COMMENT

THE ILLUSORY COVERAGE DOCTRINE: A CRITICAL REVIEW

IAN WEISS†

INTRODUCTION

How should a court handle a liability insurance policy sold to a tavern that purports to cover general commercial liability, yet contains an exclusion for liability "arising out of or in connection with the manufacturing, selling, distributing, serving or furnishing of any alcoholic beverages"?[1] How about a

† Executive Editor, Volume 166, *University of Pennsylvania Law Review*. J.D. Candidate, 2018, University of Pennsylvania Law School; B.A., 2012, Bard College. My deepest gratitude to Executive Editor Alyssa Lattner, Comments Editor Max Linder, and all of this Comment's other editors for their meticulous work and helpful input. I am also tremendously grateful to Professor Tom Baker for inspiring my enthusiasm for insurance law, and for so graciously showing me the ropes in the field.

1 Monticello Ins. Co. v. Mike's Speedway Lounge, Inc., 949 F. Supp. 694, 695 (S.D. Ind. 1996).

liability insurance policy sold to DISH Network that contains an exclusion for liability "arising out of the ownership, operation or use of any satellite"?[2] Or how about one that purports to cover a business for its liability arising out of "discrimination," yet contains exclusions for discrimination that either violates a statute, is done knowingly or intentionally, is directed towards prospective, current, or wrongfully terminated employees, or is "committed on the basis of race, creed, color, sex, age or national origin"?[3]

In all three of those cases, the policyholders argued that it would be unfair for the court to enforce the exclusions[4] in their policies as they were written. Those exclusions, the policyholders argued, wiped out so much of the coverage that otherwise would have existed under the policies' insuring clauses[5] that the coverage would be practically worthless.[6] Thus, the courts were asked to analyze those policies under the doctrine known as the Illusory Coverage Doctrine (ICD). The ICD is implicated when an insurance policy is written in such a way that could give the policyholder the "illusion" that the policy covers risks that are not actually covered. The ICD is somewhat obscure, and no precise formulation of the doctrine has yet achieved predominance among American jurisdictions.

This Comment will discuss the status of the ICD in American insurance law, especially liability insurance law, and will also offer my own views as to how the doctrine can be best understood and refined. I will first argue that, while some courts have conceived of the issue of illusory coverage as an interpretive one related to *contra proferentum*, or as matter of "public policy," the ICD is best understood instead as a doctrine of enforceability whose function is to protect policyholders from procedurally unconscionable insurance policies.[7]

I will then address the questions of what standards are and ought to be used to determine whether an insurance policy "triggers" the ICD. In other

2 Dish Network Corp. v. Arch Specialty Ins. Co., 989 F. Supp. 2d 1137, 1153-54 (D. Colo. 2013), *aff'd sub nom.* Dish Network Corp. v. Arrowood Indem. Co., 772 F.3d 856 (10th Cir. 2014).

3 Jostens, Inc. v. Northfield Ins. Co., 527 N.W.2d 116, 117 (Minn. Ct. App. 1995).

4 "An 'exclusion' is a term in an insurance policy that identifies a category of claims that is not covered by the policy." RESTATEMENT OF THE LAW OF LIAB. INS. § 32 (AM. LAW INST., Proposed Final Draft 2017).

5 "An 'insuring clause' is a term in a liability insurance policy that grants insurance coverage." *Id.* § 31. I will occasionally use the term "coverage provision" to refer to the same thing.

6 In *Mike's Speedway*, the court agreed with the policyholder that the "absolute liquor" exclusion rendered the tavern's general commercial liability insurance illusory. 949 F. Supp. at 702. Likewise, the court in *DISH Network* found that the "Satellite Exclusion" rendered DISH Network's coverage illusory, and thus that the exclusion was unenforceable. 989 F. Supp. 2d at 1153-54. In *Jostens*, the court did not disagree with the policyholder that its policy's exclusions "effectively swallow the general grant of discrimination coverage," but found that those exclusions were nonetheless enforceable because the policy still provided real coverage for other kinds of liability. 527 N.W.2d at 118-19.

