is not bound to walk across the Brooklyn Bridge, but A is bound to pay B \$100 if B does so.”).

⁴⁰ See *id.*

⁴¹ See *id.* at 136-38.

⁴² By 1939, these hypotheticals must have been firmly established in law teaching, prompting Llewellyn to complain that real life business cases have little to do with “the idiosyncratic desires of one A to see one B climb a fifty-foot greased flagpole or push a peanut across the Brooklyn Bridge” that apparently preoccupied classrooms. K. N. Llewellyn, *Our Case-Law of Contract: Offer and Acceptance, II*, 48 YALE L.J. 779, 785 (1939) [hereinafter Llewellyn, *Our Case-Law of Contract* (Part II)]; see also Pettit, *supra* note 4, at 551 (noting widespread use of flagpole-related hypotheticals, including greased flagpoles, to illustrate unilateral contracting).

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contract on the ground that the rule is “hard” on B, forget the primary need for mutuality of withdrawal and in lamenting the alleged hardships of B, they completely lose sight of the fact that B has the same right of withdrawal that A has. . . . [T]he doctrine of unilateral contract is thus as just and equitable as it is logical. So long as there is freedom of contract and parties see fit to integrate their understanding in the form of a unilateral contract, the courts should not interfere with their evident understanding and intention simply because of alleged fanciful hardship.⁴³

In response to the perceived unfairness, a consensus arose that the beginning of performance in response to a unilateral contract offer permitted enforcement of the contract if the offeree completed the task.⁴⁴ However, mere preparation to perform was insufficient; the task sought needed to have been commenced.⁴⁵ Eventually, even Professor Wormser accepted this view and conceded that his earlier position was incorrect.⁴⁶ During the same time period, the doctrines of promissory

⁴³ See Wormser, *True Conception*, *supra* note 25, at 138. In addition to lacking empathy for the Bridge walkers and flagpole climbers of the world, Professor Wormser also appears to have harbored a view of the importance of mutuality that is now regarded as incorrect. Courts have stated, and do occasionally still, that there cannot be a contract unless other parties are bound. However, this view, at least in absolutist form, is widely regarded as incorrect by mainstream contracts scholars and case law. See, e.g., PERILLO, *supra* note 2, § 4.12, at 177 (arguing that the phrase that “both parties must be bound or neither is bound . . . is an over-generalization. The doctrine is not one of mutuality of obligation but rather one of mutuality of consideration. . . . The concept of ‘mutuality of obligation’ has been thoroughly discredited.”); *id.* (noting that the *Restatement (Second) of Contracts* does not always require mutuality of consideration and that “[i]n a unilateral contract there is no mutuality of obligation”); FARNSWORTH, *CONTRACTS*, *supra* note 3, § 3.2; FULLER & EISENBERG, *supra* note 3, at 87 (arguing that the notion of “principle of mutuality” asserted “as a general rule of contract law that both parties must be bound or neither is bound . . . needs more qualification than it usually receives in judicial opinions” and in fact “requires a good deal of qualification”); WILLISTON, *supra* note 3, § 7:13 (same).

⁴⁴ See RESTATEMENT (FIRST) OF CONTRACTS § 45 cmts. a & b (1932); Peter M. Tiersma, *Reassessing Unilateral Contracts: The Role of Offer, Acceptance and Promise*, 26 U.C. DAVIS L. REV. 1, 7 (1992) (noting academic support for part performance formation of unilateral contracts and adoption of the view in the *Restatement (First) of Contracts*). Academic support for this view existed around the time Wormser staked out his extreme position. See, e.g., Clarence D. Ashley, *Offers Calling for a Consideration Other Than a Counter Promise*, 23 HARV. L. REV. 159, 164 (1910); Henry W. Ballantine, *Acceptance of Offers for Unilateral Contracts by Partial Performance of Service Requested*, 5 MINN. L. REV. 94, 96-97 (1921); Arthur L. Corbin, *Offer and Acceptance, and Some of the Resulting Legal Relations*, 26 YALE L.J. 169, 191-92 (1917) (beginning of part performance of the requested act precludes the offeror from effectively revoking and gives contract rights to the performer who completes the act); D.O. McGovney, *Irrevocable Offers*, 27 HARV. L. REV. 644, 658-60 (1914).

⁴⁵ See, e.g., *Ever-Tite Roofing Corp. v. Green*, 83 So.2d 449 (La. Ct. App. 1955) (making a distinction between the actual beginning of performance, which establishes a contract, and mere preparation to perform, which does not).

⁴⁶ See I. Maurice Wormser, *Book Review*, 3 J. LEGAL EDUC. 145, 146 (1950) [hereinafter Wormser, *Book Review*] (reviewing EDWIN W. PATTERSON & GEORGE W. GOBLE, *CASES ON CONTRACTS* (1949)). Wormser noted that his 1916 article was quoted in the casebook but “[s]ince that time I have repented, so that now, clad in sackcloth, I state frankly, that my point of view has changed. I agree, at this time, with the rule set forth in the *Restatement of the Law of*

estoppel and substantial performance, both of which could also protect the bridge walker and the flag climber, were also gaining support.⁴⁷

The resulting taming of the potential unfairness of the unilateral contract helped to cement its status as part of the legal lexicon. The first *Restatement of Contracts* formally recognized the unilateral/bilateral dichotomy and divided the universe of contracts accordingly.⁴⁸ However, the *Restatement* also established a presumption in favor of a bilateral characterization of contracts where feasible,⁴⁹ reflecting the prevailing common law approach.⁵⁰ Notwithstanding its firm place in the contracts establishment, the concept of the unilateral contract continued to be questioned and even attacked, initially and most

Contracts of the American Law Institute, Section 45” that the beginning of performance by a unilateral contract offeree creates enforceable contract obligations and limits the offeror’s rights of revocation. *Id.*; RESTATEMENT (FIRST) OF CONTRACTS § 45 (1932).

⁴⁷ See PERILLO, *supra* note 2, §§ 6.1-6.4; FARNSWORTH, *CONTRACTS*, *supra* note 3, § 2.19; GRANT GILMORE, *THE DEATH OF CONTRACT* (1974) (noting the rise of promissory estoppel and substantial performance doctrine during mid-twentieth century); Kevin M. Teeven, *Origins of Promissory Estoppel: Justifiable Reliance and Commercial Uncertainty Before Williston’s Restatement*, 34 U. MEM. L. REV. 499, 563 (2004).

⁴⁸ RESTATEMENT (FIRST) OF CONTRACTS § 12 (1932).

⁴⁹ The relevant section provides:

In case of doubt it is presumed that an offer invites the formation of a bilateral contract by an acceptance amounting in effect to a promise by the offeree to perform what the offer requests, rather than the formation of one or more unilateral contracts by actual performance on the part of the offeree.

Id. § 31.

The *Restatement (First) of Contracts* justified the presumption as fairer and more benign, explaining, “[i]t is not always easy to determine whether an offeror requests an act or a promise to do the act. As a bilateral contract immediately and fully protects both parties, the interpretation is favored that a bilateral contract is proposed.” *Id.* cmt. a.

⁵⁰ See, e.g., *Davis v. Jacoby*, 34 P.2d 1026 (Cal. 1934) (courts have preference to construe contracts as bilateral if possible). Like chestnuts of unilateral contracting such as *Carlill v. Carbolic Smoke Ball*, *Davis v. Jacoby* has been popular in contracts casebooks. In *Davis* the California Supreme Court construed an uncertain contract as bilateral to protect the reliance interests of a couple induced to relocate from Canada to take care of elderly friends in response to an offer of compensation through the older couple’s estate upon death. *Id.* However, the elderly husband/promisor died before making the will that was to have provided the promised distribution, thereby revoking his offer prior to the younger couple’s performance. *Id.* Thus, under the traditionalist perspective of the early twentieth century, if the arrangement was unilateral, the contract under the prevailing views of the time had not adequately been accepted and formed so as to create enforceable rights. But if bilateral, the arrangement resulted in an enforceable contract because the younger couple had accepted through assuring that they would come to the aid of their older friends.

Well before mid-century the *Restatement (First) of Contracts* and cases like *Davis v. Jacoby* had established a preference for bilateral characterization of contracts. The intellectual and judicial inclination favoring bilateralism was thought sufficiently important that *Davis v. Jacoby* is often reproduced contracts casebooks. See, e.g., BLUM & BUSHAW, *supra* note 3, at 117-28; BURTON, *supra* note 3, at 52-58; CRANDALL & WHALEY, *supra* note 3, at 59-66, 76; DAWSON ET AL., *supra* note 3, at 372; EPSTEIN ET AL., *supra* note 3, at 118-23; FULLER & EISENBERG, *supra* note 3, at 86-88, 504-35; HOGG ET AL., *supra* note 2, at 235; KUNEY & LLOYD, *supra* note 2, at 76.

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prominently by leading law professor Karl Llewellyn⁵¹ and later more directly by then-prominent Australian contracts scholar Samuel Stoljar.⁵²

However, the unilateral/bilateral dichotomy continued to hold its ground as part of mainstream contracts theory for some time, although gradually losing ground in academic and lawmaking circles. The Uniform Commercial Code, largely authored by Llewellyn, did not incorporate the concept,⁵³ while the *Restatement (Second) of Contracts* also attempted to shed the unilateral/bilateral contract dichotomy.⁵⁴ The *Restatement (Second) of Contracts* dropped references to unilateral and bilateral contracts in its black letter text, determining that the terms confused rather than clarified the law of contracts and stating, “[i]t has not been carried forward because of doubt as to the utility of the distinction, often treated as fundamental, between the two types.”⁵⁵

In the courts, however, the dichotomy retained support and arguably even enjoyed a renaissance of sorts. The unilateral construct was applied to a range of emerging contract matters involving claims of at-will employees and persons seeking to enforce government entitlements,⁵⁶ while continuing to be used in cases involving rewards and prizes⁵⁷ or brokerage commissions.⁵⁸ The courts’ use of a unilateral contract construction as a mechanism to protect weaker parties gives the authors pause at any impulse to abolish this genre of contract altogether.⁵⁹ Despite that, it appears to us that the arguably beneficial roles of the doctrine could be equally achieved under theories of promissory estoppel, equitable estoppel, and attachment of due process

⁵¹ See Llewellyn, *On Our Case-Law of Contract* (Part I), *supra* note 5, at 36; Llewellyn, *Our Case-Law of Contract* (Part II), *supra* note 42, at 813-14.

⁵² See Stoljar, *supra* note 1.

⁵³ See PERILLO, *supra* note 2, § 2.10, at 59-60 (noting that the UCC does not make a unilateral/bilateral distinction and that section 2-206(1)(b), which states that an ambiguous offer to purchase goods “invites acceptance either by performance or promise,” prevents use of a “unilateral contract trick”).

⁵⁴ See Epstein & Liebesman, *supra* note 9 (discussing the history of and rationale for abandoning the unilateral/bilateral terminology).

⁵⁵ RESTATEMENT (SECOND) OF CONTRACTS § 1 cmt. f, reporter’s note (1981).

⁵⁶ See Pettit, *supra* note 4, at 551-52.

⁵⁷ See Tiersma, *supra* note 44, at 79 (rewards and prizes continue to be a leading area of unilateral contract analysis); Mark B. Wessman, *Is “Contract” the Name of the Game? Promotional Games as Test Cases for Contract Theory*, 34 ARIZ. L. REV. 635, 645-54 (1992) (noting that unilateral contract theory is often applied to rewards, prizes, games, and contests).

⁵⁸ See FARNSWORTH, CONTRACTS, *supra* note 3, § 3.4 (brokerage cases are a significant example of unilateral contract decisions).

⁵⁹ As described by Professor Pettit, these modern applications of unilateral contract theory tend to provide rights to persons or entities that can largely be described as litigation’s “little guys” who might otherwise be taken advantage of by larger, wealthier, more sophisticated litigants. See Pettit, *supra* note 4, at 551-52; *id.* at 594 (“In the modern cases judges generally use unilateral contract to impose liability. They begin by finding an implied promise by the defendant and then justify enforcement of that promise solely by invoking the unilateral contract idea.”).

rights to the creation of reasonable expectations of an entitlement from governments.⁶⁰

Although the *Restatement (Second) of Contracts* eliminated “unilateral” and “bilateral” contracts from its lexicon, it did not eliminate the concept that some contracts could be accepted only by performance, and that they were fully executed on one side by that performance.⁶¹ Moreover, even while abandoning the dichotomy, the *Restatement (Second) of Contracts* retained a preference for bilateral construction of contracts in a roundabout fashion, providing that, “[i]n case of doubt an offer is interpreted as inviting the offeree to accept either by promising to perform what the offer requests or rendering the performance, as the offeree chooses.”⁶²

The preference for bilateralism remains if the offeree may choose between accepting by promise or performance because “[s]uch an acceptance operates as a promise to render a complete performance.”⁶³ In cases of doubt, the offeree’s performance stands in the place of a promise by which the offeree is bound and must complete performance. In addition, despite the retreat in the *Restatement (Second) of Contracts* from the unilateral/bilateral dichotomy, courts generally continue to use the terminology and continue to adhere to the presumption in favor of bilateralism.⁶⁴ As contract law entered the twenty-first century, the often-maligned unilateral contract was perhaps bloody but largely

⁶⁰ Professor Pettit acknowledges this prospect. See, e.g., *id.* at 588-96 (noting that notions of estoppel, public policy, and due process entitlements may support outcomes reached under unilateral contract approach); *id.* at 594 (“In most situations, and particularly in contexts in which courts are expanding the scope of obligation into new areas, there are both promissory and non-promissory reasons for imposing liability. Recognition and articulation of each might lead to better-reasoned and more consistent decisions.”); *id.* at 589 (“Although it certainly can be argued that in the last half-century government has been making more promises and creating more expectations, the primary explanation for increased judicial intervention lies in social, intellectual, and political developments and not in the ‘promise principle.’” (citing P.S. ATIYAH, *THE RISE AND FALL OF FREEDOM OF CONTRACT* (1979); Charles Reich, *The New Property*, 73 *YALE L.J.* 733 (1964))).

⁶¹ See Epstein & Liebesman, *supra* note 9, at 289-94. The *RESTATEMENT (SECOND) OF CONTRACTS* § 45 (1981) retains the concept of unilateral contracts, substituting the language, by describing the situation where an offeror “invites an offeree to accept by rendering performance and does not invite a promissory acceptance.”

⁶² *RESTATEMENT (SECOND) OF CONTRACTS* § 32 (1981).

⁶³ *Id.* § 62.

⁶⁴ See, e.g., *Fosson v. Palace (Waterland), Ltd.*, 78 F.3d 1448 (9th Cir. 1996) (noting that under California law a contract is rebuttably presumed to be bilateral); *Woodbridge Place Apartments. v. Wash. Square Capital, Inc.*, 965 F.2d 1429 (7th Cir. 1992) (applying Indiana law and determining that when language in loan commitment contract is ambiguous contract is bilateral); *Rode Oil Co. v. Lamar Adver. Co.*, No. W2007-02017-COA-R3-CV, 2008 WL 4367300, at *6 (Tenn. Ct. App. Sept. 18, 2008) (“[W]e note that many authorities speak of a long-established presumption against finding a unilateral rather than a bilateral contract where there is doubt as to which type of contract was intended.”).

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unbowed, with use of the concept continuing in judicial decisions, to the praise of some commentators.⁶⁵

II. THE INSURANCE POLICY AS A “REVERSE-UNILATERAL” CONTRACT

Despite more than a century of debate on the “great dichotomy” dividing the contracts of the world into unilateral and bilateral,⁶⁶ little had been done to assess insurance policies (although they were historically viewed as unilateral). Professor Joseph Perillo, the most prominent contracts scholar⁶⁷ to devote any significant attention to the unilateral/bilateral distinction in insurance, not only placed insurance policies squarely within the unilateral camp, but also fine-tuned the conventional assessment by referring to some insurance policies as “reverse-unilateral.”⁶⁸ The reverse-unilateral term is used in only a few cases of any type⁶⁹ and employed in only two reported insurance coverage decisions,⁷⁰ although the mere description of the insurance policy as unilateral appears in many more cases⁷¹ (but few law review articles).⁷²

⁶⁵ See, e.g., Pettitt, *supra* note 4, at 551-52.

⁶⁶ See Llewellyn, *On Our Case-Law of Contract* (Part I), *supra* note 5, at 36; see also Tiersma, *supra* note 44, at 8-11 (noting the importance of classification in twentieth century contracts law).

⁶⁷ Professor Perillo’s treatise, PERILLO, *supra* note 2, is one of the leading treatises in the field. Professor Perillo has been a member of the Fordham Law School faculty for more than forty-five years and has authored many scholarly articles and been a prominent speaker and panelist on contract matters. Consequently, his express insistence that insurance policies are unilateral contracts carries substantial weight, particularly in view of the relative absence of other scholarly commentary on the issue.

⁶⁸ See PERILLO, *supra* note 2, § 2.10(a), at 58; see also Epstein & Liebesman, *supra* note 9, at 285 (using the Calamari and Perillo treatise as a basis for reverse-unilateral contract category). The general concept of a reverse-unilateral contract was described in the RESTATEMENT (FIRST) OF CONTRACTS § 57 (1932) (“Unilateral Contract Where Proposed Act is to Be Done by Offeror”) and in WILLISTON, *supra* note 3, at 31.

⁶⁹ Fewer than ten cases discuss and consider the concept of a reverse-unilateral contracts. See, e.g., *Southtrust Bank v. Williams*, 775 So.2d 184 (Ala. 2000) (concerning the enforceability of an arbitration provision in a checking account); *Herman v. Stern*, 213 A.2d 594 (Pa. 1965) (concerning a brokerage commission).

⁷⁰ See *Winters v. State Farm Ins. & Cas. Co.*, 35 F. Supp. 2d 842 (E.D. Okla. 1999); *Nat’l Union Fire Ins. Co. v. FDIC*, 957 P.2d 357 (Kan. 1998).

⁷¹ But there are not all that many cases relative to the universe of contract decisions. As of March 10, 2010, only 223 cases in the LexisNexis database specifically described the insurance policy as unilateral, although this implicit description appears to be hardwired into the background assumptions of insurance law. As discussed below, there is a long line of precedent restricting a policyholder’s right to recover on a theory of anticipatory breach or repudiation and strictly construing requirements listed as conditions in the policy. Both traits are more consistent with a unilateral characterization than a bilateral characterization. See *infra* Part III.

⁷² As of March 10, 2010, only twenty-three articles in the LexisNexis legal periodical database used the terms “reverse-unilateral.” Most used the term to describe “shrinkwrap” contracts. See, e.g., Steven A. Heath, *Contracts, Copyright, and Confusion: Revisiting the*

The insurance policy could be characterized as a unilateral contract principally because of the perceived absence of a promise on the part of the policyholder. As discussed in Part I, where only one party to a contract promises and the other performs, historically the contract has been deemed unilateral. For the typical unilateral contract, an offer or conditional promise is first made (e.g., "I'll pay you \$100 if you walk across the Brooklyn Bridge"). The offer is accepted and is completed by performance following the offer (e.g., the offeree walks across the bridge, hopefully before any revocation by the offeror).⁷³

In contrast to typical unilateral formation, in an insurance policy, the policyholder often makes payment (performance) prior to receiving promises by the insurer such as indemnity for loss and defense of liability claims. Because the insurance policy is aleatory,⁷⁴ the policyholder may never receive any indemnity or defense from the insurer. However, through the insuring agreement contained in the policy, the insurer in effect promises to provide protection or payment to the policyholder in the event of a covered occurrence. When payment by the policyholder precedes the insurer's promise to insure, the resulting contract is a reverse-unilateral contract and the

Enforceability of "Shrinkwrap" Licenses, 5 CHI-KENT J. INTEL. PROP. 12 (2005); Deanna L. Kwong, *The Copyright-Contract Intersection: SoftMan Products Co. v. Adobe Systems, Inc. & Bowers v. Baystate Technologies, Inc.*, 18 BERKELEY TECH. L.J. 349 (2003). A significant number also described employment-at-will contracts in this manner. See, e.g., Richard A. Lord, *The At-Will Relationship in the 21st Century: A Consideration of Consideration*, 58 BAYLOR L. REV. 707 (2006); Brian T. Kohn, Note, *Contracts of Convenience: Preventing Employers From Unilaterally Modifying Promises Made in Employee Handbooks*, 24 CARDOZO L. REV. 799 (2003). A moment's reflection leads to some of the same concerns this Article expresses as to whether the classification of these arrangements as reverse-unilateral contracts is really correct, a topic beyond the scope of this Article. One can say with confidence that the concept of the reverse-unilateral contract, however creative, has not significantly penetrated the legal lexicon.

⁷³ See Wormser, *True Conception*, *supra* note 25, at 136. For a fascinating examination of the tragic historic circumstances producing a Supreme Court opinion permitting the type of revocation and unfairness attacked by critics of traditional unilateral contract doctrine, see Joseph M. Perillo, *Screed for a Film and Pillar of Classical Contract Law: Shuey v. United States*, 71 FORDHAM L. REV. 915 (2002) (describing a case in which citizen giving information leading to capture of co-conspirator in Lincoln assassination was denied reward due to government's revocation of offer by means far less prominent than initial offering of reward and because Court construed offer to require that claimant himself effect capture).

⁷⁴ See DORFMAN, *supra* note 2, at 163 (parties to insurance policy "know in advance the dollars they will exchange will be unequal"); REJDA, *supra* note 2, at 99 ("An insurance contract is aleatory rather than commutative" in that the "values exchanged may not be equal but depend on an uncertain event" while commutative contract "is one in which the values exchanged by both parties are theoretically equal."). Emmett and Therese Vaughan state that an aleatory contract is one in which:

[T]he outcome is affected by chance and [] the number of dollars given up by the contracting parties will be unequal. The insured pays the required premium, and if no loss occurs, the insurance company pays nothing. If a loss does occur, the insured's premium is small in relation to the amount the insurer will be required to pay. In the sense that it is aleatory, an insurance contract is like a gambling contract.

VAUGHAN & VAUGHAN, *supra* note 2, at 168.

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policyholder is the offeror according to Professor Perillo.⁷⁵ Indeed, insurers typically structure the transaction in this manner so that their underwriting departments can vet the applicant prior to acceptance and avoid issuing policies to bad risks.⁷⁶ By making an application and paying the premium, the applicant-cum-policyholder seeks a promise from the offeree—the insurer. After the premium is paid and the application approved, the insurer provides its promise to the insured.

Two courts have stated, in accord with the Perillo analysis, that the insurance policy “is a reverse-unilateral contract in that the applicant’s acts of performance induce insurer’s promise.”⁷⁷ Under this approach, the insurance contract forms upon the payment of a premium by the policyholder. In exchange for the premium payment, the insurer promises to provide insurance coverage. “The insured has not made any promise, but rather, has performed.”⁷⁸ Because only one promise (that by the insurer) has been given, “the contract fits within the standard definition of a unilateral contract.”⁷⁹

There has been some dissent to the unilateral orthodoxy. Professor Karl Llewellyn, writing in 1939, lamented the characterization of insurance as unilateral, noting that it just did not feel correct.

