

To speak effectively, plainly, and shortly, it becometh the gravity of the profession.

— Sir Edward Coke, 1600

## Simplification of Commercial Contracts in the Property/Casualty Insurance Industry

By A. Richard Meitin

The movement towards the simplification of legal documents has been active in the property/casualty\* insurance industry for a number of years. Most attorneys are aware of simplified consumer insurance policies (Homeowners and Private Passenger Automobile policies, for example.) Some commercial insurance policies have also been simplified; within a few years, simplified commercial contracts will predominate in the marketplace. This article will highlight the history and explain the rationale of the industry's commercial insurance forms simplification effort.

### I. The Development of Standardized\*\* Consumer Contracts

Standardized insurance contracts are designed to meet the typical coverage requirements of the insurance marketplace. Standardized contracts provide insurers with the basic tools to help them define, price, and deliver coverage economically.

\*Property/casualty insurance and life health insurance are the two main divisions of the industry. Property/casualty insurance includes a wide range of liability insurance (auto, professional liability, premises/operations, etc.) and a wide range of property insurance (fire, multi-peril, boiler and machinery, business interruption, etc.). Many policies contain combinations of property and liability coverages.

\*\*The word "standardized" in this context does not imply that the contracts necessarily meet any minimum legal "standard" of protection. Nor does it imply that the contracts necessarily constitute a mandatory "standard" which must be adhered to by insurers. It means simply that these basic contracts, or variations of them, are widely used in the industry.


The industry depends upon the pooling of industry-wide data to price its coverages accurately. However, it would be pointless to pool statistics without standardization of contracts. This is because standardized forms and the rates which apply to them are two sides of the same coin. It makes sense to pool industry-wide loss and pricing data in order to establish the correct price of a given coverage *only if* the forms providing that coverage are substantially the same throughout the industry.

The early development of a prototypical consumer contract, the Homeowners Policy, dates back to the 1950s. Due to the nature of insurance laws at that time, a homeowner needed to purchase several types of policies to obtain appropriate coverage for typical property and liability exposures. Through legislative action, the industry secured the necessary legal authorization to develop and market "package policies," in particular, the Homeowners Policy. The Homeowners Policy allows a consumer to purchase the proper "package" of liability and property insurance to cover typical consumer needs, all within one contract.

In the early 1970's, the insurance industry began a movement towards making consumer insurance policies more "readable." A good deal of attention was focused on the Homeowners Policy. This was largely because early

Homeowners Policies were not easy to understand. They contained too much technical language and "legalese." The policies were too long, contained tiny print and pages of varying lengths, and were otherwise confusing. Consumer advocates had begun to complain about the incomprehensibility of Homeowners and other standard form insurance contracts.

The industry began developing simplification techniques: Shortening the policy; ordering the policy in a logical sequence; making the policy "easier on the eyes" by enlarging the print and using colored captions and boldface; indexing the policy; making coverage more uniform throughout the country by eliminating state and regional differences; substituting simple words and phrases for difficult ones; using active, not passive voice; and making the tone of the policy a bit friendlier by using the personal pronouns "we" and "you" as substitutes for the more impersonal phrases "the company" and "the insured," for example.

Lawyers are used to reading long, tedious, technical documents. Unfortunately, the legal draftsmen of the standard forms did not seem to appreciate how difficult it was for laymen (and many lawyers) to wallow through the language the draftsmen had grown used to. For example, the "insuring agreement" 

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clause of a typical non-simplified standard policy used to read as follows:

**In consideration of the provisions and stipulations herein and added hereto and of the premium above specified or specified in the endorsement or endorsements made a part hereof, this company, for the term shown above from inception date shown above at noon time . . . , etc., etc.**

Although this is enough verbiage to stop most readers, this clause contains an additional 200 words!

In contrast, here is a new, simplified insuring agreement:

**We will provide the insurance described in this policy in return for the premium and compliance with all applicable provisions of this policy.**

It should be evident that even lawyers are better served by the new language.

Shortly after the industry's decision to move forward with the simplification of consumer policies, regulatory and legislative bodies began to take up the idea. In 1975, Pennsylvania implemented a regulation which mandated the simplification of consumer policies. In response, the industry accelerated development of the Homeowners contract and the Personal Auto Policy. (As of March, 1985, seventeen states have laws or regulations which mandate the simplification of consumer policies.)

## II. The Simplification of Commercial Contracts

While the simplification of commercial lines forms is fundamentally a voluntary effort of the industry, there were and are some rather compelling reasons for the industry to proceed as quickly as possible. For example, an exemption for commercial automobile policies (as opposed to private passenger automobile policies) had not been made in the mandatory simplification laws of several states. These commercial contracts, therefore, had to be simplified very early on.

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Even more important: certain simplification laws and regulations are threatening to draw *all* property and casualty lines of insurance within their ambit. The so-called "Policyholder Bill of Rights" in Florida initially gave the Commissioner the power to require simplification of both personal and commercial lines. The state of Kansas issued a bulletin urging companies to simplify all lines of insurance. Laws in Arizona and Minnesota gave the Commissioner the authority to extend the application of the simplification laws to all lines of insurance.

For the most part, the insurance industry has succeeded in forestalling legislative and regulatory mandates for the simplification of commercial lines of insurance. However, it is widely believed that this success is because the industry has convinced legislators and insurance commissioners that *voluntary* simplification efforts are proceeding in a business-like fashion.

But beyond the mere threat of legislative or regulatory mandates, it is widely held in the industry that the simplification of commercial lines, although expensive and time consuming, is worthwhile for a number of reasons:

- 1) The old, complicated language gave rise to thousands of court cases based on ambiguity or incomprehensibility of the contracts. It is very likely that the simplified contracts will reduce such litigation.
- 2) Insureds, agents, and even company personnel sometimes have difficulty in understanding certain commercial coverages. This is because many varied coverage changes have been "tacked on" over several decades in different (and often confusing) ways: separate insuring agreements, modifications of definitions, exceptions to exclusions, etc. This welter of technical language is being reduced by the industry simplification effort.
- 3) Contract provisions are in need of modernization. The simplification effort presents the opportunity to provide up-to-date coverages and to eliminate coverages which are no longer desired.
- 4) The simplification effort presents the opportunity to establish additional commonality in format, style, printing, typesize, etc.
- 5) The insurance industry has been subject to considerable well-deserved criticism regarding the incomprehensibility

of its products. Too often, the industry has been perceived as being indifferent to the needs of insurance purchasers. Other industries which deal with both personal and commercial accounts are now providing simplified documents for both. The simplification effort is a chance for the industry to polish its tarnished image, and to assist insurance purchasers in better understanding their own insurance needs and the products which they are purchasing.

6) Several major insurance companies have introduced their own independent simplified commercial policy programs. Certainly, companies which have not yet simplified their commercial forms do not want to put themselves at a competitive disadvantage by not offering simplified programs.

7) Simplification and modernization of the contracts has accomplished a substantial reduction in the number of forms which must be printed and distributed.

8) The simplification program has also resulted in the parallel simplification of commercial lines rating procedures. Thus, price quotes may be obtained more readily. Many of the rating rules and procedures for commercial lines were developed before the advent of package policies and automated policy systems; the former procedures were often slow and cumbersome. But the computation of an accurate quotation in a minimum amount of time is critical in today's competitive sales environment.

For these reasons the industry will, no doubt, continue its efforts to simplify contracts for commercial lines of insurance. It is expected that the balance of this work will be concluded by 1987. ■

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