Insurance has sometimes been thought a type of contract formed as a unilateral. Outside of twenty-five cent a week “industrial insurance,” I do not find it so. Fire insurance “binders”; initial premiums “paid” by check, whether the check be given with the application or after approval; blanket coverage billed monthly according to user thereof—this is the picture as I get it, with most of it in terms of initiation by agreement *and* mutual obligation.⁸⁰

But unlike Llewellyn’s criticism of unilateral contracts generally, his position on insurance as bilateral has not gained traction. The prevailing view among those few commentators and courts that have considered it remains that “all forms of insurance are presumed to be unilateral contracts.”⁸¹ Dean Robert Jerry, addressing the question of

⁷⁵ Professor Perillo explains:

In a reverse-unilateral contract the offeree makes the only promise. For example, if A, a homeowner, pays \$500 to an insurance company asking for the company’s promise to pay A \$200,000 if A’s house is destroyed by fire, A is the offeror but has made no promise. Rather A has performed and requested a promise from B, the offeree.

PERILLO, *supra* note 2, § 2.10(a), at 58.

⁷⁶ See STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, §§ 3.01-3.02.

⁷⁷ *Winters v. State Farm & Cas. Co.*, 35 F. Supp. 2d 842, 845 (E.D. Okla. 1999) (quoting *Nat’l Union Fire Ins. Co. v. FDIC*, 957 P.2d 357, 363 (Kan. 1998)).

⁷⁸ *Combs v. Int’l Ins. Co.*, 354 F.3d 568, 600 n.18 (6th Cir. 2004).

⁷⁹ *Id.*

⁸⁰ Llewellyn, *Our Case-Law of Contract* (Part II), *supra* note 42, at 814.

⁸¹ *Winters*, 35 F. Supp. 2d at 845. When insurance is renewed periodically, courts often construct the contract as “a series of unilateral contracts, each beginning with the payment of a premium for a specified period . . . and terminat[ing] at the expiration of that . . . period.”

whether an insurance contract is bilateral or unilateral, essentially answered with another question: “Who cares?”

One who labors through this theoretical quagmire is likely to be disappointed by the following observation: whether an insurance contract is categorized as bilateral, unilateral, reverse-unilateral or bilateral-become-unilateral has no apparent significance. However the offer-acceptance process is described, the result upon the successful completion of this process is a promise for the breach of which the law will give a remedy—in short, a contract.⁸²

Although Dean Jerry is correct that the unilateral/bilateral dichotomy appears to add nothing to our understanding of insurance disputes, he unduly minimizes its largely negative impact on the operation of insurance and the resolution of insurer-policyholder disputes. In an exchange between Professor Perillo and Dean Jerry, the two scholars defended both their divergent characterizations of insurance policies and their differing views as to the consequences of the characterization of policies. Professor Perillo argued that viewing the policy as a unilateral contract compels a different result in many insurance cases than would a bilateral characterization.⁸³ In essence, we

Banner Life Ins. Co. v. Mark Wallace Dixon Irrevocable Trust, 206 P.3d 481 (Idaho 2009) (quoting *Guy v. Guy*, 560 P.2d 876, 878 (Idaho 1977)).

⁸² ROBERT H. JERRY, UNDERSTANDING INSURANCE LAW § 31[a], at 224 (3d ed. 2002). Dean Jerry shares our skepticism over a unilateral construction. “Although an insurance contract could theoretically be structured in either form, insurance contracts are usually bilateral.” *Id.* at 223.

⁸³ See Email from Joseph M. Perillo to Robert H. Jerry, II (Mar. 24, 2009) (on file with *Cardozo Law Review*) (finding Professor Jerry’s view of “no practical significance” to the characterization question as “astonishing” and contending that judicial enforcement of conditions in policies, rather than treating these provisions as promises, is heavily influenced by the unilateral nature of insurance policies). Dean Jerry responded to Professor Perillo:

[T]he problem with [unilateral contract] analysis is that a unilateral contract is not formed until performance is completed (the offeree can walk away during performance without liability) and it makes no sense to say that an insurer can cancel a contract at will any time prior to the end of the contract’s term. Likewise, to say that the insurer is bound to do nothing at the outset of the policy term makes no sense; instead, what the insurer provides, in exchange for the insured’s promise to pay a premium (not that the insurer’s duty will be constructively, and perhaps expressly conditioned on the insured’s performance of that promise) is an immediate promise to pay proceeds (and to do other things, like defend in the case of liability insurance) on the condition that a loss within coverage occurs. Indeed, the economics of an insurance contract involve a present transfer: the insured provides the premium (or promise thereof), and the insurer provides security through a present promise to assume risk and pay proceeds in the event of a covered loss. So in every sense of the concept, an insurance contract is an immediate bilateral exchange with consideration on both sides.

....

[But] I cannot recall ever seeing a case where the court’s labeling of the contract as “unilateral” or “bilateral” made a difference to the outcome; even if a court goes down the “unilateral” path, which makes little sense (as noted above), the outcome will be explainable if the contracts is properly understood as bilateral.

Email from Robert H. Jerry, II to Joseph M. Perillo (Mar. 28, 2009) (on file with *Cardozo Law Review*). Dean Jerry also suggested that the *General Credit* case in the Perillo casebook could be explained in a manner consistent with characterization of the policy as a bilateral contract. *Id.*;

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conclude that Dean Jerry is correct as to the characterization and that Professor Perillo, although incorrect as to characterization, is right about the consequences of classification. Part III below explores this seeming paradox, outlining not only the case for bilateral status but also the manner in which a unilateral characterization creates mischief in insurance coverage disputes.

III. PROBLEMS WITH A UNILATERAL CATEGORIZATION OF INSURANCE POLICIES

The continuing persistence of the unilateral/bilateral dichotomy, particularly the alleged status of insurance policies as reverse-unilateral contracts, continues to present problems for the operation of insurance. As an organizing concept, the unilateral/bilateral or reverse-unilateral classification does little to help resolve insurance disputes because most such disputes involve the construction of a concededly applicable policy rather than disputes over contract formation.⁸⁴ As reflected in

Gen. Credit Corp. v. Imperial Casualty & Indem. Co., 95 N.W.2d 145 (Neb. 1959). Professor Perillo responded:

Your book states that there is no practical reason to label a contract as unilateral or bilateral. I question that conclusion. Of course, there are conditions in bilateral contract if they are clearly stated but there is a canon of construction that says if the language assigning a task is unclear as to its intended legal effect, the preferred construction is that the language creates a promise rather than a condition. This maxim cannot logically be applied to a unilateral contract because in a unilateral contract, by definition, only one party is ever under an obligation and only one party speaks. Therefore, it makes a difference which classification is chosen. In *General Credit* and many cases like it, the court makes the point that only one party (the insurer) speaks. It treats the contract as unilateral.

You argue that the insurer cannot simply walk away. That is because it has received consideration for its promise. To my way of thinking, unilateral contract analysis explains why the insurer cannot sue the insured for not cooperating, etc.

I am aware of a trend that resists treating late notice of an insured event as a failure of condition. But wouldn't it make more sense to say that conditions in insurance policies are sometimes treated as sui generis where the insurer is not prejudiced[?]

Email from Joseph M. Perillo to Robert H. Jerry, II (Apr. 16, 2009) (on file with *Cardozo Law Review*).

⁸⁴ See insurance treatises and casebooks cited *supra* note 3. Nearly every case reproduced, discussed, or cited in those sources involves a dispute over the meaning and application of an insurance policy rather than a dispute over whether a contract was in fact made and a policy issued. Although insurers often argue that a policy is no longer in effect because of misrepresentation, fraud, or lapse of premium payment (the last item tending to refute the traditional view that insurance is always reverse-unilateral because the policyholder performs at the outset), these defenses seek to terminate or rescind a policy rather than to argue that the contract was never formed. There may also be issues of lost policies in which the question then becomes proof of insurance. See *STEMPEL ON INSURANCE CONTRACTS*, *supra* note 3, § 3.17. But, this is not a defense questioning the mechanics of contract formation. There may also be disputes about whether insurance evidenced by a binder (for property insurance) or conditional

illustrations such as the Brooklyn Bridge and flagpole hypothetical, unilateral contract doctrine has largely focused on formation and revocation of contracts rather than their construction.⁸⁵ More troubling, a closer look at insurance policies and their operation strongly suggests that they are in fact bilateral agreements in which promises are exchanged and not the reverse-unilateral oddities of conventional wisdom. Finally and most importantly, the dominance of the unilateral characterization of insurance policies has produced problematic results in insurance coverage cases.

A. *Conceptual Concerns: The Questionable Continuing Utility of the Unilateral/Bilateral Distinction*

As discussed above, mid-twentieth century contracts scholars and contemporary insurance scholars have questioned whether the unilateral/bilateral contract distinction has any meaning. Karl Llewellyn was probably unilateralism's most famous critic and his attack continues to resonate today. He viewed the preoccupation with unilateralism, and its obsession with performance versus promise, as running counter to the common sense of real world contracting actors who seek to attain objectives rather than to engage in a ritualistic and formalistic process of contract formation.⁸⁶ Professor Peter Tiersma summarized Llewellyn's argument:

[A] definite offer can be accepted in any reasonable way of expressing agreement unless the offeror specifically requires otherwise. Real people outside of lunatic asylums do not offer a promise for a promise. What businessmen offer is an assurance that after a deal is 'on,' it will not be withdrawn, and that performance will occur in due course.⁸⁷

Perhaps the most vocal critic of the unilateral contract concept itself was Professor Stoljar, whose attack on unilateral contract theory as insufficiently protective of reliance interests likewise resonates well in the modern legal world.

[T]he distinction between bilateral and unilateral contracts is false because it establishes a contrast between expectation- and

receipt (for life insurance) is operative. See WIDISS, *supra* note 3, § 2.3, at 43-62. But these cases largely involve the application of the binder or receipts language rather than doctrinal questions of contract formation.

⁸⁵ See *supra* notes 37-43 and accompanying text (discussing Brooklyn Bridge hypothetical and flagpole hypothetical); *infra* Part III.A (discussing the focus of unilateral contract doctrine and the debate on contract formation).

⁸⁶ See Llewellyn, *On Our Caselaw of Contract* (Part I), *supra* note 5, at 36; Llewellyn, *Our Caselaw of Contract* (Part II), *supra* note 42, at 788-89.

⁸⁷ See Tiersma, *supra* note 44, at 9.

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restitution-contracts but totally ignores the reliance-bargain. The distinction completely obscures the logical interrelation involved in the protection of the three contractual interests. If our law of contract at one end protects restitution (and indeed must protect promised restitution if promises are to be enforceable at all), and at the other end protects promised expectations (including purely aleatory expectations), the law must logically also protect actual reliance justifiably induced by the promisor. Again, by confusing two different meanings of acceptance, the distinction disregards a third type of acceptance and hides the identity of acceptance and reliance in the reliance-bargain. The promisee's reliance is as much a manifestation of assent to the exchange which the promisor proposes in his promise as is the counter-promise in the bilateral contract.⁸⁸

To the extent that these criticisms have any weight at all, they are more compelling in the insurance context, perhaps particularly so because of the asserted "reverse-unilateral" nature of insurance contracts as compared to other species of unilateral contract. To echo Professor Stoljar's concern, reliance interests are at particularly high tide where insurance is concerned. Trite as it may sound, policyholders do pay premiums in order to obtain the "peace of mind" of knowing that they are protected from potential liability or loss.⁸⁹ Insurance is defined as the incurring of a small but certain loss (the premium payment) in return for protection against a larger but contingent loss.⁹⁰ Putting the peace of mind concept more technically, the policyholder as part of a risk management plan devotes a set portion of its resources to the purchase of contractual protection against contingent risk.⁹¹ Premiums are prepaid (at least prior to any loss if not prior to inception of the contract) so that the insurer may obtain the investment benefits as part of a comprehensive system of social risk-spreading and financing of risk management.

In addition, the policyholder has relied not only by spending money that it could have otherwise invested itself for self-insurance or other gain, but also by forgoing the opportunity to purchase alternative insurance products. The policyholder is now highly dependent on the insurer for performance. After a loss or liability event has occurred, the policyholder is effectively precluded from purchasing insurance from

⁸⁸ See Stoljar, *supra* note 1, at 534 (citing Llewellyn, *On Our Case-law of Contract* (Part I), *supra* note 5, at 33-36; Llewellyn, *Our Case-law of Contract* (Part II), *supra* note 42, at 792-98).

⁸⁹ See, e.g., *Weinberger v. Wiesenfeld*, 420 U.S. 636, 642 n.10 (1975); *Apartment Inv. & Mgmt. Co. v. Nutmeg*, 593 F.3d 1188, 1194 (10th Cir. 2010); *Schwartz v. Liberty Mut. Ins. Co.*, 539 F.3d 135, 150 (2d Cir. 2008).

⁹⁰ See ABRAHAM, *supra* note 3, at 3-4; FISCHER ET AL., *supra* note 3, §1.02, at 14.

⁹¹ See ABRAHAM, *supra* note 3, at 4-7; DORFMAN, *supra* note 2, at 2-8; FISCHER ET AL., *supra* note 3, §§ 1.01-1.02; REJDA, *supra* note 2, at 20-22; VAUGHAN & VAUGHAN, *supra* note 2, at 12-14; see also DORFMAN, *supra* note 2, ch. 3.

another carrier.⁹² Even commercial entities with solid balance sheets depend on insurance to maintain liquidity. If an insurer fails to perform without coercion, a policyholder may be substantially hurt even if it later prevails in coverage litigation. Without the expected insurance protection (which usually includes legal defense to liability claims as well as payment to enable repair and rebuilding in property claims) promptly provided, even commercial policyholders may face cash flow problems and perhaps even insolvency as well as severe damage to reputation and ability to continue operations. Individual policyholders may lose homes, opportunity for medical care, or experience financial ruin.⁹³

To the extent that unilateral characterization of contracts is conceptually problematic in general, the discord is heightened when unilateral contract doctrine is applied to insurance. Of course, some degree of intellectual incoherence may be justified in the service of a needed concept. However, the Llewellyn and Stoljar criticisms strongly suggest that the concept is unnecessary, especially when applied to an area of law in which there is relatively little dispute over matters of contract formation. Although not attacking the unilateral contract concept itself, two commentators recently found it to be essentially useless as a legal tool, even in the context of contract formation: “The important question is how a court determines whether there is a contract, not whether courts continue to use the phrase ‘unilateral contract.’ . . . The words ‘unilateral contract’ are no more important in answering these ‘real world’ questions than the words ‘Denny Crane.’”⁹⁴

⁹² After filing a claim for a loss, a policyholder will often not be able obtain insurance, at least under normal circumstances and for reasonable rates. There are, however, instances in which an insurer will underwrite coverage after the loss or liability event. For example, billionaire financier Warren Buffett’s companies have been known to issue liability policies covering a pipeline of anticipated claims, expecting to make money if correctly calculating the amount of premium dollars and investment income that can be collected in relation to the eventual final tally of payments necessary to resolve pending claims. See Jeffrey W. Stempel, *Assessing the Coverage Carnage: Asbestos Liability and Insurance After Three Decades of Dispute*, 12 CONN. INS. L.J. 349, 467 (2006). Another example was provided when liability insurance was sold (undoubtedly at high premium) to the MGM Grand Hotel and Casino after a tragic fire spurred many claims, with MGM “offloading” the risk of paying for complete resolution of the claims to the insurer, which collected the large premium, invested it, and then attempted to pay claims as parsimoniously and gradually as possible so as to profit from the arrangement. See *In re MGM Grand Hotel Fire Litig.*, 570 F. Supp. 913, 928 (D. Nev. 1983).

⁹³ For examples of how fragile a grip on solvency may be held by individuals and small businesses, see Robert M. Lawless, *Bankruptcy Filing Rates After a Major Hurricane*, 6 NEV. L.J. 7 (2005); Katherine Porter, *Going Broke the Hard Way: The Economics of Rural Failure*, 2005 WIS. L. REV. 969 (2005).

⁹⁴ See Epstein & Liebesman, *supra* note 9, at 307 (referring to the rakish main character—a senior attorney played in typical over-the-top fashion by the irrepressible actor William Shatner of Star Trek and Priceline fame—in then-popular television program *Boston Legal* (ABC television network 2004-2008)).

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The unilateral/bilateral distinction focuses almost exclusively on matters of contract formation and revocation. The substantial body of ink spilled during the twentieth century on the topic centered on the factors that made for creation of a contract and on whether one offering a unilateral contract could “pull the plug” on an unsuspecting incipient acceptor after it had begun to perform the requested act sought by the offeree. The horrible hypotheticals surrounding the issue, such as walking across the Brooklyn Bridge, were exclusively focused on whether the promisor would evade a contract when the performer was only a few yards from making it to the other borough and emphasized that the contract formed by performance rather than a return promise.

Although the Brooklyn Bridge problem was (and to some extent remains) fascinating and fun stuff for the classroom, it focuses—like much of the standard contracts course—excessively on issues of formation relative to their importance in the real world.⁹⁵ In most contracts litigation, no question exists that there is a contract. The parties are fighting over construction and application of the agreement, not its existence or whether an offer was revoked or a deal improperly rescinded. Particularly since the rise of promissory estoppel and creation of contract by detrimental reliance, the classic brainteasers about contract formation are relatively unimportant for most practicing attorneys. Except for counsel representing real estate brokers, companies running contests, or employers concerned over deviating from the at-will doctrine through publication of rules or handbooks, the

⁹⁵ Contract scholarship and legal education have generally tended to give inordinate attention to issues of contract formation relative to the degree to which such issues arise in the real world, where issues of interpretation, breach, materiality, and damages appear to dominate the case reports. See, e.g., E. ALLAN FARNSWORTH, WILLIAM F. YOUNG, CAROL SANGER, NEIL B. COHEN, & RICHARD R.W. BROOKS, *CONTRACTS: CASES AND MATERIALS* (7th ed. 2008) (roughly 200 pages of 958-page text devoted to issue of contract formation and 320 pages concerning contract construction); CHARLES L. KNAPP, NATHAN M. CRYSTAL & HARRY G. PRINCE, *PROBLEMS IN CONTRACT LAW: CASES AND MATERIALS* (6th ed. 2007) (350 or more pages in 1046-page text deal with contract formation matters); ROBERT E. SCOTT & JODY S. KRAUS, *CONTRACT LAW AND THEORY* (4th ed. 2007) (450-500 pages in 1070-page text devoted to matters of contract formation). An arguable exception to this overall tendency is STEWART MACAULAY, JOHN KIDWELL & WILLIAM WHITFORD, *CONTRACTS: LAW IN ACTION* (2d ed. 2003) (80 pages in an 1100-page book devoted to contract formation). Perhaps not coincidentally, Professor Perillo’s casebook is among the most interested in contract formation issues. See PERILLO, *supra* note 2 (arguably as many as 500 pages of 885-page book focusing on contract formation and related issues).

To be sure, classification of contract casebook coverage can involve characterization questions as debatable as whether insurance policies are unilateral or bilateral contracts (e.g., is material on the statute of frauds, incapacity, or unconscionability within the domain of contract formation?). Even if our classification is debatable, it remains obvious that contracts scholars pay a good deal of attention to contract formation, perhaps too much in relation to the attention paid to contract construction and remedies for breach, which appear to dominate actual contract litigation. The focus on contract formation dwarfs the attention given to assignment, intended and incidental beneficiaries, and consideration of parol/extrinsic evidence, topics that get little attention in law school but may be frequently litigated.

unilateral/bilateral distinction is likely not germane to their practices or their clients' lives.

This is especially the case with insurance. Nearly all insurance litigation focuses not on whether an insurance policy is in effect, but on whether there is coverage under the terms of a concededly operative contract. The issue is usually "is this loss or liability covered?" not "is the purported insurance policy in force?" There are, of course, more than a few insurance disputes involving rescission. However, these are not cases involving revocations of an offer. Instead, the typical rescission case alleges that the applicant-cum-policyholder made a material misrepresentation inducing conceded issuance of the contested insurance policy. The unilateral/bilateral distinction is irrelevant to resolution of such a case.

Alternatively, insurance litigation may address whether insurance is in force prior to the formal issuance and delivery of an insurance policy. Most commonly, this occurs when a life, health, or disability applicant/policyholder suffers loss while the application is processing. Where the applicant has not yet paid the premium and received a conditional receipt, the insurer typically wins easily because it does not "accept" the applicant's offer to buy insurance until it issues the policy. As discussed in Part III.B below, the insurer's issuance of the policy as a promise to cover contingent losses or liabilities is better viewed as acceptance of the applicant's offer than as a mere precursor to performance of a unilateral contract. If the insurer has issued a conditional receipt, the case will usually be resolved based upon interpretation of the conditional receipt rather than upon concepts of unilateral and bilateral contracts.⁹⁶

In addition, as with other areas of the law, obligations may be created by acts or words reasonably inducing detrimental reliance.⁹⁷ Consequently, an insurance agent's statement that an applicant or policyholder is "covered" may be enough to establish the existence of an insurance policy even without formal application processing and insurer issuance of a policy form.⁹⁸ However, the precise contours of coverage remain open for determination based on the type of policy at issue; the agent's statement, even if sufficient to establish an insurer-policyholder relationship, does not necessarily bind the insurer to provide coverage for the loss at issue. This fact of legal life also undermines the potential importance of any difference between unilateral contracts and bilateral contracts.

⁹⁶ See WIDISS, *supra* note 3, at 42-64; *infra* Part III.B.

⁹⁷ See RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981).

⁹⁸ See, e.g., *Bill Brown Constr. Co. v. Glens Falls Ins. Co.*, 818 S.W.2d 1 (Tenn. 1991); *Dixon v. Pickle*, 327 S.W.2d 50, 52 (Tenn. Ct. App. 1959).

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In addition, as contrasted to typical contract relations, the law generally views the insurer-policyholder relationship as somewhat fiduciary in nature (for most first-party insurance) or even fully fiduciary (for liability insurance where the insurer is charged with defending and settling claims).⁹⁹ Although the fiduciary-like duties of the insurer do not accrue until there is an insuring agreement in place, the special relationship of the parties and the duties of insurer to policyholder logically increase the importance of protecting reliance-based interest. Even for non-insurance contracting, duties of minimal good faith may attach during negotiation¹⁰⁰ that prevent sharp practices, a duty logically enhanced in the insurance context.

In the same vein, state law or regulation usually restricts an insurer's right to cancel, further minimizing the possibility that unilateral/bilateral concepts can conceivably impact issues of formation, rescission, continuation, or modification of an insurance policy.¹⁰¹ Although the insurer may usually reserve a right to modify policy terms, at least when renewing (and sometimes even during the policy period), insurers are also usually required to disclose any coverage-reducing changes in the policy.¹⁰²

The nature of insurance has thus created an environment in which contract formation generally is not much of an issue and in which the unilateral/bilateral distinction is even less of an issue, at least in the vast bulk of insurance matters and disputes. It therefore seems wasteful and misleading to devote significant attention to the unilateral/bilateral distinction because it falsely implies that contract formation is a major problem of insurance jurisprudence.

In short, the unilateral/bilateral distinction appears to have nothing positive to contribute to insurance law. As demonstrated in Part III.C below, the distinction has adverse effects in disputes surrounding insurance contract performance. Further, as outlined in Part III.B below, the classification of insurance policies as unilateral or reverse-unilateral contracts appears incorrect when one appreciates the actual operation of insurance contracting.

⁹⁹ See ANDERSON ET AL., *supra* note 3, §§ 11.02, 11.06; ROBERT H. JERRY, II & DOUGLAS RICHMOND, UNDERSTANDING INSURANCE LAW § 25G (4th ed. 2007); STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, § 10.01.

¹⁰⁰ See E. Allan Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 COLUM. L. REV. 217, 272 (1987) (explaining the concept of precontractual good faith).

¹⁰¹ See FISCHER ET AL., *supra* note 3, § 4.08; STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, § 3.16.

¹⁰² See, e.g., *Canadian Universal Ins. Co. v. Fire Watch, Inc.*, 258 N.W.2d 570 (Minn. 1977); see also STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, §§ 4.09, 4.13.

B. *Characterization Concerns: Insurance Policies as Better Resembling Bilateral Contracts*

For the most part, insurance scholars have devoted almost no attention to the issue of whether insurance policies are unilateral or bilateral contracts.¹⁰³ Those that have touched on the issue at all have largely reiterated, with little or no comment, the conventional view that insurance is a unilateral arrangement—a view largely put forth by contracts authorities who conducted relatively limited insurance scholarship¹⁰⁴—or suggest that the unilateral/bilateral classification is unimportant.¹⁰⁵

As noted above, the most influential and authoritative modern voice in the classification debate, one strongly supporting the unilateral denomination, has been that of Professor Perillo. His popular treatise characterizes the insurance policy as a reverse-unilateral contract because the offeror-applicant-policyholder “performs” or fulfills its contract obligations in advance by paying a premium in return for the insurer’s promise of coverage in the event of loss.¹⁰⁶ The Calamari and Perillo treatise is unusual in that it both focuses on insurance as a type of unilateral contract and uses the term “reverse-unilateral” to more closely describe the transaction and bring insurance policies into the realm of unilateral contracts. Most mainstream contracts treatises and casebooks not only give little attention to insurance, but also give little or no attention to the question of whether insurance contracts are unilateral or bilateral.¹⁰⁷

As a result, the limited exploration on the unilateral/bilateral question in the context of insurance has largely been the province of contract generalists rather than insurance specialists. Literature labeling insurance as a unilateral contract has perhaps for that reason tended to overlook or under-appreciate specific aspects of insurance that cast doubt on the unilateral characterization. When viewed in a comprehensive, practical, and ongoing fashion, the insurance policy begins to look much more like a bilateral contract.

Consider the basic manner in which insurance is sold. Insurers are ubiquitous advertisers. Standard contract law doctrine establishes that an advertisement is normally not an offer, but instead is an invitation for

¹⁰³ See *supra* note 2.

¹⁰⁴ See *supra* note 3.

¹⁰⁵ See JERRY, *supra* note 82, § 31, at 224; see also sources cited *supra* note 3.

¹⁰⁶ See PERILLO, *supra* note 2, § 2.10, at 57-58.

¹⁰⁷ See *supra* note 3.

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the prospective customer to make an offer.¹⁰⁸ Insurers in particular attempt to benefit from this construct because the prospective policyholder normally must not only ask for insurance but also complete an application for insurance that can be reviewed by the insurer's underwriting department to determine whether the insurer wishes to assume the risks presented by the particular policyholder for the type of insurance sought.¹⁰⁹ In addition to giving the insurer the option of taking a longer, harder look before committing to cover contingent risks presented by an applicant/policyholder, this structuring of the transaction permits the insurer to seize upon inaccuracies in the application and pursue rescission on misrepresentation grounds where the matter is material and substantially inaccurate.¹¹⁰

Commonly, the applicant also tenders the first premium with the application so that coverage is created immediately upon the insurer's approval of the risk and decision to issue the policy.¹¹¹ Life, disability, and individual health insurance often differ in stating that the insurance contract is not in effect until the policy is delivered to the applicant/policyholder,¹¹² although decades of case law have largely turned this into a matter of constructive delivery rather than actual in-hand receipt of paper by the policyholder.¹¹³

In a perhaps inconsistent approach to the contracting process, insurers also commonly issue a conditional receipt when taking a life, health or disability application and premium payment.¹¹⁴ Although there are several types of conditional receipts, the most common variety provides that coverage is considered to begin as of the date of the application, provided that the applicant is eligible for the coverage sought according to the insurer's prevailing underwriting criteria.¹¹⁵ In this manner, the insurer encourages prepayment of premiums, which it can invest, and discourages the applicant from pursuing competing insurance products. The conditional receipt also protects the

¹⁰⁸ See CALAMARI ET AL., *supra* note 83, at 28-29.

¹⁰⁹ See STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, §§ 3.01-3.02, 3.06.

¹¹⁰ See *id.* §§ 3.07-3.11.

¹¹¹ See *id.* §§ 3.01-3.02.

¹¹² See JERRY & RICHMOND, *supra* note 99, § 32; STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, § 3.06; see also Edwin W. Patterson, *Delivery of a Life-Insurance Policy*, 33 HARV. L. REV. 198 (1919).

¹¹³ See JERRY & RICHMOND, *supra* note 99, § 32; STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, § 3.06.

¹¹⁴ See STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, § 3.05; WIDISS, *supra* note 3, at 42-63.

¹¹⁵ See JERRY & RICHMOND, *supra* note 99, § 32; ROBERT E. KEETON & ALAN I. WIDISS, *INSURANCE LAW: A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES, AND COMMERCIAL PRACTICES* § 2.3 (2d ed. 1989); STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, § 3.05.

policyholder from fortuitous injury during the pendency of the underwriting process, which may take several weeks.¹¹⁶

By contrast, property and casualty underwriting is more encapsulated, with insurers tending to accept risks immediately, often through the authority of the sales agent, so long as the information provided by the applicant is correct.¹¹⁷ Property insurers, for example, issue “binders” rather than conditional receipts and depend on misrepresentation and other rescission doctrines to protect themselves from unwanted risks. This is in contrast to the more extensive pre-policy investigation that accompanies life, health, and disability insurance.¹¹⁸

So far, so good for the proponents of reverse-unilateralism. The applicant is offering to buy insurance and performing its part of the bargain by paying the premium. In return, the insurer accepts the offer (and cashes the applicant’s check) while promising to cover specified contingent losses that may take place. Thereafter, however, the insurance relationship and the typical insurance claim become considerably more complicated than walking across the Brooklyn Bridge.

First, there is the practical matter of premium payment. Although the applicant has paid the initial premium in return for coverage for a specified period, modern insurance is often not a one-shot transaction. Rather, it tends—at least for many policyholders and insurers—to be a classic relational contract.¹¹⁹ The first premium payment is often for a short period, perhaps as little as a month. In order to keep coverage in force, the policyholder is required to continue making regular payments. Traditionally, insurance premiums were paid every six months, although many insurers now bill quarterly. Perhaps more common still is monthly billing facilitated through the regular debiting of the policyholder’s checking or savings account.¹²⁰ All of this requires

¹¹⁶ See KEETON & WIDISS, *supra* note 115, § 2.3; STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, § 3.05.

¹¹⁷ See JERRY, *supra* note 82, § 33 at 245; KEETON & WIDISS, *supra* note 115, § 2.3; STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, § 3.05.

¹¹⁸ See FISCHER ET AL., *supra* note 3, § 4.03(A); JERRY, *supra* note 82, § 33, 245; STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, § 3.05.

¹¹⁹ A relational contract is one in which the parties are or expect to be engaged in ongoing interactions and therefore value, among other things, cooperation and flexibility in order to preserve the relationship. See generally IAN R. MACNEIL, THE NEW SOCIAL CONTRACT: AN INQUIRY INTO MODERN CONTRACTUAL RELATIONS (1980); Stewart Macaulay, *An Empirical View of Contract*, 1985 WIS. L. REV. 465, 467-68 (1985); Ian R. Macneil, *Values in Contract: Internal and External*, 78 NW. U. L. REV. 340 (1983); Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 NW. U. L. REV. 854 (1978).

¹²⁰ Twenty or more years ago, such arrangements were sufficiently novel to merit substantial comment in litigation concerning whether a policy had lapsed due to failure of timely premium payment. See, e.g., *Horace Mann Life Ins. Co. v. Lunsford*, 324 S.E.2d 808 (Ga. Ct. App. 1984).

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administrative activity by the insurer, both in establishing a regime of periodic payment and in tracking and collecting payment.

As a result, what in first-year Contracts class may look like the policyholder's "complete performance" of its payment obligations in an insurance contract begins in operation to look much more like a down payment on the policy with a promise to continue paying premiums on the policy at regular intervals. Consequently, the exchange between applicant/policyholder and insurer tends in practice to look more like an exchange of promises rather than an exchange of performance for promise—at least for policyholders who are establishing an insurance or risk management program rather than simply buying short-term insurance.¹²¹

Proponents of the unilateral school would undoubtedly argue that the policyholder's promise of a continued stream of premium payments is not a true bilateral promise because the policyholder is free to stop making payments at any time without apparent liability to the insurer. However, to the extent this is true (and as discussed below, it is a misleading view of the policyholder's prerogatives), the same might be said of magazine subscriptions, record clubs, yard service, pool service, or countless other contractual arrangements that are generally regarded as bilateral (to the extent anyone pauses to classify them at all).

Consider what happens when a policyholder ceases paying premiums. The insurer typically sends a reminder of delinquency and permits the policy to be reinstated if the past due premiums are made good. It is common, particularly for life, health, or disability insurance, for the insurer to provide for a grace period prior to cancelling the policy.¹²² The insurer invests nontrivial administrative resources in attempting to induce policyholders to keep their at least implicit promises of continued premium payment. If the policyholder persists in nonpayment, the policy lapses and become ineffective or expires by its terms.

Termination of an insurance policy for failure to pay new premium obligations that accrue is not much different from failing to renew a

Today, such regular (usually monthly) automatic debiting of a bank account for premium payment is widespread. In addition, other payment arrangements are possible as well. For instance, insurers may collect premiums after the policy has been issued. *See* Great Am. Ins. Co. v. Matzen Constr. Co., 494 N.Y.S.2d 464 (N.Y. App. Div. 1985). They may also accept promissory notes. *See* Raney v. Piedmont S. Life Ins. Co., 387 F.2d 75 (8th Cir. 1967).

¹²¹ Dean Jerry makes many of these same points in his email exchange with Professor Perillo, excerpted *supra* note 83.

¹²² Dean Jerry views the grace period as the policyholder's temporary indebtedness to the insurer. JERRY, *supra* note 82, at 623. If the new premium is paid, coverage continues, but if it is not, then the policy terminates on the date the premium was due. *Id.* If the policyholder dies during the grace period, the policy is in effect and the premium is paid out of the proceeds. *Id.*; *see, e.g.,* Furtado v. Metro. Life. Ins. Inc., 131 Cal. Rptr. 250 (Cal. Ct. App. 1976) (calculating grace period in conjunction with nonforfeiture provision in a whole life policy).

magazine subscription (which typically earns the subscriber three to four plaintive entreaties from the publisher seeking renewal, often at ever more attractive subscription rates). Similarly, when a customer stops paying for lawn care, pool care, newspaper delivery, or the like, the vendor attempts to induce the customer to stand by its earlier implicit promise of patronage and is normally eager to keep the relational and rolling contract in effect.

Further, if the vendor has rendered continued services after payment has stopped, the vendor in theory has a cause of action for breach of contract or at least *quantum meruit* recovery, unless given adequate and timely notice by the customer that services were no longer required, just as the customer would have a claim against the vendor that failed to show up and provide promised services.¹²³ In practice, such small claims are almost never brought because the logistical costs of enforcement exceed any real injury. Vendors who deliver and are unpaid, however, usually at least bill the nonpaying customer and may even commence collection actions.¹²⁴

Where the policyholder announces a desire to end coverage rather than simply failing to pay newly billed premiums, the bilaterality of insurance contracts appears more pronounced. For example, a policyholder on a six-month billing cycle for her automobile policy may call her agent during the third month and cancel coverage, planning to switch to a less expensive insurer. As unilateral contract enthusiasts point out, the insurer cannot compel the policyholder to stay and commonly returns roughly half of the six-month premium paid some three months earlier. This hardly means the cancelling policyholder, as one performing prior to the policy period, was free of obligations sounding in promise.

In policy termination situations, the insurer usually refunds a portion of the previous premium payment—but only a portion. The insurer regards the first three months' premium as "earned" because the insurer assumed the risk, even if the policyholder had no auto-related mishaps. The refunded half of the six-month premium is the "unearned premium."¹²⁵ In practical terms, the policyholder is not walking away

¹²³ See EPSTEIN ET AL., *supra* note 3, at 150 (citing *Austin v. Burge*, 137 S.W. 618 (Mo. Ct. App. 1911)) (describing potential customer liability for continuing to receive services despite tardy or imperfectly expressed intent to cancel or reject). The Postal Reorganization Act of 1970 subsequently made it an unfair trade practice to bill a recipient for unsolicited merchandise sent through the mail. See *id.* (citing 39 U.S.C. § 3009).

¹²⁴ See, e.g., Jim Dwyer, *Hello, Collections? The Worm Has Turned*, N.Y. TIMES, Nov. 29, 2009, at 1 (describing creditor and law firm's aggressive pursuit of the wrong person in connection with \$919 credit card debt).

¹²⁵ State laws vary as to whether and how insurers may use a short rate method to recalculate and retain more than a pro rata share of the unearned premiums when policyholders cancel prematurely. LEE R. RUSS & THOMAS F. SEGALLA, 5 COUCH ON INSURANCE § 79:22 (Westlaw 2010). When permitted, a short rate refund works like a liquidated damages provision and allows

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without any liability to the insurer but rather permissibly breaches the insurance contract and essentially pays liquidated damages¹²⁶ based on an implicit out-of-pocket or restitution¹²⁷ formula for the insurer. The policyholder has no further obligation and can get a refund of unearned premium, but the earned premium remains with the insurer—and is considered earned by the insurer even though the policyholder has submitted no claims and the insurer has paid nothing (although it did incur sales and administrative costs). The insurer also gained from having all premiums previously paid at its disposal for investment.

In some states, however, insurers are not required to refund premiums on a pro-rata basis and may retain at least a portion of the unearned premium. To the extent this occurs, the entire process looks even more like contract “breach” by the policyholder (ending the insurance policy earlier than promised) that leads to the imposition of a type of de facto liquidated damages as a result.

If the insurance policy were purely unilateral or reverse-unilateral, the policyholder’s full “performance” through paying the premium would not logically lead to a withdrawal or repudiation of performance already delivered. For example, in the Brooklyn Bridge hypothetical, performance by the offeree trekking the Bridge cannot be undone or reversed. The same can be said of the flagpole climber in that famous hypothetical. Although characterizing insurance policies as reverse-unilateral arguably provides an explanation for this oddity, our view is that it provides a stronger argument that the insurance policy is better viewed as bilateral rather than as a mutated species of unilateral contract.

The policyholder terminating coverage arguably forfeits or loses the premiums previously paid covering the three months for which the policyholder received nothing more than the insurer’s assurances that it would provide coverage if the need arose. The better view, however, is that the policyholder did indeed get what it paid for during those three months—protection against contingent loss that the policyholder was fortunate enough not to have incurred during the time the policy was in

the insurer to recalculate the premium based upon “the customary rates charged for insuring like property, in a like amount” for a shorter term and return less than a pro rata calculation. *Home Ins. Co. v. Hamilton*, 128 S.W. 273, 274 (Mo. App. 1910); *see also* *Amgro, Inc. v. Lincoln Gen. Ins. Co.*, 361 F. App’x 338 (3d Cir. 2010) (discussing a New Jersey statute regarding short rate premium refund); *Argonaut Sw. Ins. Co. v. Amco Mesh & Wire Co.*, 472 S.W.2d 843 (Tex. App. 1971) (discussing insurance policy language providing for a short rate calculation when insured cancels prematurely). Regarding premium refunds, *see* DORFMAN, *supra* note 2, at 187-88; VAUGHAN & VAUGHAN, *supra* note 2, at 122-26.

¹²⁶ Liquidated damages are a sum stipulated within the contract as the damages for breach. The sum must be “reasonable in light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss.” RESTATEMENT (SECOND) OF CONTRACTS § 356 (1981).

¹²⁷ Restitution damages are a sum of damages measured by “the benefit that has been conferred upon” the liable party. *Id.* § 371 cmt. a.

effect. Under either view, however, neither the policyholder nor the insurer gains because of any unilateral concept of the insurance policy. The policyholder could just as easily have promised regular payments and then stopped making payment, rather than paying the initial six months of premiums and then seeking a refund. If anything, the latter arrangement is a boon to the insurer by providing it with capital that it would not otherwise have had if the policyholder had only promised to pay (rather than paid) at the outset.

In theory, the insurer might be able to seek consequential damages when a policyholder breaches by cancellation. However, under the classic common law approach of *Hadley v. Baxendale* and its progeny,¹²⁸ this is unlikely in that the policyholder usually has no reason to know of any adverse consequences that will befall the insurer from cancellation.¹²⁹ Further consequential damages are thus usually outside the contemplation of the parties and not recoverable. If permitted by state regulators, however, insurers could probably structure the transaction to recover actual damages for early cancellation.

Such damages provisions in policies or full-blown litigation over a prematurely terminated insurance policy seldom occur, not only because of the economics of litigation, but also because of prevailing insurer views regarding effective marketing and customer relations. Insurers appear to have made the decision not to push the contract doctrine envelope and seek full compensation from policyholders who walk away from policies even though it would appear they could make non-frivolous attempts to do so. Instead, insurers appear content to let policyholders leave and to concentrate their efforts upon enlisting new customers rather than pursuing claims against those who leave.

Characterization of the insurance policy as unilateral or reverse-unilateral does not change this calculus or the options facing insurers and policyholders. Even where premium payment is regarded as full performance, seeking a refund of premium after the insurer has promised coverage for a given time constitutes a breach of any such reverse-unilateral contract and, as discussed above, entitles the insurer to retain premium for the time when coverage was provided (and perhaps some of the unearned premium) even if the policyholder is allowed to end the arrangement earlier than expected. But if a consumer insurer (e.g., an auto insurer such as State Farm) were to do more, such as retaining some of the unearned premium as an approximation of incidental or consequential damages or suing for such damages, the insurer would almost certainly reap significant adverse

¹²⁸ *Hadley v. Baxendale*, (1854) 156 Eng. Rep. 145 (Exch. Div.).

¹²⁹ Consequential damages are “those which will not always result from a breach of contract of the character of the particular breach, but which did flow from this breach and were foreseeable.” WILLISTON, *supra* note 3, § 66:57.

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publicity. Seldom will an insurer consider this detriment smaller than the expected value of a full-blown breach of contract claim against the policyholder who walks out early. In the less public arena of surplus lines insurance, adverse publicity is less of a problem.

Perhaps more important, most state insurance regulations require refunds of unearned premium, precluding the insurer from taking a tough approach to terminating policyholders even if it is convinced that this is a legally supportable and valid business proposition. Insurance is, at least as compared to most contractual activity, heavily regulated.¹³⁰ As a result, positive law may circumscribe insurer behavior, as well as policyholder or applicant behavior. This aspect of insurance not only tends to make contract characterization issues less important than might otherwise be the case, but also makes insurance contracting and the operation of insurance something more than a purely contractual exercise. The problems of policyholder cancellation and premium refund illustrate the degree to which the relentlessly unilateral view of insurance policies seems not to square with the actual insurer-policyholder relationship in practice.

Insurance is not only publicly regulated, but also reflects a type of private ordering arrived at by the insurance industry¹³¹ which, because of exceptions to the antitrust laws, is permitted to collaborate to an extent not found in most other businesses.¹³² In addition, the highly standardized nature of insurance and the use of standardized policies as components of widely shared risk management goals by certain types of businesses and individuals makes insurance policies something akin to products rather than pure contracts.¹³³ Moreover, the importance of insurance in achieving policy goals and fostering commerce makes it something of a social institution or instrument for effecting social policy.¹³⁴ Although none of these different perspectives strip insurance policies of their core character as contracts, they make the unilateral/bilateral distinction and contract formation issues generally less important than in other areas of contract.

In addition, because the insurer-policyholder relationship carries with it more significant obligations of good faith than found in the

¹³⁰ See JERRY, *supra* note 82, at 69-78 (discussing the justifications for state regulation and the historical rise of comprehensive state regulation of insurance and the influence of the National Association of Insurance Commissioners); STEMPER ON INSURANCE CONTRACTS, *supra* note 3, §§ 2.03-2.05.

¹³¹ See Jeffrey W. Stempel, *The Insurance Policy as Statute*, 42 MCGEORGE L. REV. 203 (2010).

¹³² See 15 U.S.C. § 1011 (2006).

¹³³ See Daniel Schwarcz, *A Products Liability Theory for the Judicial Regulation of Insurance Policies*, 48 WM. & MARY L. REV. 1389 (2006); Jeffrey W. Stempel, *The Insurance Policy as Thing*, 44 TORT TRIAL & INS. PRAC. L.J. 813 (2009).

¹³⁴ See Jeffrey W. Stempel, *The Insurance Policy as Social Instrument and Social Institution*, 51 WM. & MARY L. REV. 1489 (2010).

ordinary contract relationship, the insurer is logically restricted in its options in dealing with the policyholder in any way that may harm the policyholder.¹³⁵ Because a “no harm, no foul” ethos and tradition dominates policyholder cancellation of policies, the issue has not been well tested. One can make a compelling argument that an insurer with fiduciary-like duties to the policyholder acts in bad faith if it responds to the policyholder’s termination and request for a refund with undue efforts to hold the policyholder to the original arrangement or wrings from the policyholder every last cent in seeking full compensation of every arguable injury suffered by the insurer when the policyholder leaves.¹³⁶ Good faith requires that the insurer give equal consideration to the policyholder’s interests as to those of the insurer,¹³⁷ a standard that arguably precludes a scorched earth, retaliatory attitude toward customers who want to leave.

¹³⁵ Every contract carries with it an implied covenant of good faith and fair dealing. *See* RESTATEMENT (SECOND) CONTRACTS § 205 (1981); PERILLO, *supra* note 2, § 11.38, at 412-17; FARNSWORTH, CONTRACTS, *supra* note 3, § 7.17. However, outside of insurance, the duty has relatively modest scope and consequences. For example, Article 1 of the Uniform Commercial Code governing sales defines good faith as mere “honesty in fact and the observance of reasonable commercial standards of fair dealing.” U.C.C. § 1-201(20) (2010).

By contrast, an insurer’s duty of good faith toward a policyholder is fiduciary in nature or even fully fiduciary when the insurer is discharging its role of defense and settlement of liability claims against the policyholder. Further, most jurisdictions treat an insurer’s breach of the covenant of good faith and fair dealing as a tort and permit an aggrieved policyholder to pursue tort remedies (which are generally more expansive than contract remedies), including punitive damages. *See* FISCHER ET AL., *supra* note 3, § 14.01; JERRY, *supra* note 82, § 25[G]; OSTRAGER & NEWMAN, *supra* note 3, §§ 12.01, 12.12; STEMPER ON INSURANCE CONTRACTS, *supra* note 3, § 10.01.

¹³⁶ Good faith toward a policyholder generally requires that the insurer give the policyholder’s interest at least equal consideration to the insurer’s own interests and to refrain from sharp practices. *See* FISCHER ET AL., *supra* note 3, § 14.01; OSTRAGER & NEWMAN, *supra* note 3, § 12.06, at 862; STEMPER ON INSURANCE CONTRACTS, *supra* note 3, § 10.01. Because an insurer cancelling a policy expects to terminate its responsibility for contingent liability or loss, the equal consideration principle logically suggests that the insurer facing a policyholder’s termination should happily refund unearned premium, irrespective of whether the insurance policy is viewed as a unilateral contract or a bilateral contract. Selling insurance and collecting a premium in advance of acceptance of contingent risk but then refusing to refund unearned premium would permit the insurer to unfairly elevate its own interests above those of the policyholder. It would also permit the insurer to take undue advantage of policyholders, particularly less sophisticated policyholders who have not thought through issues of policy termination and its consequences.

In addition, it should be noted that policy termination by the policyholder is often not the result of calculating behavior by the policyholder such as bargain-hunting among available insurance products. For example, a policyholder may wish to terminate a policy and seek a premium refund because of a job transfer, sale of the insured assets, divorce, death, or other situations that have changed the policyholder’s risk management preferences since the time the policy was initially purchased.

¹³⁷ *See* STEMPER ON INSURANCE CONTRACTS, *supra* note 3, § 10.01 (equal consideration standard for good faith by insurers); *see also* STEPHEN S. ASHLEY, BAD FAITH ACTIONS: LIABILITY AND DAMAGES §1.2, at 1-3 (2d ed. 2009) (essentially the same perspective in that the covenant of good faith requires “each party to refrain from doing anything that would injure the right of the other party to receive the benefits of the agreement”).

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In addition, the degree of good faith required for insurance greatly exceeds that imposed on most contractual relations. The insurer-policyholder relationship is considered semi-fiduciary in all jurisdictions and fully fiduciary in most jurisdictions in the liability insurance context where the insurer has the right and duty to defend the policyholder in litigation and attempt to settle claims, particularly where there is risk that a resulting judgment could exceed policy limits.

The existence of the substantial good faith duties that attach to insurance policies tends to undermine the unilateral characterization. On one hand, treating premium payment by the policyholder as full performance helps to support the idea that the policyholder is vulnerable and should not be deprived of the benefit of the bargain in receiving performance should the insured contingent events take place. But more important, the good faith obligations of the insurer, combined with the duties of the policyholder after a claim or loss, tend to show that the relationship is ongoing rather than fully performed by premium payment or limited on the insurer's part to mere execution of a simple task such as traversing a bridge, climbing a flagpole, or handing over an agreed sum.

Once the insurer "accepts" the policyholder's "offer" to buy insurance, gives "full performance" through premium payment, and the insurer issues the insurance policy, the resulting arrangement begins to look much more like a standard bilateral contract than a vendor paid in advance to cross the Brooklyn Bridge or shinny up a flagpole. In addition to the policyholder's implicit promise to continue paying premiums and to keep the policy in force, there remains, as discussed above, the strong possibility that the insurer will revise policy terms, either during the policy period or upon renewal. Although there are some regulatory and case law constraints, insurers for the most part have substantial latitude to unilaterally amend the provisions of their policies, as do most commercial vendors dealing with consumers.¹³⁸ In these other contexts, of course, the contracts involved (e.g., credit card accounts, utility services, banking accounts) are universally recognized as bilateral. By contrast, as a theoretical matter, unilateral amendment of the terms should have no rule in unilateral contracts because, by definition, there has been no contract formed or the contract is formed and fully executed at the same moment. Logically, then, the mere presence of unilateral amendment of contract terms suggests that the contract in question is not unilateral.

As a matter of classification and nomenclature, any modification to the original offer to form a unilateral contract is not a change in terms, but a revision of the offer in question. For example, in the classic

¹³⁸ See David Horton, *The Shadow Terms: Contract Procedure and Unilateral Amendments*, 57 U.C.L.A. L. REV. 605 (2010).

agreed instances of unilateral contracts such as the Brooklyn Bridge hypothetical, the offeror's sudden reduction of the promised payment yelled to the walker minutes before she reaches the end of the Bridge is not a change in contract terms (because the contract is as yet unformed), but is instead a revoked original offer, a revised offer, or a new offer.¹³⁹ Once it was agreed that the beginning of substantial performance by the walker precluded revocation of the offer,¹⁴⁰ it also logically followed that the offeror could also not unilaterally alter the offer to the partial performer's detriment. But for insurance policies, we find unilateral amendment to be a constant.¹⁴¹

If the insurance policy were truly unilateral or reverse-unilateral, full performance through premium payment would logically make such changes in terms ineffective unless they gave the policyholder greater protection than promised in the original deal.¹⁴² Unilateral amendments to contracts are generally justified by those who support them on the ground that the initial contract gave the vendor the right to such modification. As Professor David Horton has shown, much of the rationale undergirding the legal system's toleration of such unilateral amendment is faulty and a good case can be made for prohibiting such unilateral rewriting of contracts altogether.¹⁴³ Regardless of one's position on this issue, however, the presence of unilateral modification of insurance policy terms tends to suggest an ongoing and iterative relationship between policyholder and insurer, rather than the more simplified schematic advanced by a unilateral classification of the insurance policy and the parties' relationship.

Even where an insurer is not routinely making unilateral changes to policy terms, the insurer will at the very least offer the insurance at different (usually higher) premium prices during subsequent time

¹³⁹ See *supra* notes 37-47 and accompanying text (describing unilateral contract theory and its application).

¹⁴⁰ See *supra* note 44 and accompanying text (describing how the harshness of the original view that the offeror could revoke after the offeree began performance led to the consensus that substantial part performance created contract rights for the performing offeree).

¹⁴¹ Skeptical readers need only look at the inserts commonly included with premium billings from their insurers, which often contain a unilateral change in the terms of the policy. Although the unilateral changes may not become operative until the next pay period (which provides the additional consideration and de facto acceptance of the new terms required in some states), the practical impact is a pure unilateral amendment. This is because the typical insurance policyholder, particularly a consumer policyholder, routinely keeps paying the premium without reading the insert. See Stempel, *The Insurance Policy as Social Instrument*, *supra* note 134, at 1502 n.38 (noting that consumers regularly pay insurance premium billings in a timely fashion, considering them to be second in importance only to monthly mortgage payments).

¹⁴² If the reverse-unilateral characterization were correct, then the insurer, having received full performance from the policyholder, would logically be powerless to change the terms of the agreement just as the person offering money in the Brooklyn Bridge hypothetical could not unilaterally decide to pay less than the promised \$100 after the offeree had already traversed the Bridge.

¹⁴³ See Horton, *supra* note 138.

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periods. These offers are commonly accepted by policyholders who write new (and usually ongoing) premium checks, in effect accepting insurer offers *seriatim* over the years. Rather than a one-time performer in a unilateral contract, the policyholder begins to look more like a regular customer at a local retailer such as a grocery store, returning to the store with regularity, but often paying a different price for slightly different products.¹⁴⁴

By offering to continue coverage and sending a bill, the insurer has engaged in nontrivial administrative costs. When the policyholder pays, usually by check, the policyholder is in effect promising that the funds will clear and that the premium will be paid, as much as it is paying the premium. The process at that point begins to look more like a series of bilateral contracts or a larger, more comprehensive relational contract in which mutual promises are exchanged rather than an act induced by promise or promise induced by an act.

Perhaps more important, however, the policyholder will not reap any benefit from the insurer's promise of payment in the event of loss unless the policyholder keeps several promises made as part of the insuring arrangement. Consequently, it is inaccurate to assume—as have the unilateralists—that upon payment of the premium, the policyholder has no further obligations. If the policyholder wants defense against liability claims or indemnity for loss, it will need to keep several promises contained in the insurance contract.

The standard insurance policy lists these promises under the often misleading heading of “conditions” of the policy. Under standard contract law, a condition is an event that must occur before a given contracting party is obligated to perform.¹⁴⁵ Most obviously for insurance, there must be a covered (or at least a potentially covered)

¹⁴⁴ Similarly, retail customers of this type may have fully performed common side agreements such as opening a preferred customer account entitling them to discounts on merchandise or the accrual of bonus points and coupons. Traditionalists could argue that such arrangements are another form of unilateral contract, but this also seems incorrect because the retailer's promised performance is so nebulous, consisting of whatever favors the retailer may wish to convey to its most loyal customers in order to retain their loyalty. In theory, the customer could enroll in such a program, faithfully swipe his or her member card (or punch in a phone number at checkout) and never receive any benefit other than those available to other shoppers not enrolled in the program. Only market forces prompt the retailer to do anything for the loyal customer in the program. This may make such contracts illusory, or perhaps not contracts at all. But once again, characterizing them as unilateral adds little or nothing helpful to assessing such arrangements.

¹⁴⁵ See PERILLO, *supra* note 2, § 11.2, at 361; FARNSWORTH, CONTRACTS, *supra* note 3, § 8.2. Historically, conditions were often divided into “conditions precedent”—those that must occur before there is any obligation to perform—and “conditions subsequent,” which will extinguish the duty to compensate for a breach after the breach has occurred. RESTATEMENT (FIRST) OF CONTRACTS § 250 (1932). The *Restatement (Second) of Contracts* has abolished the terms and speaks only of “conditions.” RESTATEMENT (SECOND) CONTRACTS § 224 (1981). However, courts and counsel continue to use the precedent and subsequent terminology. CALAMARI ET AL., *supra* note 83, at 412-17; FARNSWORTH, CONTRACTS, *supra* note 3, § 8.2.

event before the insurer is obligated to do anything other than collect premiums and maintain the paperwork required by the insuring arrangement. In liability insurance, for example, there must first be a lawsuit against the policyholder.¹⁴⁶ For property insurance, there must be damage to the property from a covered cause.¹⁴⁷ For life insurance, the person whose life is insured must die.¹⁴⁸ Similar conditions exist for disability insurance, health insurance, or more specialized lines such as political risk insurance, pollution abatement insurance, workers' compensation insurance and so on.¹⁴⁹ The need for a covered event constitutes a true condition precedent to receiving insurance coverage.

In contrast, many of the "conditions" of common insurance policies are in reality promises the policyholder must keep in order to obtain the promised coverage. Although the policyholder need not fulfill these promises in the sense that there is seldom liability imposed upon the policyholder for breach, in the actual operation of insurance, the policyholder that fails to satisfy conditions of a policy suffers through being unable to receive the insurance coverage it purchased in the past by "performing" through the payment of premium. In this sense, a policyholder not only performs through the initial premium payment, but also makes multiple promises (disguised or mislabeled as conditions), just as in the most involved of bilateral contracts.

The policyholder that fails to keep a promise embodied in the insurance policy's conditions may be worse off than the typical bilateral contracting party. Where the typical promise is breached or unfulfilled, a contracting party may avoid penalty if the failure to keep the promise is not material,¹⁵⁰ or may have contract rights diminished proportionately.¹⁵¹ By contrast, the policyholder who fails to satisfy the conditions/promises of the policy may suffer total forfeiture of the contract benefits it purchased through prepayment and on which it

¹⁴⁶ Regarding the operation of liability insurance generally, see JACK P. GIBSON ET AL., *COMMERCIAL LIABILITY INSURANCE* (1999); JERRY, *supra* note 82, § 65(C); *STEMPEL ON INSURANCE CONTRACTS*, *supra* note 3, ch. 14.

¹⁴⁷ Regarding the operation of property insurance generally, see JERRY, *supra* note 82, § 42; LINDA G. ROBINSON & JACK P. GIBSON, *COMMERCIAL PROPERTY INSURANCE* (1989).

¹⁴⁸ Regarding the operation of life insurance generally, see JERRY, *supra* note 82, § 13[A](b); *STEMPEL ON INSURANCE CONTRACTS*, *supra* note 3, ch. 18; LESTER W. ZARTMAN & WILLIAM H. PRICE, *LIFE INSURANCE* (2d ed. 2003).

¹⁴⁹ See generally JERRY, *supra* note 82 (surveying insurance, generally, and types of insurance); *STEMPEL ON INSURANCE CONTRACTS*, *supra* note 3, §§ 4.01-4.08 (same).

¹⁵⁰ See RESTATEMENT (SECOND) OF CONTRACTS §§ 241, 241 cmt. a (1981) (only a material breach terminates contract rights or permits a non-breaching party to avoid contract; an immaterial breach gives rise to a claim for damages but otherwise does not alter operation of contract).

¹⁵¹ See *id.*; *id.* cmts. b, c (even where a clear breach exists, a contract is not abrogated and a breaching party does not forfeit all contract rights unless a breach is sufficiently material; where a breach does not require forfeiture of contract rights, damages paid by the breaching party should be proportional to injury caused by the breach).

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relied.¹⁵² Where the design of the insurance sought is to protect the policyholder from catastrophic loss or liability, the loss of insurance coverage becomes forfeiture on steroids.

If a court adjudicating coverage takes a strict view of required compliance with conditions and finds substantial compliance insufficient and even immaterial breach to negate coverage, the punishment of the policyholder for failing to keep a promise is severe indeed. Similarly, the insurer's failure to keep a promise of providing coverage, if sufficiently unreasonable, may give rise to bad faith liability, and even punitive damages if the insurer's unreasonable behavior was in willful or wanton disregard of policyholder rights.¹⁵³ Taking a functional perspective on the insurance policy—rather than formally labeling it unilateral and deeming the policyholder's promises to be conditions simply because these promises are contained in a “conditions” section of the policy—suggests that the insurance policy operates more like a bilateral exchange of important promises with substantial consequences.

Regarding the actual operation of many “conditions” as promises, consider the typical general liability policy. Among the conditions of any liability policy is the requirement that the policyholder provide to the insurer reasonably timely notice of an incident, claim, or suit against the policyholder¹⁵⁴ and that the insurer be provided with sufficient detail to investigate the matter¹⁵⁵ so that it can, if required, assume defense of the matter and seek to settle the claim if this is a prudent course of action.

Historically, late notice was regarded as the failure of a condition precedent that prevented the otherwise promised insurance coverage

¹⁵² See *infra* Part III.C; see, e.g., *P.R. Mallory & Co. v. Am. Cas. Co.*, 920 N.E.2d 736, 746-47 (Ind. Ct. App. 2010) (failure to comply with policy conditions precludes any recovery by policyholder irrespective of magnitude of non-compliance); *Vitto v. Davis*, 23 So. 3d 1048, 1052-54 (La. Ct. App. 2009) (same). To avoid such harsh results, courts, in addition to finding substantial satisfaction of a condition to be sufficient, have tended to treat many conditions as promises. As such, they apply materiality analysis rather than the historical rule that conditions must be strictly satisfied to permit contractual recovery. See, e.g., *Jackson v. Richards 5 & 10 Inc.*, 433 A.2d 888, 895 (Pa. Super. Ct. 1981).

¹⁵³ See JERRY, *supra* note 82, § 25[G](d)(2)-(3); STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, §§ 10.01, 10.05.

¹⁵⁴ The notice provision of a commercial general liability (CGL) policy usually requires the policyholder to give notice “as soon as practicable” of any accident or offence that may result in a claim and of any lawsuit brought against the policyholder. See, e.g., Insurance Services Office (ISO), CG 00 01 12 04, Part IV, Condition 2 (2003), reprinted in DONALD S. MALECKI & ARTHUR L. FLITNER, CGL, COMMERCIAL GENERAL LIABILITY, app. I, at 10 (8th ed. 2005).

¹⁵⁵ The notice provision of most policies provides that notice must include the date, time, and location of any “occurrence” giving rise to liability as well as names and addresses of injured persons or witnesses and the nature of the injury or damage. See, e.g., ISO, CG 00 01 12 04, Part IV, Condition 2 (2003), reprinted in MALECKI & FLITNER, *supra* note 154, app. I, at 10.

from becoming applicable.¹⁵⁶ The modern rule (now established in roughly forty states) is that late notice prevents coverage only if the insurer has been prejudiced by the delay, usually with the insurer required to prove any asserted prejudice.¹⁵⁷ However, if notice were a true condition precedent—something that both contractually and logically must happen as specified in the contract in order to trigger contractual obligations—the insurers who once won these battles over whether prejudice was necessary to use late notice as a defense would have continued winning. Instead, from the 1970s forward, insurers have almost always lost these battles as jurisdiction after jurisdiction has embraced the “notice-prejudice” rule. As most courts have acted to soften the traditional no-prejudice-required rule, they have implicitly recognized either that prompt notice is not a true condition precedent or that forfeiture of otherwise available coverage is too high a price to pay for failure to satisfy the condition.

The modern judicial view of notice is indubitably correct. It makes no sense to deprive the policyholder (who long before paid cash to the insurer that benefited from investing it) of insurance coverage just when the aleatory contingency arises. The policyholder purchased insurance for just that purpose. If law generally abhors a forfeiture, it surely must detest stripping a policyholder of promised insurance due to tardy notice if there has been no harm to the insurer. Denying coverage in such circumstances gives the insurer an undeserved windfall and makes the insurance policy fail its intended purpose as well as its social and economic function.

But despite the modern trend, courts occasionally continue to adhere to the historical rule, in part because of the formal logic that failure of a condition precedent leaves contract obligations untriggered. Although excessive formalism is hardly rare in cases involving bilateral contracts, classifying insurance policies as unilateral arguably contributes to these errors and impedes analysis, even in jurisdictions that appear at times to embrace the sensible functionalism and abhorrence of forfeiture reflected in the modern notice-prejudice rule. For example, in 2010, the Arkansas Supreme Court embraced with vigor the historical rule that no prejudice to the insurer was required to sustain a late notice defense so long as the notice provisions of the

¹⁵⁶ See *P.R. Mallory & Co.*, 920 N.E.2d at 746-47 (traditional rule requiring strict compliance with prompt notice provisions of insurance policy or coverage was lost).

¹⁵⁷ See RANDY J. MANIHOFF & JEFFREY W. STEMPEL, *COMMERCIAL GENERAL LIABILITY COVERAGE: KEY ISSUES; EVERY STATE* ch. 2 (forthcoming 2010) (noting that at least thirty-eight states have clear precedent requiring that there be prejudice to an insurer from late notice, with most placing the burden on the insurer to prove prejudice; only a handful of states clearly continue to follow the old majority rule finding even slight or unimportant delays in giving notice to preclude coverage); OSTRAGER & NEWMAN, *supra* note 3, § 4.02(c)(2) (same); STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, § 9.01[I] (same).

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policy were clearly denominated as a condition precedent to coverage.¹⁵⁸ Talismanically intoning that “a condition precedent is still a condition precedent,”¹⁵⁹ the court distinguished seemingly inconsistent case law, which had led federal courts applying Arkansas law to employ a notice-prejudice rule, on the ground that in cases requiring the insurer to show prejudice, the notice provisions of the policy “did not indicate that the giving of proper notice was a condition precedent to recovery” making it “proper to require that the insurance company show prejudice.”¹⁶⁰

Rather than viewing notice as a condition precedent to coverage, however, it makes at least as much sense to regard the policyholder as promising adequate notice (reasonably prompt, or at least without

¹⁵⁸ See *Fireman's Fund Ins. Co. v. Care Mgmt.*, No. 09-662, 2010 Ark. LEXIS 131 (Ark. Mar. 4, 2010).

This court has applied the general rule, that where an insurance policy provides that the giving of notice of a loss, claim, or lawsuit is a condition precedent to recovery, the insured must strictly comply with the notice requirement, or risk forfeiting the right to recover from the insurance company. The insurance company need not show that it was prejudiced by any delaying in or lack of notification. However, if the notice provision is not a condition precedent, the insured does not automatically forfeit the right to recover. Instead, the insurance company must show that it was prejudiced by noncompliance with the terms of the policy. The insurance company may be prejudiced if the delay in notice was unreasonable.

Id. at *6.

The *Care Management* opinion has an almost childlike focus on the magic words condition precedent, as though it were the insurance law equivalent of “Open Sesame” or “Abracadabra.” Apparently, if the magic words are used in the policy labeling notice as a condition precedent, tardy notice justifies severe forfeiture even if there is no prejudice to the insurer. However, if the notice requirement of a policy is not so labeled, notice can be eons late and the insurer must still demonstrate prejudice. But the notice provisions of all insurance policies serve the same purpose and function regardless of how they are packaged or labeled. The Arkansas Supreme Court elevates form over substance to an astonishing degree, an error that arguably was aided by the unilateral view of insurance policies and its tendency to treat conditions as absolute while bilateral contract breaches are usually fatal only if material.

The policyholder in *Care Management* was not particularly sympathetic. It was accused of mistreating an elderly patient and, with no apparent excuse, waited a long time to notify its liability insurer. The policyholder was sued in June 2006 but did not notify the insurer until September 2008, with the case scheduled for final hearing in October 2008. Although the Court, hearing the matter pursuant to a certified question from the Eighth Circuit, did not address the issue of prejudice, the potential for a finding of prejudice from this sort of delay is obvious. Ruling against the policyholder on notice-prejudice grounds would have been a much more defensible resolution of a case where the bench may have viewed the policyholder as undeserving. Instead, the Court embraced a jurisprudential approach that has been in decline for a half-century. See *id.* (reaffirming approach of *Teutonia Ins. Co. v. Johnson*, 82 S.W. 840 (Ark. 1904)); see also *id.* at *6 n.1 (citing *Alcazar v. Hayes*, 982 S.W.2d 845 (Tenn. 1998)) (acknowledging that “many states are increasingly” adopting the notice-prejudice rule as though development of the issue had ceased in the twentieth century). Nearly forty states have embraced the notice-prejudice rule, including longtime traditional rule state New York. N.Y. INS. LAW § 3420(a)(5) (McKinney 2010); MANIHOFF & STEMPEL, *supra* note 157.

¹⁵⁹ See 2010 Ark. LEXIS 131 at *6 n.1.

¹⁶⁰ See *id.* at *12. In addition to embracing historical rule precedents dating from 1903, the *Care Management* court overruled *Members Mut. Ins. Co. v. Benefield*, 499 S.W.2d 608 (Ark. 1973), which appeared to adopt the notice-prejudice rule. 2010 Ark. LEXIS 131 at *13.

prejudicial delay) if it is to receive the promised coverage. Material breach of the promise results in forfeiture of coverage. Although not explicit, this view in effect recasts the “condition” as a promise and the contract as bilateral.

Liability insurance policies also state that the policyholder must cooperate in the insurer’s defense of a claim.¹⁶¹ Property insurance imposes a similar requirement that the policyholder cooperate “in the investigation or settlement of a claim.”¹⁶² If the policyholder breaches this promise and fails to cooperate, coverage may be completely lost, even when it is uncontested that the loss or claim involved falls squarely within the scope of the insurance policy. Although the cooperation requirements have often not been stringently enforced by courts and anything resembling substantial compliance is usually enough, the cooperation clause of insurance policies operates in practice as a promise by the policyholder in that it involves activity largely under the policyholder’s control. Policyholder cooperation is not “an event, not certain to occur” (as set forth in the *Restatement*),¹⁶³ but instead is a representation by the policyholder that it will assist the insurer in implementing the policy. Where the policyholder is uncooperative, this looks more like breach of a promise than failure of a true condition.

In liability insurance and in other types of insurance, the commercial policyholder also promises to submit to a “premium audit” in which the insurer checks the books of the policyholder (usually with the policyholder required or promising to submit data to the insurer) to determine if it has paid the required premium. The premium is initially set based on underwriting criteria such as the policyholder’s number of employees, volume of business, etc. at the time the policy period began. It is recalibrated according to the actual experience of the policyholder during the time insured.¹⁶⁴ Here the policyholder is indeed promising to permit the insurer to reassess the cost of insurance and promising to pay any funds that may be owed the insurer after the premium audit is concluded.¹⁶⁵

¹⁶¹ See, e.g., ISO, Commercial General Liability Form, CG 00 01 10 01, Section IV, Condition 2(c), reprinted in FISCHER ET AL., *supra* note 3, app. E, at 13.

¹⁶² See, e.g., ISO, Commercial Property Form, CP 00 10 04 02, Loss Condition 3(a)(8) (2001), reprinted in ALLIANCE OF AMERICAN INSURERS, THE INSURANCE PROFESSIONAL’S POLICY KIT: A COLLECTION OF SAMPLE INSURANCE FORMS 227 (2004).

¹⁶³ See RESTATEMENT (SECOND) CONTRACTS § 224 (1981) (defining “condition”).

¹⁶⁴ Regarding premium audits and retroactive revision of premiums in light of the policyholder’s actual loss experience, see REJDA, *supra* note 2, at 612, 624 (retrospective rating means that “the insured’s loss experience during the current policy period determines the actual premium paid for that period.”); VAUGHAN & VAUGHAN, *supra* note 2, at 124 (“A deposit premium is charged at the inception of the policy and then adjusted after the policy period has expired, to reflect actual losses incurred.”); see also *id.* at 133-34 (illustrating application of retrospective rating formula).

¹⁶⁵ A standard premium audit provision provides that the insurer “will compute all premiums for this Coverage part in accordance with our rules and rates” and that:

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This aspect of insurance dramatically undercuts the contention of the unilateralists that the policyholder has satisfied its obligations through complete performance at the outset of the policy. On the contrary, the policyholder has made a promise to pay additional premiums if necessary and does not satisfy this promise until much later, often after the conclusion of the policy period. Unlike a policyholder's decision to switch insurers and seek a refund of unearned premium, the commercial policyholder's failure to pay adjusted premiums will in all likelihood lead to a collection action by the insurer for the additional amounts owed.

Most important, however, the premium audit condition found in most commercial liability insurance policies (and in many commercial first-party policies as well) demonstrates that the policyholder is not performing the entirety of even its solely monetary contractual obligations to the insurer at the outset of the insurance relationship. Rather, the policyholder is making a promise regarding potentially adjusted premium payments in return for the insurer's promise of coverage. This alone makes the insurance policy contract more bilateral than unilateral.¹⁶⁶

Another common condition in insurance policies, both liability and property, commercial and personal, is the policyholder's promise to cede to the insurer any legal rights it may have against persons causing injury or damage.¹⁶⁷ These contractual subrogation clauses are

Premium shown in this Coverage as advance premium is a deposit premium only. At the close of each audit period we will compute the earned premium for that period and send notice to the [policyholder]. The due date for audit and retrospective premiums is the date shown as the due date on the bill. If the sum of the advance and audit premiums paid for the policy is greater than the earned premium, we will return the excess to the [policyholder].

....
[The policyholder] must keep records of the information we need for premium computation, and send us copies at such times as we may request.

ISO, CG 00 01 12 04, Part IV, Condition 5 (2003), *reprinted in* MALECKI & FLITNER, *supra* note 154, app. I, at 11; *see also* ISO, Common Policy Conditions, IL 00 07 11 98, Condition C (1998), *reprinted in* ALLIANCE OF AMERICAN INSURERS, *supra* note 162, at 214 ("We may examine and audit your books and records as they relate to this policy at any time during the policy period and up to three years afterward.").

¹⁶⁶ *See* ISO, Common Policy Conditions, IL 00 07 11 98, Condition D (1998), *reprinted in* ALLIANCE OF AMERICAN INSURERS, *supra* note 162, at 214 ("We have the right to: a. Make inspections and surveys at any time; b. Give you reports on the conditions we find; and c. Recommend changes.").

¹⁶⁷ In the standard CGL policy, the provision reads:

If the insured has rights to recover all or part of any payment we have made under this Coverage Part, those rights are transferred to us. The insured must do nothing after loss to impair them. At our request, the insured will bring "suit" or transfer those rights to use and help use enforce them.

ISO, CG 00 01 12 04, Part IV, Condition 8 (2003), *reprinted in* MALECKI & FLITNER, *supra* note 154, app. I, at 12.

promises by the policyholder both to let the insurer sue on its behalf for recompense of loss caused by others as well as a further promise to cooperate with the insurer in pursuing any such actions. Once again, it appears that, far from just paying a premium and waiting, the policyholder has promised something of value to the insurer in return for the insurer's valuable promise of coverage in the event of liability or loss.

Other provisions of insurance policies tend to establish promissory obligations of the policyholder—at least if it wants to collect on the coverage it has purchased in the event of litigation or loss. For example, liability policies often provide for a reduction in benefits paid by the policy to the extent there is other available insurance and usually attempt to require that other insurers pay before the instant insurer is responsible, typically establishing a manner of pro-rating available coverage from two or more insurance policies.¹⁶⁸ Some liability and property policies go so far as to eviscerate coverage completely if there is other insurance covering the claim or loss.¹⁶⁹ In these latter instances in particular, the policyholder is in essence promising that it will not purchase any additional insurance on the risk if it wishes to collect from the insurer.¹⁷⁰

Subrogation arrangements are even more common in property insurance and may arise by operation of law even in the absence of specific policy language. However, most property insurance policies expressly provide that the policyholder will permit the insurer to pursue such actions. For example, the standard ISO Commercial Property policy provides:

If any person or organization to or for whom we make payment under this Coverage Part has rights to recover damages from another, those rights are transferred to us to the extent of our payment. That person or organization must do everything necessary to secure our rights and must do nothing after loss to impair them. But you may waive your rights against another party in writing:

Prior to a loss to your Covered Property or Covered [Lost Business] Income [as a result of property loss].

After a loss to your Covered Property or Covered Income only if, at the time of loss, that party is one of the following: Someone insured by this insurance; A business firm: Owned or controlled by you; or That owns or controls you; or Your tenant.

ISO, Commercial Property Form, CP 00 90 07 88, Condition I (1987), *reprinted in* ALLIANCE OF AMERICAN INSURERS, *supra* note 162, at 216.

¹⁶⁸ See STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, §§ 13.02, 13.03; ISO, CG 00 01 12 04, Part IV, Condition 4 (2003), *reprinted in* MALECKI & FLITNER, *supra* note 154, app. I, at 12.

¹⁶⁹ See STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, §§ 13.02, 13.03 (discussing application of such “escape” clauses that, if enforced literally, relieve insurer of coverage obligation if there is any other applicable insurance covering the risk).

¹⁷⁰ One of the authors regards at least some of the exclusions within a policy as containing implicit promises to refrain from those behaviors. For example, a policyholder's de facto executory promise required for insurability is provided by a core exclusion found in liability policies that provides that there is no coverage for injury that is “expected or intended” by the policyholder. See, e.g., ISO, CG 00 01 12 04, Part IV, Condition 4 (2003), *reprinted in* MALECKI & FLITNER, *supra* note 154, app. I, at 2 (“This insurance does not apply to” bodily injury or property damage “expected or intended from the standpoint of the insured.”) (providing an exception to the exclusion where bodily injury results “from the use of reasonable force to protect

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Property insurance policies often contain other “loss conditions” that are in practical terms promises obligating the policyholder and providing that if the promise is breached, there will be reduced coverage or loss of coverage. In a typical property policy, for example, the policyholder is required to take reasonable action to preserve the property after loss and prevent losses from exacerbating due to neglect, exposure to the elements, looting, vandalism, and the like.¹⁷¹ The policyholder must also provide as requested a “complete inventory of the damaged and undamaged property, includ[ing] quantities, costs, values and amount of loss claimed,”¹⁷² as well as submit a signed, sworn proof of loss to the insurer within a specified time.¹⁷³ The policyholder also promises to permit the insurer to “inspect the property

persons or property”). This exclusion is generally described as one that gives definition to the concept that insurance covers only fortuitous loss rather than intentionally caused loss. See *STEMPEL ON INSURANCE CONTRACTS*, *supra* note 3, § 1.06. However, it can also be viewed as a promise that the policyholder will not intentionally injure others or engage in activity substantially certain to cause such injury if it is to receive liability coverage. Breach of this promise through intentionally inflicted injury to a third party prevents coverage under the liability policy.

Likewise, first party insurance will not pay for claims that are the result of a policyholder’s intentional desire to bring about the loss through misbehavior such as arson, staged auto wrecks, self-inflicted wounds (for fraudulent disability or workers compensation claims), or murder (of a person insured by a beneficiary or where the policyholder is someone other than the person whose life is insured). *STEMPEL ON INSURANCE CONTRACTS*, *supra* note 3, § 1.06[A]. These sorts of “Double Indemnity” (*DOUBLE INDEMNITY* (Paramount Pictures 1944)) or “Body Heat” (*BODY HEAT* (Warner Bros. 1981)) style murders for insurance are proscribed by law, public policy, and morality. But, one might also view these restrictions on insurance coverage as implicit promises made by the policyholder, or others, to refrain from certain improper behavior where breach of the promise, if detected, is treated as inherently material and results in withdrawal of insurance benefits that would have otherwise been available in the event of loss. For insurance, as with any bilateral contract, substantial breach of a policyholder’s promises in the agreement itself and failure to conform to overarching legal and ethical rules can result in forfeiture of contract benefits.

In addition, many of the exclusions listed in an insurance policy can be viewed as not only attempts to reduce and tailor the coverage provided in the insuring agreement, but also as promises by the policyholder that it will not engage in certain activity in return for receiving coverage. For example, a life insurance policy typically excludes coverage for suicide during the first two years the policy is in effect and also excludes coverage for death due to war. More particularized life insurance policies may also exclude coverage for death resulting from skydiving, spelunking, or other high risk activities. To the extent that the policyholder has some control over whether it enters into such activities, the policyholder is, in effect, promising not to commit suicide, enlist, skydive, explore caves, and the like if it wishes to collect life insurance benefits.

¹⁷¹ See, e.g., ISO, Commercial Property Form, CP 00 10 04 02, Loss Condition 3(a)(4) (2001), reprinted in *ALLIANCE OF AMERICAN INSURERS*, *supra* note 162, at 226 (“Duties In the Event of Loss or Damage” include requiring policyholder to “[t]ake all reasonable steps to protect the Covered Property from further damage and keep a record of your expenses necessary to protect the Covered Property.” In addition, the policyholder should “if feasible, set the damaged property aside and in the best possible order for examination.”).

¹⁷² See, e.g., *id.* at 226 (Loss Condition 3(a)(5)).

¹⁷³ See, e.g., *id.* at 227 (Loss Condition 3(a)(7); policyholder must send insurer proof of loss within sixty days of insurer’s request).

proving the loss or damage and examine [the policyholder's] books and records."¹⁷⁴ Property insurance coverage is also typically restricted, suspended or unavailable when the insured property is "vacant," as defined in the policy,¹⁷⁵ for more than a specified period of time, typically sixty days.¹⁷⁶

Property policies patterned after marine insurance also may include a "sue and labor" clause, which provides that the policyholder will make reasonable efforts to prevent future related losses and to minimize the damage wrought by a covered peril.¹⁷⁷ For example, if a vessel's hull is damaged and develops a leak, the policyholder should attempt to save as much cargo as possible by relocating it away from the source of water intrusion and may be required to effect repairs at sea or to put into the nearest port rather than continuing to sail and permitting additional damage to cargo.

In addition, property insurance typically has a "co-insurance" clause that requires the policyholder to insure property at eighty percent of its value.¹⁷⁸ Failure to do so results in a proportionate reduction of insurance payments after loss.¹⁷⁹ The policyholder's promise to meet the co-insurance clause and "insure to value" on the property is one where breach does not typically result in litigation against the policyholder by the insurer, but often results in the insurer imposing its own brand of liquidated damages by reducing coverage payments after loss.

Property insurance policies also may void coverage or provide for a retroactive premium increase in the event of loss if there is an "increase" of the "hazard" posed to the insurer in covering the property or a heightened risk of loss due to a change in use of the property.¹⁸⁰ For example, if a farm is turned into a factory, the insurer originally underwriting the property as a farm can rightfully claim that the change in function logically abrogates the insuring arrangement. Alternatively, the insurer can argue that the change in use at least requires that the policyholder pay premiums commensurate with the risks posed by a

¹⁷⁴ See, e.g., *id.* at 226-27 (Loss Condition 3(a)(6)).

¹⁷⁵ See, e.g., *id.* at 227-28 (Loss Condition 6).

¹⁷⁶ See, e.g., *id.* at 228 (Loss Condition 6(b); where building "vacant for more than 60 consecutive days" insurer will "not pay for any loss or damage caused by . . . Vandalism; Sprinkler leakage; Building glass breakage; Water damage; Theft; or Attempted Theft" and all other payments for covered causes of loss will be reduced by fifteen percent).

¹⁷⁷ Regarding the sue and labor concept, see generally STEMPER ON INSURANCE CONTRACTS, *supra* note 3, § 15.05.

¹⁷⁸ See, e.g., ISO, Commercial Property Form, CP 00 10 04 02, Loss Condition F1 (2001), reprinted in ALLIANCE OF AMERICAN INSURERS, *supra* note 162, at 228-29.

¹⁷⁹ See STEMPER ON INSURANCE CONTRACTS, *supra* note 3, § 8.03.

¹⁸⁰ See *id.* §§ 8.03, 15.01[A] (discussing coinsurance generally and coinsurance in property insurance, which should not be confused with the co-pay or coinsurance provisions of health insurance policies or plans).

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factory (rather than the generally less liability-producing farm) if coverage is to remain in force.

Insurance policies also typically contain a condition in which the policyholder essentially agrees that it may not assign the insurance policy to a third party, including a successor company, without the insurer's consent.¹⁸¹ Such clauses are usually enforced by courts, at least with respect to contingent risks.¹⁸² In this way, the insurance policy differs from most contracts, where assignment of contract rights and delegation of duties is rather freely permitted in the interest of freedom of contract and economic efficiency provided that this does not increase the risk of breach or nonperformance to the other party.

Like the increase of hazard provision, this aspect of insurance attempts to prevent the original policyholder from providing insurance to another, riskier potential policyholder that the insurer has not had the opportunity to investigate and underwrite. The potential unfair forfeiture risks of strict enforcement of this language is softened by the general rule that, while insurance on a contingent risk may not be assigned without insurer consent, assignment of rights under a policy after the occurrence of the contingent events is permitted notwithstanding policy language.¹⁸³ However, insurers have had significant recent success in invoking the anti-assignment clause and principle to avoid coverage in matters of complex corporate succession.¹⁸⁴

As with other "pseudo-conditions" in insurance policies, breach of an increase-of-hazard clause or an anti-assignment clause in a policy seldom, if ever, results in suit against the breaching policyholder (save for a possible declaratory judgment action to rescind the policy). However, breach of one of these clauses effectively places the policyholder in breach of the policy and imposes upon it the liquidated damages of no coverage, even though liability or loss facing the policyholder would otherwise fall within the scope of an insurance policy's coverage.

¹⁸¹ See, e.g., ISO, Common Policy Conditions:

Your rights and duties under this policy may not be transferred without our written consent except in the case of death of an individual named insured. If you die, your rights and duties will be transferred to your legal representative but only while acting within the scope of duties as your legal representative.

ISO, Common Policy Conditions, IL 00 07 11 98, Condition F (1998), *reprinted in* ALLIANCE OF AMERICAN INSURERS, *supra* note 162, at 214.

¹⁸² Even a church's attempt to assign its insurance policy to another church is usually barred by anti-assignment clauses. See *Christ Gospel Temple v. Liberty Mut. Ins. Co.*, 417 A.2d 660 (Pa. Super. Ct. 1979), *cert. denied*, 449 U.S. 955 (1980).

¹⁸³ See STEMPER ON INSURANCE CONTRACTS, *supra* note 3, § 3.15.

¹⁸⁴ See *Henkel Corp. v. Hartford Accident & Indem. Co.*, 62 P.3d 69 (Cal. 2003); *Glidden Co. v. Lumbermens Mut. Cas. Co.*, 861 N.E.2d 109 (Ohio 2006); STEMPER ON INSURANCE CONTRACTS, *supra* note 3, § 3.15.

A typical property policy also requires that the policyholder submit to dispute resolution by appraisal in the event of a valuation controversy. Property and other insurance policies may also require that the policyholder agree to arbitration or mediation of coverage disputes or may bind the policyholder to selected forums or jurisdictions in pursuing resolution of coverage disputes. Property policyholders also commonly agree to allow examination under oath regarding the circumstances of a loss if the insurer desires.¹⁸⁵

In addition to largely ignoring many of the particular features of insurance policies and the operation of insurance products in the marketplace, scholarly discussion of unilateral and bilateral contracts has also largely overlooked the aleatory nature of insurance policies. An aleatory contract is distinguished from a commutative contract in that the latter involves exchange of consideration of equal value, while, in the former, the contracting parties accept at the outset that the dollar value of their exchange may not be equal due to the contingent nature of the risks accepted and coverage provided.¹⁸⁶ Insurance is aleatory in that the arrangement between policyholder and insurer is often one of unequal exchange. If the policyholder pays premiums for years and suffers no significant loss, the insurer effectively received much more than the policyholder (notwithstanding the well-established nostrum that with insurance, the policyholder is purchasing peace of mind). Conversely, if the policyholder holds a policy for only two months and then incurs a house fire, auto collision bills or liability, or suffers disease or disability, the insurer will surely pay far more than it has collected in premiums from the policyholder. Although insurance differs significantly from gambling, there are surely elements of gambling in the risk transfer and distribution of insurance.¹⁸⁷

By contrast, in nearly all other contracts, the exchange between the parties is essentially equivalent, at least as measured by the parties' own valuation of the items involved in the contract. If a homebuyer pays the prevailing local market price to a seller for a three-bedroom rambler, lawyers and economists largely see the contract as one of equal exchange. The buyer gets what it paid for, measured relatively objectively by the market for home sales in the vicinity. Even where a

¹⁸⁵ See, e.g., ISO, Commercial Property Policy:

We may examine any insured under oath while not in the presence of any other insured and at such times as may be reasonably required, about any matter relating to this insurance or the claim, including an insured's books and records. In the event of an examination, an insured's answers must be signed.

ISO, Commercial Property Policy, CP 00 10 04 02, Loss Condition E.3.b., reprinted in ALLIANCE OF AMERICAN INSURERS, *supra* note 162, at 227.

¹⁸⁶ See DORFMAN, *supra* note 2, at 163; REJDA, *supra* note 2, at 99; VAUGHAN & VAUGHAN, *supra* note 2, at 168.

¹⁸⁷ See DORFMAN, *supra* note 2, at 163; VAUGHAN & VAUGHAN, *supra* note 2, at 168.

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purchaser pays what others might consider an outrageous price for an item, economists regard the exchange as equivalent because of the incommensurability of respective parties' valuations of goods, services, and promises. One may think a portrait or piece of sculpture ugly and worthless, but if another patron finds the work breathtaking and pays \$100,000 for it, the buyer has received something worth \$100,000, at least to the buyer.¹⁸⁸

For aleatory contracts such as insurance, there is unequal exchange because the respective final monetary outcomes of the arrangement are unknown at the time of contracting.¹⁸⁹ Consequently, the promise made by the insurer is dramatically more contingent than that made by most contracting parties and of much more attenuated value to the "performing" (through premium payment) policyholder. For certain types of insurance policies, the possibility of performance may be so unlikely as to make coverage "illusory" or the arrangement unconscionable, such as when disability coverage attaches only if the policyholder cannot work at all and only after social security or other benefits have been exhausted.¹⁹⁰ Even in less extreme circumstances, an insurer's promise of coverage may realistically be quite modest where the "small print" in a policy takes away that which the "large print" appears to have promised in return for the policyholder's premium payment/performance.

Insurance policy sales thus appear quite distinct from the classic types of unilateral contracts. In insurance, as opposed to the famous Brooklyn Bridge hypothetical, the offeror takes considerable risk by both prepaying for an aleatory contract and relying on a promisor who may not fulfill the promise under circumstances where the offeror has little leverage over the promisor. In addition, the policyholder cannot revoke its offer readily, the insurer has substantial ability to shorten the

¹⁸⁸ In addition, purchasing decisions can be motivated by factors other than the buyer's evaluation of the product itself. See, e.g., JOHN GRISHAM, *THE APPEAL* 41-45, 70-71 (2008) (describing an instance where the "villain," a wealthy corporate executive attempting to alter the composition of a state supreme court to avoid environmental liability, pays several million dollars at a charity auction for a piece of avant garde sculpture that he hates but that his wife covets for the prestige the purchase will bring).

¹⁸⁹ The psychic reassurance or "peace of mind" obtained by the policyholder, through having insurance in place that promises to respond to contingent losses, could conceivably serve the same purpose as idiosyncratic artwork and make insurance non-aleatory for the policyholder who pays high premiums for years and never suffers loss or liability. Notwithstanding the general rule of incommensurability of value between persons, legal scholars and the insurance community generally accept that insurance contracts often do not involve equal exchange. See, e.g., Jeffrey W. Stempel, *Assessing the Coverage Carnage: Asbestos Liability and Insurance After Three Decades of Dispute*, 12 CONN. INS. L.J. 349, 471-72 (2005).

¹⁹⁰ See, e.g., discussion and case excerpts in ABRAHAM, *supra* note 3, at 391-420. Regarding the concept of insurance coverage as illusory generally, see Beth Skillern & Linda M. Bolduan, *Insurance Coverage for Employment-Related Claims: Real or Illusory?* (ALI-ABA Course of Study, Nov. 13, 1997), WL SB96 A.L.I.-A.B.A. 87.

window for revocation (e.g., by cashing the premium check and issuing a binder or conditional receipt), and where later withdrawal by the policyholder results in only a partial refund of premiums by an insurer that earned investment income in the interim and, in the vast majority of cases, was not required to do anything of substance for the policyholder. At least the offeror in Professor Wormser's famous Brooklyn Bridge hypothetical had the advantage of watching the other party trek across the famous Bridge and even (prior to the *Restatement*) had the opportunity to harass the other party through last minute revocation.

Other classic unilateral contract situations also seem far afield from insurance. Although insurance has aspects of gambling, the policyholder is not "rewarded" if it suffers a liability or loss event as are the performers in the reward, contest, or prize cases of unilateral contract lore.¹⁹¹ Even a suffering performer such as Mrs. Carlill of *Carbolic Smoke Ball* fame, who contracted influenza despite assurances otherwise, was not a victim of fate to the degree found with most policyholders suffering loss or liability.¹⁹² She gambled on the efficacy of the device and was disappointed, but had not relied on the smoke ball to indemnify or protect her from catastrophic loss.

Likewise, performing brokers in those unilateral contract cases take on the credit and collection risks that sellers or buyers will attempt to avoid payment, a risk quite different from depending on the promising party to cover a risk the performer cannot shoulder itself. Similarly, employees seeking to enforce employer promises as a result of continuing to work,¹⁹³ although sympathetic, still probably have more economic options than a policyholder who has lost a house or faces major litigation liability. Those claiming government entitlements under unilateral contract theory¹⁹⁴ may be so close to the edge that unfair payment denials are similarly devastating,¹⁹⁵ but the government

¹⁹¹ See *Chenard v. Marcel Motors*, 387 A.2d 596 (Me. 1978) (affirming judgment for plaintiff who scored a hole-in-one in a golf tournament where defendant dealership had donated an automobile as a prize for holes-in-one—also much better than insured event, no matter how bad the weather or how mediocre the golf course outing); *Lefkowitz v. Great Minneapolis Surplus Store, Inc.*, 86 N.W.2d 689 (Minn. 1957) (finding a valid contract based on a retail advertisement that promised the first customer to arrive at a store a one dollar fur coat—which, to everyone but hardcore PETA members, certainly beats a home fire, lawsuit, hospitalization, disability, or death).

¹⁹² See *Carlill v. Carbolic Smoke Ball Co.*, [1893] 1 Q.B. 256 (Ct. App.) (U.K.), which is reprinted in nearly every contracts casebook; see also BARNETT, *supra* note 3, at 350-52 (providing additional background information on *Carlill* and noting that the active ingredient in the smoke ball appears to have been a carcinogen).

¹⁹³ See Pettit, *supra* note 4, at 559-67.

¹⁹⁴ See *id.* at 570-73, 589-91.

¹⁹⁵ See, e.g., *Goldberg v. Kelly*, 397 U.S. 254 (1970) (finding recipient of public assistance benefits is entitled to due process before subsistence level benefits may be terminated, including adequate notice, explanation of government action, and determination by a sufficiently neutral government officer).

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benefit sought, although important, is often not of such life-and-death magnitude.

More important, in all these other cases arguably involving unilateral contracts, the party seeking compensation (be it promisor or performer) is engaged in a commutative contract of equal exchange of value, rather than depending on another promisor or performer who may forsake them when they are unable to obtain substitute performance and who may profit handsomely as a result of good luck effectively releasing it from its aleatory obligations.

In sum, the insurance policy is simply quite different than other arrangements viewed as unilateral contracts, a difference that cannot be effectively explained away by deeming insurance to be a reverse-unilateral contract. Insurance policyholders appear to promise substantially more than appears to have been appreciated by those promoting the unilateral characterization of insurance policies. The promising insurer also often has performance obligations due to regulation and the duty of good faith. Further, the insurer is allowed to give highly contingent promises and, through adequate risk pooling, exploit the aleatory nature of the insurance policy. As a result of these factors, characterizing the insurance contract as unilateral appears not to be an accurate assessment, notwithstanding that most judicial precedent, formed by early-twentieth century academic assessments, does not square with traditional contract interpretation. Unfortunately, as discussed in Part III.C below, classification of insurance policies as unilateral is not a purely academic exercise, but has largely negative ripple effects in the real world of coverage litigation.

C. *Impact Concerns: Ways in Which the Detriments of the Unilateral Characterization Exceed Purported Benefits*

As discussed above, we find the legal profession's historic fixation on unilateral and bilateral contracts misguided and view the traditional unilateral (or reverse-unilateral) label inaccurate as applied to insurance, which we regard as primarily bilateral in nature. The unilateral characterization of insurance policies not only errs as a matter of classification, but also has important intellectual, doctrinal, and practice consequences. Several practical effects flow from characterizing the insurance contract as unilateral. First, as outlined in Parts III.A and III.B above, the unilateral characterization fails to appreciate the nuances and actual operation of insurance and errs in failing to appreciate the degree to which the insurer-policyholder relationship is indeed promissory. Second, any presumption that an insurance contract

is unilateral¹⁹⁶ rather than bilateral conflicts with the overarching contracts *Grundnorm* that, wherever possible, contracts should be construed as bilateral in order to afford more protection to the parties.¹⁹⁷

Third, characterizing insurance contracts as unilateral results in an impoverished conception of the respective responsibilities of policyholders and insurers. By pretending that policyholders make no promises to insurers and instead describing everything the policyholder must do under the contract as a condition rather than a promise,¹⁹⁸ the traditional view impedes application of the rich complexities of the concepts of good faith, substantial performance, and material breach. Depending on the circumstances, these errors of analysis may unfairly impact either policyholders or insurers. Courts that take a strict view on compliance with conditions may impose unfair forfeiture on the policyholder. Other courts spend inordinate amounts of energy attempting to soften the harshness of the law's historic all-or-nothing approach to conditions and the draconian effects of strict compliance and forfeiture, an endeavor that sometimes assists policyholders even to the detriment of insurers.

Fourth, the characterization of insurance as a unilateral contract has limited the application of anticipatory repudiation, a doctrine that allows parties to restore a contractual relationship or move on. The doctrine of anticipatory repudiation has been traditionally inapplicable to contracts that are fully executed on one side.¹⁹⁹ Courts that follow this rule and presume that the insurance contract is unilateral leave

¹⁹⁶ See, e.g., *Winters v. State Farm & Fire Cas. Co.*, 35 F. Supp. 2d 842, 845 (E.D. Okla. 1999); *Nat'l Union Fire Ins. Co. v. FDIC*, 957 P.2d 357, 363 (Kan. 1998) ("Customarily, all forms of insurance are presumed to be unilateral contracts."); see also *Combs v. Int'l Ins. Co.*, 354 F.3d 568, 600 (6th Cir. 2004) (explaining that a director and officer liability policy is unilateral and characterizing all insurance policies as generally unilateral).

¹⁹⁷ The *Restatement (First) of Contracts* expressed the view that bilateral construction was preferred. See RESTATEMENT (FIRST) OF CONTRACTS § 31 (1932). The *Restatement (Second) of Contracts* abandoned the language of unilateral and bilateral contracts, but retains a preference for the mutuality of a bilateral formation. See RESTATEMENT (SECOND) OF CONTRACTS § 62 (1981) (providing that where an offeree may accept by performance or promise, the tender of the beginning or beginning of the performance operates as a promise, thus favoring a bilateral construction).

Case law continues to express a preference for bilateral contracts. See, e.g., *Fosson v. Palace (Waterland), Ltd.*, 78 F.3d 1448, 1454 (9th Cir. 1996) (rebuttable presumption that contract is bilateral); *Motel Servs., Inc. v. Cent. Me. Power Co.*, 394 A.2d 786, 788 (Me. 1978) ("contracts are presumed to be bilateral"); *Rode Oil Co. v. Lamar Adver. Co.*, No. W2007-02017-COA-R3-CV, 2008 WL 4367300, at *6 (Tenn. Ct. App. Sept. 18, 2008) (collecting citations and stating "we note that many authorities speak of a long-established presumption against finding a unilateral rather than a bilateral contract where there is doubt as to which type of contract was intended").

¹⁹⁸ See *Winters*, 35 F. Supp. 2d at 845 (insured's undertakings are conditions of coverage, not affirmative promises).

¹⁹⁹ See FARNSWORTH, CONTRACTS, *supra* note 3, § 8.18, at 532.

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policyholders with inadequate remedies for an insurer's prospective repudiation.²⁰⁰

Fifth, characterization of an insurance contract as unilateral focuses too much attention upon the act of paying the premium.²⁰¹ In fact, as outlined above, policyholders often make and insurers often accept promises to pay premiums,²⁰² partial payments with implied promises to pay more later, and financed payments.²⁰³ By labeling the act of paying the premium as the *sine qua non* of formation, courts are unnecessarily forced to agonize over lost mail, dishonored checks, and all the other potential payment glitches that might mean forfeiture of coverage. The machinations courts must use to pigeonhole these contracts into a unilateral construction ignores the complicated courtship of offer and acceptance and the promises exchanged between policyholders and insurers within a complex, ongoing relationship.

1. The Destructive Force of Construing Policyholder Duties as Conditions

By definition, only one party in a unilateral contract makes a promise.²⁰⁴ In a unilateral insurance contract, the insurer is regarded as the only promising party. "Because a 'unilateral contract' is one in which no promisor receives promise as consideration for his promise, only one party is bound."²⁰⁵ Thus, in a consummated insurance contract, only the insurer is bound to the insured; the policyholder has

²⁰⁰ See WILLISTON, *supra* note 3, § 63:63 (discussing divided approaches to application of anticipatory repudiation for an insurer's prospective repudiation).

²⁰¹ See *Warren v. Confederation Life Ass'n*, 401 F.2d 487, 489 (1st Cir. 1968) ("A life insurance policy is a unilateral contract—the applicant may pay the premium, or not, as he chooses; he is under no legal obligation to do so."); *La Salle Cnty. Farm Bureau v. Thompson*, Gen. No. 7,712, 1927 WL 4140, at *3 (Ill. App. Sep. 24, 1927) ("[T]here was no promise to pay on the part of the member or nothing which could be tortured into an undertaking on the part of the member to pay for any definite length of time; that the whole scheme of insurance is based on a contract purely unilateral and whether the payment for insurance be termed a premium or an assessment, the right of the association or company is to declare a forfeiture for nonpayment of premium or assessment and not a right to recover the assessment or premium in a suit; that a contract for insurance in any benevolent association is a unilateral contract and the member's failure to pay is his declaration of severance and that the forfeiture as provided in the by-laws was self-executing and the member, without any action on the part of the association, by mere force of his failure to pay . . . ceased to be a member."); *Gibson v. Megrew*, 56 N.E. 674 (Ind. 1900) (holding that as a unilateral contract, failure to pay a premium is not an indebtedness, but failure of a condition precedent and a forfeiture of the contract).

²⁰² See *Kelly v. Great W. Accident Ins. Co.*, 189 P. 785 (Cal. Ct. App. 1920) (insured promised to pay for life insurance annually for a term of five years).

²⁰³ See *Aetna Life Ins. Co. v. Doerr*, 115 N.E. 700 (Ind. Ct. App. 1917) (insured paid with a promissory note).

²⁰⁴ See PERILLO, *supra* note 2, § 2.10(a), at 56-57 (in a unilateral contract, "only one party has made a promise and therefore only this party is subject to a legal obligation").

²⁰⁵ *S. Trust Bank v. Williams*, 775 So.2d 184, 188 (Ala. 2000).

completely performed by paying the premium and may now unilaterally walk away without breach simply by failing to renew or even by terminating the policy and seeking a refund of unearned premium. In this section, we discuss two negative effects that result from construing the policyholder's obligations as conditions. The first is that a failure of a condition will result in forfeiture unless the court intervenes with a judicially established anti-forfeiture device, such as the requirement in most states that the insurer establish prejudice from failure to satisfy the condition of prompt notice.²⁰⁶ The second is that, by construing the policyholder's obligations as conditions, the law asks too little of the policyholder and diminishes the relational aspects of the contract.

If it is true that the policyholder has completely performed simply by paying the premium, then anything the policyholder does or fails to do during the policy period is not a breach of the insurance contract because the policyholder did not promise to do or refrain from doing anything. Yet during the life of an insurance contract, its provisions seem to provide that the policyholder is expected to "do" quite a bit, including such things as providing notice of claims, proof of loss, and giving cooperation to the insurer.²⁰⁷

If the policyholder is not "bound" by the contract and has made no promises, the only alternative is to label the policyholder's enumerated responsibilities in the insurance contract as conditions.²⁰⁸ "The difference is not only one of semantics but also of substance; it determines the rights and responsibilities of the parties. . . ."²⁰⁹ Constructing the policyholder's return obligations as conditions deprives courts of material breach and substantial performance as tools to forgive trivial breaches.

Conditions traditionally demand "strict compliance," and the failure to strictly comply with a condition extinguishes any promissory duty on the other side.²¹⁰ Simply put, failure to comply with a condition

²⁰⁶ See *supra* notes 154-58 and accompanying text (discussing law of late notice and importance of judicial attitudes toward conditions in shaping that law).

²⁰⁷ *Winters v. State Farm Fire & Cas. Co.*, 35 F. Supp. 2d 842, 845 (E.D. Okla. 1999) ("[D]espite the many acts to be done by the insured under a fire policy, the fire contract is a unilateral contract." (quoting *Nat'l Union Fire Ins. Co. v. FDIC*, 957 P.2d 357, 363 (Kan. 1998))). Some of the insureds' undertakings include paying premiums, providing notice of claims, cooperating in documenting claims, and in the case of liability insurance, assisting in the defense of the claims.

²⁰⁸ *Id.* at 842. The *Restatement (Second) of Contracts* defines a condition as "an event, not certain to occur, which must occur, unless its non-occurrence is excused, before performance under a contract becomes due." RESTATEMENT (SECOND) OF CONTRACTS § 224 (1981).

²⁰⁹ *Williams*, 775 So.2d at 188.

²¹⁰ Professor Farnsworth explains the consequences of characterizing a term as a condition: "If the occurrence of a condition is required by the agreement of the parties, rather than as a matter of law, a rule of strict compliance traditionally applies." FARNSWORTH, CONTRACTS, *supra* note 3, § 8.3, at 422-23. In addition, the entire contract is imperiled when a condition does not occur:

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will result in forfeiture of the benefits under the contract. In the insurance context, this means that when a policyholder does not strictly comply with the insured's duties, such as notice and cooperation, the policyholder puts both the premiums paid and the coverage promised at risk.²¹¹

Faced with the harsh consequence of forfeiture, courts frequently strain to apply anti-forfeiture tools excessively and sometimes without a principled framework. In the context of insurance conditions, judicial devices to avoid forfeiture have seemingly swallowed the rule that conditions must be strictly met.²¹² Courts employ a variety of equitable doctrines to overcome the harsh consequence of forfeiture—indulging waiver or estoppel analysis²¹³—by requiring some showing of prejudice before allowing forfeiture.²¹⁴ Even courts that do not adopt a prejudice rule can use other tricks to avoid forfeiture, such as generously permitting excuses²¹⁵ or prolonging the time of reasonableness.²¹⁶ Of

The nonoccurrence of a condition of an obligor's duty may have two distinct effects. First, the obligor is entitled to suspend performance on the ground that the performance is not due as long as the condition has not occurred. Second, if a time comes when it is too late for the condition to occur, the obligor is entitled to treat its duty as discharged and the contract as terminated.

Id. at 421.

²¹¹ Then-Judge Cardozo explained:

Cooperation with the insurer is one of the conditions of the policy. When the condition was broken, the policy was at an end, if the insurer so elected. The case is not one of the breach of a mere covenant, where the consequences may vary with fluctuations of the damage. There has been a failure to fulfill a condition upon which obligation is dependent.

Coleman v. New Amsterdam Cas. Co., 160 N.E. 367, 369 (N.Y. 1928).

²¹² See STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, § 9.01[B], at 9-10 (Supp. 2008) ("The word 'reasonable' rings throughout so much of this and other formulations of the duty as to suggest a tautology. It is a concept and doctrine rooted in common sense but one nonetheless surrounded by inconsistent and sometimes unfair judicial results.").

²¹³ JERRY, *supra* note 82, at 192 (observing that waiver and estoppel can prevent insurers from enforcing a timely notice provision); see also PERILLO, *supra* note 2, § 11.29, at 397-98.

²¹⁴ JERRY, *supra* note 82, at 635 ("Under the modern view, late notice does not discharge the insurer's duties unless the insurer is prejudiced as a result of the late notice.").

²¹⁵ See 13 COUCH ON INSURANCE, *supra* note 125, § 186.5 (discussing the historical development of notice and proof of loss requirements).

In addition, where the consequences of late notice are substantial and where the insurer need not show prejudice, courts in New York have provided that notice that is chronologically late may nonetheless be excused under appropriate circumstances so that late notice will not defeat coverage. A valid excuse makes the notice timely in terms of legal effect

STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, § 9.01[B], at 9-12 (footnotes omitted).

²¹⁶ According to one treatise:

There exists a wide range as to what constitutes timely notice or insufficient notice. All other things being equal, it appears that states that require insurers to demonstrate prejudice from late notice are more likely to find notice timely, in part because the insurer's failure to show prejudice in the instance case suggests that the notice was not in fact too late. . . .

However . . . courts in "no prejudice required" states also display variance in views regarding permissible delay. . . . To avoid denying coverage to a policyholder,

course, not all courts are merciful when it comes to the law of conditions. However, strictly construing the so-called conditions in an insurance policy may be principled at the expense of fairness.²¹⁷

As another device to avoid forfeiture, courts sometimes engraft a version of substantial performance onto the law of conditions,²¹⁸ but as a doctrinal matter substantial performance is not supposed to have any role in construing conditions.²¹⁹ Nevertheless, while characterizing the insured's responsibilities as conditions precedent, courts may not ask for strict performance, but instead may examine the "materiality" of the insured's performance or the "substantial" character of the insured's failure to comply.²²⁰

A second consequence of characterizing the insured's obligations as conditions is that the policyholder cannot breach the contract.²²¹

even where the insurer has suffered no prejudice, courts in such states are undoubtedly tempted to apply a liberal yardstick as to what constitutes tardiness or permit the tardiness to be excused.

STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, § 9.01[B], at 9-13.

²¹⁷ See JERRY, *supra* note 82, at 634 ("The traditional rule, and one that is still followed in some jurisdictions, is that timely notice is a condition precedent to coverage, and unexcused delay in giving notice will relieve the insurer of its obligations to the insured, whether or not the delay prejudiced the insurer.").

²¹⁸ See, e.g., *MXL Indus. v. Mulder*, 623 N.E.2d 369, 375 (Ill. Ct. App. 1993) (explaining that substantial performance applies to constructive conditions of exchange but not to express conditions; "an express condition precedent, unless otherwise excused, operates by agreement of the parties to define the satisfaction of a necessary antecedent to a party's performance under the contract and is subject to the rule of strict compliance, unless such compliance is waived").

²¹⁹ See *Oppenheimer & Co. v. Oppenheim, Appel, Dixon & Co.*, 660 N.E.2d 415, 418 (N.Y. 1995) ("Express conditions must be literally performed, whereas constructive conditions, which ordinarily arise from language of promise, are subject to the precept that substantial compliance is sufficient.").

²²⁰ *Burmac Metal Finishing Co. v. West Bend Mut. Ins. Co.*, 825 N.E.2d 1246, 1258 (Ill. Ct. App. 2005) (substantial compliance with conditions precedent); *Watson v. Nat'l Sur. Corp.*, 468 N.W.2d 448, 451 (Iowa 1991) (express conditions in an insurance contract require substantial rather than strict compliance); *Hoekstra v. Farm Bureau Mut. Ins. Co.*, 382 N.W.2d 100, 106 (Iowa 1986) (adopting substantial performance to insurance conditions); *Haynes v. Dairyland Mut. Ins. Co.*, 199 N.W.2d 83, 87 (Iowa 1972) (construing notice and cooperation as conditions precedent and stating insured has the obligation of showing "substantial performance"); *PAJ, Inc. v. Hanover Ins. Co.*, 243 S.W.3d 630, 644 (Tex. 2008) ("Texas law, for example, has long recognized that 'substantial compliance' with a policy's notice or proof-of-loss provisions will suffice and that trivial missteps in complying with notice or other policy requirements are excused."); *Munchenbach v. Nationwide Mut. Fire Ins. Co.*, No. CL-2005-6226, 2007 WL 6002108, at *4 (Va. Cir. Ct. 2007) (notice is a condition precedent requiring substantial compliance).

²²¹ Even good faith and fair dealing is not expected of a performing party in a unilateral contract. See *E.B.C. Trust Corp. v. JB Oxford Holdings, Inc.*, No. CV-00-8812-RMT (Mex), 2004 WL 5641999, at *1 (C.D. Cal. Oct. 26, 2004) (holding that because a promissory note is a unilateral contract, the lender completed the contract by lending the money, and "the implied covenant of good faith and fair dealing cannot create a claim against the party that has already fully performed under a unilateral contract").

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Using Professor Wormser's enduring Brooklyn Bridge hypo,²²² Professor Perillo explains:

The distinction between an express condition and a promise is critical. While failure to perform a promise, unless excused, is a breach, failure to comply with an express condition is not a breach. . . . If B does not walk the Bridge, B will not be liable because B did not promise to walk. One cannot be liable for breach of contract unless one breaches a *promise*.²²³

Thus, if insurance is a unilateral contract, a policyholder must strictly meet conditions to obtain coverage (unless an anti-forfeiture device is applied), but a policyholder cannot breach the insurance contract by not meeting those conditions.

For example, in a unilateral contract, the policyholder's failure to "cooperate" with the insurer during the policy period is not a breach because the policyholder does not promise to cooperate.²²⁴ But cooperation is a condition of obtaining coverage, and therefore the policyholder's failure to cooperate can result in forfeiture of coverage, unless a judicial doctrine ameliorates that result. With forfeiture as the dire consequence, courts often expend inordinate amounts of effort determining just how uncooperative a policyholder may be without forfeiting.

*Winters v. State Farm & Fire Casualty Co.*²²⁵ illustrates the challenges courts face when insurance is constructed as a unilateral contract and the policyholder's duties as conditions of coverage. In *Winters*, the policyholder homeowners filed a claim for fire damage. The state fire marshal suspected the fire was intentionally set and

²²² According to Farnsworth, the Brooklyn Bridge hypothetical is "the most durable and influential hypothetical in American legal education." FARNSWORTH, *CONTRACTS*, *supra* note 3, § 3.24, at 356 (citing its origin as Wormser, *True Conception*, *supra* note 25). In brief, party A states that he will give party B \$100 if B walks across the Brooklyn Bridge. If the offer is construed as an offer for a unilateral contract, A is seeking only the performance. B cannot accept by promising to walk across the Bridge. B must actually walk across the bridge, and the contract is formed when B finishes the walk. Unilateral contracts such as this put B in jeopardy, because of another contract rule—offers are revocable until accepted. That means that B could begin the perilous walk across the Bridge, and A could call out, "I revoke." Hence, *Restatement (Second) of Contracts* section 45 was created to protect B while he walked across the bridge by limiting A's ability to revoke his offer once B begins performance. Yet nothing binds B, who may decide to abandon the foolhardy stunt without incurring liability for breach. See FARNSWORTH, *supra* note 3, § 3.24, at 356-62.

²²³ PERILLO, *supra* note 2, § 11.9, at 365-66.

²²⁴ Contrary to the rule that a failure to meet a condition is not a breach, courts frequently and carelessly speak of it as a breach. See *U.S.A. Elecs., Inc. v. Aetna Cas. & Surety Co.*, 120 B.R. 637, 644 (Bankr. E.D.N.Y. 1990) (characterizing cooperation as a condition precedent and failure to cooperate as a "material breach"); *Glen Falls Indem. Co. v. Lingle*, 133 So.2d 78 (Fla. Ct. App. 1961) (construing a cooperation provision as a condition precedent and explaining that "'a material breach of such a condition is frequently shown by the insured's refusal to give the company whatever information he has respecting the claim'" (citation omitted)).

²²⁵ 35 F. Supp. 2d 842 (E.D. Okla. 1999).

eventually charged the homeowners with arson.²²⁶ Due to the criminal investigation and pending charges, the policyholders would not make themselves available for examination under oath, despite their own concession that “pending criminal charges did not relieve them of their obligations under the insurance policy to give their examinations under oath.”²²⁷ State Farm then advised plaintiffs that they had failed to satisfy the conditions of cooperation and examination under oath and declined payment, while not formally and completely denying the claim. When the arson charges finally were dismissed against the homeowners two years later, State Farm, for the first time, was able to take the plaintiffs’ depositions.²²⁸ State Farm claimed that the plaintiffs had “forfeited their right to recover under the policy by failing to submit to examinations under oath.”²²⁹ But the plaintiffs argued that they had “substantially complied with the terms of the policy provisions by providing all relevant documentation and by providing the depositions that were taken separately in the instant case.”²³⁰

The *Winters* court characterized insurance as a reverse-unilateral contract. Under this construction, the insured’s application and payment of the premium constituted the offer and “once the fire insurer accepts those acts and issues the fire policy, a unilateral contract is formed, that is, an act for a promise.”²³¹ As a result, “after the insured has paid the premium, only the insurer is legally bound (by its promises) to do anything.”²³² Therefore, “despite the many acts to be done by the insured under a fire insurance policy” the insured is not legally obligated to perform those acts.²³³ Instead, the court constructed cooperation as condition of coverage. As the court explained, “[a] condition is a shield not a sword” and “[c]onditions are usually precedent to that duty and must occur to trigger the duty contained in the promise.”²³⁴

Faced with the all or nothing choice of coverage or forfeiture, the court assisted the policyholders by establishing a cooperation-prejudice rule akin to the notice-prejudice rule. “[T]he purpose of the examination under oath is to enable the insurance company to investigate and pay the claim without prejudice, and it too makes sense that [the insurer] should be required to prove prejudice before denying

²²⁶ *Id.* at 843.

²²⁷ *Id.*

²²⁸ *Id.* at 844.

²²⁹ *Id.*

²³⁰ *Id.*

²³¹ *Id.* at 845 (citing *Nat’l Union Fire Ins. Co. v. FDIC*, 957 P.2d 357, 363 (Kan. 1998)).

²³² *Id.* (citing *National Union*, 957 P.2d at 363).

²³³ *Id.* (citing *National Union*, 957 P.2d at 363).

²³⁴ *Id.* (citing *National Union*, 957 P.2d at 363).

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coverage.”²³⁵ Thus the court crafted a solution, because in its view the policyholder had substantially complied with the requirements and did not harm the insurer by the delay.

Courts do not need to do violence to the law of conditions to reach the familiar ground of the law of promises in insurance disputes.²³⁶ Insurance policies, like other contracts, should be construed as presumptively bilateral.²³⁷ The undertakings prescribed within the contract, especially when described as “duties,” should be interpreted as expressions of promise rather than as conditions.²³⁸ Similarly, particularly because the relationship between a policyholder and insurer is complex and lengthy, the policy is better classified as bilateral rather than unilateral or reverse-unilateral. In the next section, we demonstrate that under traditional canons of contract interpretation, a policyholder’s obligations might appropriately be viewed as promises, and propose that a bilateral construction would have a salutary effect on the performance of insurance contracts. We discuss several recent cases that found insurance contracts to be bilateral, and suggest that the results bring insurance contracts within traditional contract doctrine, rather than serve as an exception to it.

2. Contract Law’s Preference for Bilateral Contracts and Promises Should Apply to Insurance Contracts

Although contract law has traditionally expressed a strong preference for a bilateral contract construction, the insurance contract appears the exception.²³⁹ Similarly, canons of contract interpretation

²³⁵ *Id.* at 846.

²³⁶ See Nicholas M. Insua & Matthew J. Delude, *The Restatement (Second) of Contracts as a Useful Tool for Addressing Common Insurance Law Issues*, 13 CONN. INS. L.J. 19 (2007) (asserting that courts can benefit by looking to the *Restatement (Second) of Contracts* to find alternative approaches to resolve insurance issues).

²³⁷ FARNSWORTH, CONTRACTS, *supra* note 3, § 3.24, at 356-57 (explaining that in doubtful cases it is preferable to interpret a contract as bilateral in order to protect the offeree from harsh results); see also Insua & Delude, *supra* note 236, at 35 (“[T]he Restatement would aid a court’s determination regarding whether the notice provision was a condition precedent or a promise to exchange performance” and provide “a preference of interpretation . . . for close questions.”).

²³⁸ For example, in PAJ, Inc. v. Hanover Ins. Co., 243 S.W.3d 630 (Tex. 2008), the majority expressed doubt that notice provisions are typically conditions precedent rather than covenants. It noted that although the relevant provisions appeared in a section entitled “Commercial General Liability Conditions,” they were in a subsection labeled “Duties in the Event of Occurrence” and contained “language that more closely resemble[d] a covenant.” *Id.* at 636. In the case of ambiguity, “[c]onditions are not favored in the law; thus, when another reasonable reading would avoid a forfeiture is available, [the court] must construe contract language as a covenant rather than a condition.” *Id.*

²³⁹ Elsewhere, the *Restatement (Second) of Contracts* perpetuates the view that insurance is largely unilateral. For example, section 227 provides for standards of preference with regard to conditions. RESTATEMENT (SECOND) OF CONTRACTS § 227 (1981). It states a preference for

prefer construing clauses as promises, demanding that conditions be clearly expressed as such.²⁴⁰ Yet, a typical insurance contract is ambiguous at best, both with regard to whether it is bilateral or unilateral, and with regard to whether the insured's obligations are expressed as conditions, promises, or promissory conditions.

As an example, a typical homeowner's insurance policy begins with the agreement to insure, often stating that the insurer provides insurance in return or exchange for payment of the premium and compliance with the policy provisions.²⁴¹ A promise to insure in return

interpretations that avoid forfeiture. Moreover, if a provision is expressed as a condition, but the conditional event is a matter within the control of the party, the *Restatement (Second) of Contracts* favors a construction of a duty (promise) to make the condition occur:

The rule in Subsection (2) states a preference for an interpretation that merely imposes a duty on the obligee to do the act and does not make the doing of the act a condition of the obligor's duty. . . . Unless the agreement makes it clear that the event is required as a condition, it is fairer to apply these more flexible rules.

Id. cmt. d. Yet it states that the rule is inapplicable to insurance, based upon some vague "general understanding that only the insurer undertakes duties, the term will be interpreted as making that event a condition of the insurer's duty rather than as imposing a duty on the insured." *Id.*

Furthermore, this standard of preference does not apply when the contract is of a type under which only the obligor general undertakes duties. It therefore does not apply to the typical insurance contract under which only the insurer generally undertakes duties, and a term requiring an act to be done by the insured is not subject to this standard of preference.

Id.

²⁴⁰ See *Oppenheimer & Co. v. Oppenheim, Appel, Dixon & Co.*, 660 N.E.2d 415, 418 (N.Y. 1995) ("In determining whether a particular agreement makes an event a condition courts will interpret doubtful language as embodying a promise or constructive condition rather than an express condition."). The *Restatement* provides:

§ 227. Standards Of Preference With Regard To Conditions

(1) In resolving doubts as to whether an event is made a condition of an obligor's duty, and as to the nature of such an event, an interpretation is preferred that will reduce the obligee's risk of forfeiture, unless the event is within the obligee's control or the circumstances indicate that he has assumed the risk.

(2) Unless the contract is of a type under which only one party generally undertakes duties, when it is doubtful whether

(a) a duty is imposed on an obligee that an event occur, or

(b) the event is made a condition of the obligor's duty, or

(c) the event is made a condition of the obligor's duty and a duty is imposed on the obligee that the event occur, the first interpretation is preferred if the event is within the obligee's control.

(3) In case of doubt, an interpretation under which an event is a condition of an obligor's duty is preferred over an interpretation under which the non-occurrence of the event is a ground for discharge of that duty after it has become a duty to perform.

RESTATEMENT (SECOND) OF CONTRACTS § 227 (1981).

²⁴¹ Property and casualty insurance policies typically state that the insurer will insure in "return for the premium and compliance . . . with applicable provisions in this policy." *Martin v. Safeco Ins. Co.*, No. 06-6889, 2007 WL 2071662, at *2 (E.D. La. July 13, 2007); *accord Lloyd's of London v. Pagan-Sanchez*, 539 F.3d 19 (1st Cir. 2008); *Joseph v. Unitrin, Inc.*, No. 1:08-CV-077, 2008 WL 3822938 (E.D. Tex. Aug. 12, 2008); *GuideOne Mut. Ins. Co. v. Hall*, No. 1:06CV315-SA-JAD, 2008 WL 2817098 (N.D. Miss. July 18, 2008); *Amica Mut. Ins. Co. v. Fischer*, No. CV-F-07-1410 OWW/DLB, 2008 WL 1970639, at *4 (E.D. Cal. May 5, 2008). A Commercial General Liability policy provides "in return for the payment of the premium and

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for payment is merely a recital of the consideration exchanged. That insuring language does not preclude a bilateral construction of the contract; after all, it is not uncommon in bilateral contracts to exchange payment for performance.

Thereafter, in a typical policy, the insurer itemizes obligations of the policyholder upon a loss in a section of the contract entitled “Conditions.” Within the Conditions section, however, there are frequently provisions that are not conditions at all; some of the provisions describe undertakings of the insurer, and others set out procedures for establishing one’s claims.²⁴² It is axiomatic that merely labeling a contract provision as a condition does not make it so. Again turning to a homeowner’s insurance policy as an example, some of the enumerated actions the insured must take after a loss are expressed as duties²⁴³—a word that evokes a promissory obligation. Other provisions make clear that failure to comply renders the contract void.²⁴⁴

At least a few courts, most notably in a line of cases in Maryland, have turned to traditional canons of construction and clearly transformed the presumptively unilateral insurance contract into a bilateral contract.²⁴⁵ These courts have characterized at least some of

subject to all the terms of this policy, we agree to provide the insurance stated in this policy.” Commerce Bank, N.A. v. AMCO Ins. Co., No. 08-cv-669-JPG, 2009 WL 702220, at *3 (S.D. Ill. Mar. 17, 2009) (emphasis omitted); *accord* Nationwide Mut. Ins. Co. v. Regency Furniture, Inc., 963 A.2d 253, 260 (Md. Ct. Spec. App. 2009).

²⁴² For example, an ISO homeowners policy contains a section labeled “conditions.” It contains provisions identifying duties of the insured, such as providing notice and proof of loss. But conditions sections also contain provisions that cannot be construed as conditions. For example, loss settlement provisions describe procedures the insurer follows in valuing and paying claims. These are not conditions of coverage. *See e.g.*, Goff v. State Farm Fla. Ins. Co., 999 So.2d 684 (Fla. Ct. App. 2008) (describing loss settlement procedures in conditions section of a homeowner’s policy); Landry v. La. Citizens Prop. Ins. Co., 983 So.2d 66 (La. 2008) (same).

²⁴³ For example, the liability portion of a homeowner’s policy describes “Duties After Loss” in which it requires the insured to provide notice, information, and the names of witnesses and possible claimants. *See* ISO, Homeowner’s 3 Special Form Section II Conditions, HO 00 03 04 91 (1990), reprinted in ALLIANCE OF AMERICAN INSURERS, *supra* note 162, at 42.

²⁴⁴ For example, standard homeowners’ policies usually state that “concealment or fraud” renders the policy void. *See, e.g.*, Lanier v. State Farm Fire & Cas. Co., No. 5:07CV129-V, 2009 WL 926914, at *5 (W.D.N.C. Mar. 31, 2009).

The term “duty” is frequently associated with promises, and particularly distinguished from conditions. For example, Farnsworth characterizes duty as a promissory term: “[I]t can be said that promises, which impose duties, and conditions, which make duties conditional, are the main components of agreements.” FARNSWORTH, CONTRACTS, *supra* note 3, § 8.2, at 414. Calamari and Perillo employ the term “duty” to refer to the “promisor’s duty to perform a promise” as distinguished from conditions for which a party has no duty. *See* PERILLO, *supra* note 2, § 11.2, at 361. Conceptually, a promise creates a duty to perform and a condition places a limit on that promissory duty.

²⁴⁵ *See* Snyder v. Chester Cnty. Mut. Ins. Co., 264 F. Supp. 2d 332 (D. Md. 2003) (construing cooperation clauses as a covenant requiring substantial compliance); Lindsey v. State Farm Fire & Cas. Co., No. CIV. A. AW-00-132, 2000 WL 1597763 (D. Md. Oct. 23, 2000) (construing duties after loss as covenants requiring substantial performance); Hartford Fire Ins. Co. v.

the undertakings the insured performs under an insurance contract as promises subject to substantial performance. When an insured enters into a contract, these courts posit that the insured has made affirmative promises to the insurer: to cooperate, to give timely notice, to provide documents, and to participate in the defense of the case under a liability policy. The effect of constructing these obligations as promissory is that a judge can invoke substantial performance rather than strict compliance to decide difficult cases.²⁴⁶ These courts do not need to painstakingly search for an excuse, prejudice, waiver, or estoppel in order to avoid forfeiture.²⁴⁷

*Hartford Fire Insurance Co. v. Himelfarb*²⁴⁸ illustrates a situation in which the policyholder's responsibilities under the insurance policy were construed as promises and the decision more predictably followed

Himelfarb, 736 A.2d 295 (Md. 1999) (construing the sworn proof of loss provision of a commercial property insurance policy as a covenant calling for substantial rather than strict compliance).

²⁴⁶ Eugene Anderson, who often writes from the pro-insured position, has argued forcefully for the application of substantial performance in judging the insured's performance of duties such as notice and cooperation:

Forfeiture is an unfair, draconian remedy that should no longer be applied in insurance law, routinely or otherwise. A policyholder who has paid premiums and purchased an insurance policy that is affected with a public interest should be treated at least as favorably as a party to any type of contract. In the world of insurance, forfeiture as a punishment does not fit the crime. Draconian forfeitures can be eliminated by the simple application of traditional contractual remedies, notably, the doctrine of substantial performance. When a policyholder has regularly paid premiums on his policy, courts should find that the insurance policy has been substantially performed and that the insurance company's recovery for noncompliance with a policy condition should be limited to damages or recoupment for the harm suffered.

Eugene R. Anderson et al., *Draconian Forfeitures of Insurance: Commonplace, Indefensible, and Unnecessary*, 65 FORDHAM L. REV. 825, 861 (1996). We prefer to go to the root of the problem instead of engrafting substantial performance onto conditions. Courts do not need to recast the law of conditions. They need only recognize that duties under an insurance policy that sound "promissory," such as providing notice, cooperation, and proof of loss, should be construed as promises as provided by traditional contracts law.

²⁴⁷ The substantial performance test is sufficiently nuanced for concepts like prejudice to find a comfortable home within it. For example, in testing the materiality of a breach, the *Restatement (Second)* provides that the following circumstances are significant:

- (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
- (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
- (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
- (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
- (e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

RESTATEMENT (SECOND) OF CONTRACTS § 241 (1981). Thus, looking for substantial performance invites a rich consideration of, among other factors, the harm to the insurer, the harshness of forfeiture, and the nature of the nonperformance.

²⁴⁸ 736 A.2d at 295.

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contract law principles. In *Himelfarb*, a commercial policyholder's warehouse was burgled. At the time, the insured's premises were leased to a failing business that was in bankruptcy.²⁴⁹ Himelfarb reported the theft to its agent and engaged a public adjuster to assist in pressing its insurance claim. As provided by the policy, Hartford then requested a sworn proof of loss within sixty days of the loss.²⁵⁰ Himelfarb provided a sworn statement, but Hartford deemed it incomplete because it lacked an itemized list of losses. In particular, Himelfarb was having difficulty obtaining an itemized list of property auctioned in the lessee's bankruptcy proceedings, a necessary crosscheck to determine precisely what had been stolen.²⁵¹ Six months after the sixty-day deadline for proof of loss passed, Himelfarb finally provided an itemized list of stolen items. Hartford rejected the claim on the grounds that the proof of loss was untimely.

Himelfarb filed suit to recover for its losses.²⁵² On appeal, the issue was whether the trial court was correct to grant Hartford summary judgment on the grounds that Himelfarb did not strictly comply with a condition precedent to coverage.²⁵³ The court first stated that it would interpret the insurance contract in the same manner as it would "any other contract," including finding "the intent of the parties to be gathered from the words they have employed, and in case of ambiguity, after resort to the other permissible aids to interpretation."²⁵⁴ The court observed that the proof of loss provisions that Hartford claimed to be express conditions were ambiguously stated and could be covenants, not conditions.²⁵⁵ It explained that although the section containing the proof of loss provision was labeled "Loss Conditions," not all the provisions in the section were express conditions precedent; some described actions that Hartford, not its policyholders, was to undertake.²⁵⁶

In addition, while the provisions were labeled as conditions, the court determined that the obligations were not expressed in the familiar language of conditions,²⁵⁷ but were expressed as a "duty on the

²⁴⁹ *Id.* at 297-98.

²⁵⁰ *Id.* at 298.

²⁵¹ *Id.* at 299.

²⁵² *Id.*

²⁵³ *Id.* at 297. The trial court ruled in favor of Hartford, a Court of Special Appeals reversed, remanding the case for trial. The Court of Appeals of Maryland granted certiorari and affirmed the reversal. *Id.* at 299.

²⁵⁴ *Id.* at 300 (quoting *Chirichella v. Erwin*, 310 A.2d 555, 557 (Md. 1973)).

²⁵⁵ *Id.* at 300-01.

²⁵⁶ *Id.* at 300 (observing that one provision discussed Hartford's option of payment or repair or replacement, and noting that "[p]ayment by Hartford clearly is not a condition precedent to Hartford's obligation to pay").

²⁵⁷ The court explained, "[a]lthough no particular form of words is necessary in order to create an express condition, such words and phrases as 'if' and 'provided that,' are commonly used to indicate that performance has been expressly made conditional as have the words 'when,'

insured.”²⁵⁸ “Under these circumstances construction of [the proof of loss provision] as a covenant, rather than an express condition, is the preferred construction.”²⁵⁹ Once the proof of loss provision had been construed as a covenant rather than as an express condition, the court was free to consider substantial performance in providing proof of loss, even while not meeting the strict terms of the policy.

Substantial performance by the insured of the covenant as of the specified date may be found if, by that date, two elements are present: (1) the insured has furnished the insurer with information reasonably requested by the insurer to the extent that it is reasonably possible for the insured to do so, and (2) the insured expressly or impliedly promises to submit, when and as it is reasonably possible for the insured to do so, the balance of the information.²⁶⁰

The appellate court reversed Hartford’s summary judgment and remanded the case for trial, holding that whether Himelfarb substantially performed under the proof of loss provision was a question for the trier of fact.²⁶¹ *Himelfarb*’s construction of insurance as bilateral allowed the court to follow contract law’s doctrine of substantial performance in order to protect the policyholder from unfair forfeiture. In contrast, the construction of insurance as a unilateral contract in *Winters* required the court to invent a novel exception to the law of conditions in order to obtain a just result.

Importantly, once a contract is constructed as bilateral and once a policyholder owes a return promise, the policyholder’s performance includes an implied promise of good faith.²⁶² *Liberty Mutual Insurance Co. v. Altfillisch Construction Co.*²⁶³ is a rare insurance case in which a court found a promissory exchange of an implied promise of good faith on the policyholder’s part. There, the policyholder’s equipment was damaged by the insured’s lessee. The equipment was covered under a policy with Liberty Mutual. Unbeknownst to Liberty Mutual, the

‘after,’ ‘as soon as,’ or ‘subject to.’” *Id.* (quoting *Chirichella v. Erwin*, 310 A.2d 555, 557 (Md. 1973)).

²⁵⁸ *Id.*

²⁵⁹ *Id.* at 300-01 (citing cases and the RESTATEMENT (SECOND) OF CONTRACTS § 227(2) (1981)).

²⁶⁰ *Id.* at 306.

²⁶¹ *Id.* at 306-07. The court observed that the property was not owned by the Himelfarbs, they did not live in the same city, and they had no way to know what was stolen until they could compare “the before break-in and after break-in inventories” by obtaining the information from the bankruptcy. *Id.*

²⁶² When insurance is construed as a unilateral contract, the insured fully performs by paying the premium, and cannot thereafter breach. It follows that the insured has made no implied covenant of good faith and fair dealing to the insurer. See *E.B.C. Trust Corp. v. JB Oxford Holdings, Inc.*, No. CV-00-8812-RMT (Mcx), 2004 WL 5641999, at *1 (C.D. Cal. Oct. 26, 2004) (“[A]s a matter of law, the implied covenant of good faith and fair dealing cannot create a claim against the party that has already fully performed under a unilateral contract.”).

²⁶³ 139 Cal. Rptr. 91 (Cal. Ct. App. 1977).

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policyholder had made a prior agreement with the lessee to “insure lessee against risks resulting from its possession” of policyholder’s equipment.²⁶⁴ This agreement had the effect of cutting off Liberty Mutual’s opportunity for subrogation for any losses attributable to the lessee’s negligence.

Under the casualty policy, “Condition No. 17” provided for subrogation and required that “the insured shall execute and deliver instruments and papers and do whatever else is necessary to secure such rights.”²⁶⁵ Because the side agreement between the policyholder and its lessee occurred before the loss occurred, Condition No. 17, which protected the insurer’s right of subrogation after loss, did not technically apply.²⁶⁶

The court considered whether impairing the insurer’s potential right of subrogation violated the policyholder’s implied promise of good faith and fair dealing. Reviewing the rise of insurance bad faith in tort, the court explained:

Faced with this sweeping and portentous pronouncement on the force and dignity of such covenants, we find no difficulty in construing the scope of their impact to devolve alike upon the insured as well as the insurer and that a breach thereof by the insured would lead to the same legal consequences as any garden variety breach of contract.²⁶⁷

The court then concluded that the policyholder violated the covenant of good faith in bargaining away and therefore frustrating the insurer’s “expectation of opportunities to subrogate in the event of a loss caused by the negligence of a third party.”²⁶⁸

Altfillisch recognizes insurance as an ongoing mutual relationship between policyholder and insurer, and recognizes that the policyholder’s performance is not complete at the time the premium is paid, at least if the policyholder is to have coverage. Rather, the policyholder, like the insurer, has made an ongoing promise to engage in good faith and fair dealing.²⁶⁹

²⁶⁴ *Id.* at 92.

²⁶⁵ *Id.* at 94.

²⁶⁶ *Id.* at 94-95.

²⁶⁷ *Id.* at 95.

²⁶⁸ *Id.*

²⁶⁹ Without addressing the unilateral versus bilateral contract question, a number of courts have said that good faith and fair dealing is a two-way street in an insurance policy. *See, e.g.,* *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 200 (Cal. 1958) (“There is an implied covenant of good faith and fair dealing in every contract that neither party will do anything which will injure the right of the other to receive the benefits of the agreement. This principle is applicable to policies of insurance.” (citation omitted)); *Sargent v. Johnson*, 551 F.2d 221, 231-32 (8th Cir. 1977) (“Where a claim is made against an insured which may exceed policy limits, and where the insured and insurer may each incur liability, then each assumes an obligation to act in good faith, to face the facts realistically, and to maintain a mutual respect for the interests of the other. . . . This standard of good faith and mutual respect applies to both parties to the insurance

The notion that a policyholder makes ongoing promises subject to good faith and substantial performance cures a variety of evils. First, it has a salutary effect on the behavior of policyholders by infusing a mutual expectation of good faith into their relationship with the insurer. Second, it removes the hammer of forfeiture that comes with conditions and allows courts to evaluate conduct through the more reasonable lens of substantial performance. It thus enables policyholders to obtain coverage as expected without regard to technical breaches. We also suspect that lowering the stakes for minor deviations from policy provisions from all-or-nothing may reduce the allure of litigation and enable the parties to better self assess where the contractual relationship stands.

3. The Unjustified Absence of Anticipatory Repudiation

Traditionally, the doctrine of anticipatory repudiation has not applied to unilateral contracts, although the limitation certainly does not have universal support.²⁷⁰ The unilateral construction of the insurance

contract.”); *Rawlings v. Apodaca*, 726 P.2d 565, 570 (Ariz. 1986) (“Thus, firmly established law indicates that the insurance contract between plaintiffs and Farmers included a covenant of good faith and fair dealing, implied in law, whereby each of the parties was bound to refrain from any action which would impair the benefits which the other had the right to expect from the contract or the contractual relationship.”); *United Servs. Auto. Ass’n v. Morris*, 741 P.2d 246 (Ariz. 1987) (Holohan, J. dissenting) (asserting that insured owed a duty of good faith to insurer). A reciprocal implied promise, by itself, necessitates a bilateral construction of the contract, for it implies that an insured does indeed have return obligations toward the insurer.

²⁷⁰ Criticism of limiting anticipatory repudiation is based on the concept that even in executed contracts, anticipatory repudiation has an immediate cost. *See, e.g., PERILLO, supra* note 2, § 12.9, at 440 (taking the view that the exception for unilateral contracts is indefensible); WILLISTON, *supra* note 3, § 63.63 (concluding that when an insurer wrongfully refuses to accept a premium it is not an anticipatory repudiation, but immediate breach and full damages should be recovered). An early commentator explained the hostility to the limitation:

This basis for the distinction between bilateral and unilateral contracts in regard to anticipatory breach is, therefore, unsound. “The best reasons for allowing an immediate action for an anticipatory repudiation are that it frequently causes immediate loss in property values, it disturbs the mind and serenity of the promisee, and immediate action makes for an early settlement of the dispute and a timely payment of damages.” These apply to unilateral as well as bilateral contracts. Repudiation reduces the sale value of the chose in action, for few people care to purchase a lawsuit. Also, the plaintiff should not be forced to bring a series of lawsuits for the regular installments, and in the meantime suffer discomfort and poverty.

Comment, *Anticipatory Breach of Unilateral Contracts*, 36 YALE L.J. 263, 265-66 (1926) (citing SIR WILLIAM R. ANSON, *CONTRACTS* 464 (1924)).

Even Professor Wormser, who was once the strongest proponent of aggressive application of unilateral contract concepts, saw the traditional anticipatory breach as “anomalous” and restricted to contract conditions rather than a useful rule of damages. *See Wormser, Book Review, supra* note 46. Had Professor Wormser been an insurance scholar like Professor Patterson, he might have also realized the occasional mischief anticipatory breach doctrine worked in the context of traditional unilateral contract theory. As one court observed:

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contract precludes applying anticipatory repudiation doctrine by those courts that adhere to the rule that anticipatory repudiation does not apply when contracts are fully executed on one side. Refusing to allow policyholders to obtain relief for anticipatory repudiation prevents the policyholder from obtaining complete relief where an insurer wrongfully refuses to provide coverage under an ongoing policy.

As a result, the policyholder wrongfully denied coverage may be required to repeatedly seek relief *seriatim* as the insurer fails to deliver promised payment after promised payment. Worse yet, the policyholder may be required to continue to pretend the contract is in effect and continue to perform, including paying premiums,²⁷¹ even when it is clear the insurer will not be providing coverage. When an insurer refuses to perform, the insured should be able to suspend any return performance, thereby treating the contract as at an end.

Regarding anticipatory repudiation, *Restatement (Second) of Contracts* section 253 states the general rule presumptively applicable to bilateral contracts: “Where an obligor repudiates a duty before he has committed a breach by non-performance and *before he has received all of the agreed exchange for it*, his repudiation alone gives rise to a claim for damages for total breach.”²⁷²

However, under a unilateral contract construction, the policyholder has given and the insurer has received all of the agreed exchange—the payment of the premium—when the contract was formed. Thus, if the language of section 253 is read literally, the insurer’s prospective repudiation should not give rise to an immediate claim for damages; instead, the insured must wait until the breach actually occurs.²⁷³ Although this seems intrinsically wrong, the authors of the *Restatement*

There is some disagreement whether the doctrine of anticipatory repudiation applies only to bilateral contracts or to both bilateral and unilateral contracts. Insurance policies are generally unilateral contracts. A D&O insurance policy is a unilateral contract—the insured has already performed by paying the premium in exchange for the insurance company’s promise to provide insurance. Nevertheless, there is ample authority for the proposition that the promising party can anticipatorily repudiate a unilateral contract.

Combs v. Int’l Ins. Co., 354 F.3d 568 (6th Cir. 2004) (citations omitted).

²⁷¹ Situations of this sort make the unilateral characterization of insurance policies and the traditional view toward anticipatory repudiation look idiotic. The insurance policy is supposed to be unilateral or reverse-unilateral—yet the policyholder continues to do the act (premium payment) which supposedly was complete prior to contract formation and the court needlessly burdens the victim of the contract breach with additional transaction costs that impede relief. Under these circumstances, insurers have lowered incentives to make reasonable coverage determinations, especially if the relevant state’s bad faith law is weak. In addition, absent an exception to the traditional American bar on recovery of counsel fees by the prevailing party, a policyholder wrongfully denied coverage is not made whole.

²⁷² RESTATEMENT (SECOND) OF CONTRACTS § 253 (1981) (emphasis added).

²⁷³ See *Davis v. First Nat’l Bank*, 605 P.2d 37, 43-44 (Ariz. Ct. App. 1979) (stating that the insurer “could not breach what had become a unilateral contract until the time for performance had arrived”).

apparently meant for this result. Commentary to section 253 states “it is one of the established limits on the doctrine of ‘anticipatory breach’ that an obligor’s repudiation alone . . . gives rise to no claim for damages at all if he has already received all of the agreed exchange for it.”²⁷⁴

The rationale for the rule that a contract that has been fully performed on one side cannot trigger anticipatory repudiation stems from the idea that the non-breaching party cannot be harmed by waiting for the time of breach. Under this view, the non-breaching party owes nothing more that could be put at risk by the threatened breach.²⁷⁵ But this assessment must be incorrect as applied to insurance in that the purpose of the insurance policy is risk management, protection against contingent loss, and “peace of mind.” These objectives are threatened enough merely from the possibility that an insurer will become insolvent, wrongfully deny a claim, or undervalue a claim. Where the insurer has already expressed intent to breach, the value of the policy to the policyholder has been severely undermined and perhaps even vitiated.

The problem of inadequate resort to judicial relief based upon anticipatory repudiation sometimes arises in an insurance contract in which periodic payments are due, such as under a disability insurance policy.²⁷⁶ If an insurance policy is unilateral, it follows under the conventional rule that the policyholder cannot treat the insurer’s refusal to make a periodic payment as a total repudiation. Therefore, the policyholder is left to other devices, such as filing multiple suits or a declaratory action. In the courts that follow the conventional rule, characterizing the contract as unilateral means that a suit for total repudiation is unavailing. This transforms what might otherwise be an interesting damage issue into an anticipatory breach problem. This

²⁷⁴ RESTATEMENT (SECOND) OF CONTRACTS § 253 cmt. c (1981).

²⁷⁵ To understand the basis for the limitation, RESTATEMENT (SECOND) OF CONTRACTS § 253 Reporter’s Notes cmt. c (1981) directs readers to the dissenting opinion in *Federal Life Insurance Company v. Rascoe*. That opinion explains:

Where his part of the contract has been executed by the plaintiff, he has nothing to do but to wait, and to do so continues to be in his power. His position will not be prejudicially changed by defendant’s repudiation; and hence he will have no estoppel to rely upon to precipitate the defendant’s obligation.

Fed. Life Ins. Co. v. Rascoe, 12 F.2d 693, 697 (6th Cir. 1926) (Denison, J., dissenting).

²⁷⁶ Some courts recognize a “narrow exception” in the case of periodic payments. These courts distinguish between insurers that repudiate the policy in its entirety and those that dispute whether payments are owed.

[T]here is a narrow exception to this rule which provides for recovery of future benefits, where the insurer has repudiated the entire policy. This exception is applicable only where a plaintiff establishes that the insurer has committed an anticipatory breach by “disclaim[ing] the intention or the duty to shape its conduct in accordance with the provisions of the contract.”

Wurm v. Commercial Ins. Co., 766 N.Y.S.2d 8, 12 (N.Y. App. Div. 2003) (quoting *N.Y. Life Ins. Co. v. Viglas*, 297 U.S. 672, 676 (1936)).

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means that despite a material breach by an insurer (e.g., the refusal to make periodic payments), a policyholder cannot obtain the full value of promised coverage and end the relationship with the insurer.²⁷⁷

When a court construes the insurance contract as unilateral, thereby limiting a policyholder's use of anticipatory repudiation, it dooms the policyholder to an ongoing relationship with a breaching party. Consider the problem for Charles Fanning, who purchased an accident insurance policy from Guardian Life Insurance Company of America.²⁷⁸ Fanning was issued a conditional binding receipt. After Guardian received the premium, but before it issued the policy, Fanning suffered a serious injury that "totally and permanently disabled him."²⁷⁹ Guardian declined Fanning's application and denied coverage, claiming the contract had not yet been formed.²⁸⁰ The jury rejected the insurer's position, finding the contract had formed. Fanning also established that he was permanently disabled and so the jury awarded damages that reflected the present value of the amount of money owed over his life expectancy.²⁸¹ The jury's award provided Fanning with \$27,730, a lump sum sufficient to pay him \$100 per month over his life expectancy.²⁸²

The Washington Supreme Court agreed with Fanning and the jury that Guardian had erroneously taken the position that there was no contract, that Guardian had wrongfully refused to pay under any circumstance, and that this constituted a total breach. Nevertheless, the court reversed and held in favor of Guardian on the issue of the amount of damages owed.²⁸³ The court concluded that Fanning could not obtain damages for total breach. Citing a "great weight of authority," the court explained that anticipatory breach applies only to bilateral contracts, and then sided with "a majority of the jurisdictions [that] refuse to allow recovery for breach by anticipatory repudiation of a unilateral contract

²⁷⁷ See, e.g., *Garage & Serv. Station Emps. Union v. Pac. Mut. Life Ins.*, 82 Cal. Rptr. 821 (Cal. Ct. App. 1969) (holding that group life insurer's refusal to recognize cancelled life insurance contract presented a cause of action only as to deceased insured; thirteen living members had no cause of action based on anticipatory repudiation); *Greguhn v. Mut. of Omaha Ins. Co.*, 461 P.2d 285, 287 (Utah 1969) (ordering periodic payments until insured recovers or dies and citing "the great majority of decisions" that allows payment "only of installments accrued and unpaid").

While adhering to the rule that anticipatory repudiation is inapplicable to unilateral contracts, some jurisdictions carve out an exception for bad faith, allowing a lump-sum payment where the insurer has acted in bad faith. See *Hangarter v. Paul Revere Life Ins. Co.*, 373 F.3d 998, 1012-13 (9th Cir. 2004) (applying California law and allowing future payments in tort); *DeChant v. Monarch Life Ins. Co.*, 554 N.W.2d 225 (Wis. Ct. App. 1996).

²⁷⁸ *Fanning v. Guardian Life Ins. Co.*, 366 P.2d 207 (Wash. 1961).

²⁷⁹ *Id.* at 208.

²⁸⁰ *Id.* at 209.

²⁸¹ *Id.* at 210.

²⁸² *Id.* at 209-10.

²⁸³ *Id.*

or of a bilateral contract that has become unilateral.”²⁸⁴ The appellate court concluded that it was sufficient to hold that the insurer owed Fanning continuing monthly payments as provided by the contract, rather than awarding a lump sum, even though the insurer’s conduct constituted a total breach.²⁸⁵

Had the court characterized the insurance contract as bilateral,²⁸⁶ the court might have allowed Fanning a more satisfactory and complete remedy for Guardian’s breach. The court might have recognized that Fanning and the insurer had made ongoing bilateral promises to one another—Fanning to continue to cooperate and to submit continuing proof of disability and Guardian to make ongoing payments. Although the court acknowledged that Fanning had continuing duties under the policy to make himself available and submit to periodic physical evaluations, the court called this duty “too trivial” and “inconsequential” as to be an bilateral duty under the contract.²⁸⁷

Had the court instead recognized that Fanning had made reciprocal promises and that a bilateral relationship existed, under the doctrine of anticipatory repudiation, the court might have terminated Fanning’s continuing obligation to cooperate in light of Guardian’s breach and fashioned a remedy that relieved Fanning of duties to Guardian and allowed him to sever the relationship. Instead, Fanning was forced to remain in a lifelong contractual relationship with an insurer—even to the extent of submitting to regular physical examinations at its behest—that had breached the contract and wrongfully denied him the disability benefits he had purchased. In light of the fact that an essential aspect of insurance is that the policyholder purchases peace of mind that the insurer will pay in the event of contingent losses, to force the policyholder to remain in a relationship after breach is particularly problematic.

The court ignored the bilateral nature of the disability policy. For example, in order to collect benefits, Fanning had ongoing duties to establish his disability and to submit proof of his continuing disability. Once construed as a bilateral contract, the court might have recognized

²⁸⁴ *Id.* at 211.

²⁸⁵ Fanning argued that the rule adopted was not sound, because “if defendant company becomes hostile to the insured, plaintiff may be compelled to bring an action on every installment.” *Id.* at 212. The court rejected that possibility as an unlikely business practice which could be sanctioned. *Id.* (citing *Cobb v. Pac. Mut. Life Ins. Co.*, 51 P.2d 84, 88 (Cal. 1935)). The court also rejected Fanning’s argument that the insurer was a foreign corporation, and so future performance might not be assured. *Id.*

²⁸⁶ The insured had obligations under the accident policy, including an obligation to pay the seven dollar balance on his premium payment, and to provide ongoing evidence of his disability and documents for reimbursement. The court did not address the seven dollar balance, but it specifically rejected construing the insurer’s right to demand an examination to verify the disability as an exchanged promise. *Id.* at 210.

²⁸⁷ *Id.*

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that an absolute refusal to pay the benefits constituted a total breach that allowed Fanning to terminate the contract and sue for breach. Then the issue of whether to give Fanning a lump sum award or something else would have been reduced to a damages issue, as it properly should be. The court might still not have allowed a lump sum award because that amount would be speculative, but it might have explored other forms of damages, such as a sum sufficient to replace the insurance or to purchase an annuity to reproduce the payments. Instead, by not allowing anticipatory breach, the court may have left Fanning in a troubled relationship, yet unable to sever ties.

4. Adherence to a Unilateral Contract Characterization Excessively Focuses upon the Act of Paying Premiums

There exists yet another inconvenient artifact of a unilateral construction. When payment of the premium is the *sine qua non* of contract formation, missteps in the payment process can have inappropriately harsh consequences. When the insurance contract is characterized as a unilateral contract, too much attention must be paid to the actual payment of the premium as a test of formation.

However, there logically is no single method to form an insurance contract; “formation depends on the objective reasonable expectations of the parties.”²⁸⁸ The insurance contract may form with a formal document, an oral agreement, through the acts of an agent, with an offer from the insured accepted by the insurer, with an offer from the insurer accepted by the insured, or through bilateral promises.²⁸⁹ “Many insurers will issue a policy premised on a policyholder’s promise to pay premiums when billed, and this promise is also effective as consideration.”²⁹⁰ Such varied practices suggest that insurers do not necessarily regard the payment of the premium as a condition precedent to formation.

When courts construe payment as a condition precedent to the formation of the contract, they then must unnecessarily struggle with formation issues concerning payment by check, payment by check with insufficient funds, or lost payments.²⁹¹ In a bilateral construction,

²⁸⁸ 3 HOLMES’ APPLEMAN ON INSURANCE, *supra* note 3, § 10.2.

²⁸⁹ Among the varied methods of formation, see generally *id.* § 10.1 (formation through formal written contracts); *id.* § 10.2 (oral formation); *id.* (formation through agents of the insured or insurer); *id.* § 10.5 (formation without payment of first premium).

²⁹⁰ STEMPER ON INSURANCE CONTRACTS, *supra* note 3, § 9-144.3 to 9-144.4 (3d ed. 2008 Supp.); see *supra* note 120 (describing the variety of methods of payment).

²⁹¹ 3 HOLMES’ APPLEMAN ON INSURANCE, *supra* note 3 §10.5; 5 HOLMES’ APPLEMAN ON INSURANCE, *supra* note 3, at 24.2; JERRY, *supra* note 82, § 71[a]-[g], at 613-23 (describing payment problems and formation); see *Hartline v. Nat’l Grange Mut. Ins. Co.*, 394 F. Supp. 2d

payment also serves as a promise to pay, and that means that dishonored checks,²⁹² errors in mailing,²⁹³ partial payments,²⁹⁴ or any other of myriad payment glitches that might befall an insured will not result in a risk of forfeiture. Moreover, the view that a policyholder's acceptance of insurance indicates a promise to pay for that insurance reflects a more realistic intent of both parties.

One of the reasons the insurance policy is viewed as unilateral is that it achieves an expectation the parties seem to share that the insurer has no cause of action against the policyholder for failure to pay the premium. As Dean Jerry explains, "If . . . the insured fails to perform the duty to pay premiums, the insurer is ordinarily not entitled to force the insured to make the payments or to collect damages for the insured's nonperformance."²⁹⁵ In Dean Jerry's view, "paying the premium is more a condition . . . than it is a duty," and thus the "insurer does not have the remedy of suing the insured for the unpaid premium."²⁹⁶

Under the unilateral concept of the insurance policy, payment of the premium is a "condition precedent to the liability of the insurer" and not "a 'debt' in the sense that the insurer can enforce payment of the premium."²⁹⁷ Thus, as in any unilateral contract, nonperformance by the non-promising party is not regarded as a breach of contract.

[C]ourts and texts often refer to a "duty" of the policyholder to pay premiums, but that is not strictly accurate since the policyholder suffers no liability for breaching its promise to pay by rejecting a policy that has been issued and seldom is sued for breach if it elects to stop paying the premium.²⁹⁸

Nevertheless, both the policyholder's right to reject the insurance (by not paying the premium), as well as the insurer's right to terminate

470 (D.R.I. 2005) (finding that a policy lapsed where check for renewal premium was overdue and dishonored for insufficient funds); *Johnson v. Dairyland Ins. Co.*, 398 So.2d 317 (Ala. Civ. App. 1981) (affirming finding of no coverage where initial premium check was dishonored for insufficient funds); *Tallent v. Tenn. Farmers Mut. Ins. Co.*, 785 S.W.2d 339 (Tenn. 1990) (concluding that a dishonored premium check was not sufficient to renew coverage); *Ancro Fin. Co. v. Consumers USA Ins. Co.*, No. 02A01-9708-CV-00177, 1998 WL 684838 (Tenn. Ct. App. 1998) (holding that no policy was in effect where a premium check did not clear because of an alleged bank error that led to a stop-payment order).

²⁹² See 5 HOLMES' APPLEMAN ON INSURANCE, *supra* note 3, § 24.6 (discussing various approaches to dishonored check cases where payment of the first premium is a condition precedent).

²⁹³ *Id.* § 24.2.

²⁹⁴ *Id.* § 27.10 (discussing the legal effect of partial payments).

²⁹⁵ JERRY, *supra* note 82, § 71[b], at 612.

²⁹⁶ *Id.* There are cases where insurers or agents do file suit for payment of the premium rather than terminate the policy. See, e.g., *In re Miller Estate*, No. 6-78-630, 1980 WL 845 (Pa. Ct. Com. Pl. 1980) (holding that insurer may waive the right to terminate for nonpayment of premiums and instead keep a delinquent policy in force and collect the premiums owed).

²⁹⁷ 5 HOLMES' APPLEMAN ON INSURANCE, *supra* note 3, § 24.2 (quoting *Presentation Sisters v. Mut. Benefit Life Ins. Co.*, 189 N.W.2d 452, 458-59 (S.D. 1971)).

²⁹⁸ STEMPEL ON INSURANCE CONTRACTS, *supra* note 3, §§ 9.06[A], 9-145.

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the coverage for non-payment, remain rights that can be preserved in a bilateral construct. Even in a bilateral contract formed by a promise to provide insurance coverage and an exchange promise to pay a premium, the insurer will likely elect not to sue the policyholder for an unpaid premium, but instead will terminate for nonpayment and waive damages.²⁹⁹ An advantage of bilateral characterization is that it allows the policyholder to avoid the many dangerous formation issues that arise when a payment glitch jeopardizes coverage.

CONCLUSION

The traditional view of the insurance policy as a unilateral or reverse-unilateral contract is both largely incorrect and generally unhelpful in resolving the types of contract issues that surround the insurance relationship, creating several pernicious side effects. Characterizing insurance contracts as bilateral relationships is both appropriate and advantageous. First, in moving toward recognition of insurance as bilateral, courts can adhere to familiar, traditional canons of contract interpretation and abandon a presumption that seems without rationale. Second, a bilateral construction allows courts to avoid the rigidity of the law of conditions and instead more consistently and transparently employ the doctrines of substantial performance, mutuality of good faith and fair dealing, and anticipatory repudiation. These doctrines provide stability and fairness for the insurer-policyholder relationship. Finally, a bilateral construction pays less attention to the roles of premium payment and the usually unimportant issue of contract formation, and better recognizes the complexities, nuances, and overall objectives of the insurer-policyholder relationship.

²⁹⁹ Practically speaking, when it occurs with the first payment, the insurer has suffered little damage. On the other hand, when the insurer has provided coverage for a period of time, it may desire to collect the premium owed. “[I]nsurers often forgo efforts to collect where the premium due is relatively small, where it was at risk for a short period of time and incurred no claims, or where collection efforts would be bad public relations for the insurer.” *Id.* § 9-145 n.417.