7 Throughout this Comment, I will use the term "policyholders" to refer to all insureds—people who are insured by an insurance policy. This is simply so that the reader does not mix up "insurers" and "insureds."

words, how can we tell if an insurance policy features illusory coverage? My discussion of this issue will rely on a metaphor of shadows cast by exclusions upon the coverage that would otherwise exist. The shadow metaphor allows us to clearly visualize two distinct factors that could determine whether the ICD is triggered. The first, which I will call "scope," corresponds to the *size* of the shadow: over *how much* insurance coverage must the exclusion's shadow extend before the ICD is triggered? The second, which I will call "degree," corresponds to the *darkness* of the shadow: does the coverage that falls beneath the exclusion's shadow disappear completely, or is there still some possibility that the policyholder will be able to use that coverage?

To clarify, consider a simple hypothetical liability insurance policy sold to the owner of private campgrounds. The policy has two insuring clauses: a Weather Clause granting coverage for weather-related injuries; and a Wildlife Clause granting coverage for wildlife-related injuries. Suppose further that the policy has a Lightning Exclusion removing coverage for injuries caused by lightning. The "scope" of the Lightning Exclusion would extend only to the coverage granted by the Weather Clause, not the Wildlife Clause. The "degree" to which the exclusion would eliminate the Weather Clause's coverage would be rather low, since lightning comprises only a small proportion of weather-related risks. Thus, we should envision the Lightning Exclusion casting a faint shadow upon the coverage granted by the Weather Clause.

Now suppose instead that the policy had a Serious Injury Exclusion, removing coverage for injuries from which the victim does not recover within twenty days. The scope of this exclusion would extend to the coverage granted by the Weather Clause and the Wildlife clause, since victims of both weather- and wildlife-related injuries can take longer than twenty days to recover. The degree to which the exclusion would eliminate coverage would be relatively high, since most injuries that generate lawsuits are too serious to recover from within twenty days. Thus, the Serious Injury Exclusion would cast a dark shadow over the coverage granted by both of the policy's insuring clauses.

With respect to scope, I will conclude that no scope should be construed as being so narrow as to preclude the ICD from being triggered. In other words, as long as the shadow cast by an exclusion is dark enough, the ICD should be triggered no matter how narrow the shadow is. Once the court finds any coverage shrouded in a shadow dark enough to trigger the ICD, the court should not proceed to consider how much other coverage is left beyond the shadow's reach.

With respect to degree, I will conclude that an exclusion should not need to completely eliminate the possibility that a policyholder could benefit from the overshadowed coverage in order to trigger the ICD. Instead, the ICD should be triggered if the coverage that remains available "is extremely minimal and affords no realistic protection" even if "there might be some small circumstance where coverage could arguably exist."[8] In other words, the shadow must be very dark, but not necessarily pitch black.

Returning to our campgrounds hypothetical, on my view, the coverage granted by the policy's Wildlife Clause could be rendered illusory by a Terrestrial Animal Exclusion that removes coverage for injuries related to animals that live on land. If virtually all of the dangerous wildlife around the campgrounds are terrestrial animals—bees, bears, and so on—such an exclusion could make the coverage for wildlife-related injuries effectively useless to the policyholder. If the exclusion limits the Wildlife Clause's coverage to only the most far-fetched of scenarios—like an aquatic crab somehow taking a camper's eye out—it makes the coverage illusory.

Once the ICD is triggered—that is, once the court has found a policy to contain illusory coverage—the next question is what the court should do about it. I will conclude that the right remedy for illusory coverage is to reform the offending exclusions—and *only* the offending exclusions—to conform to the policyholder's reasonable expectations regarding their coverage. Thus, if an insurer denies coverage on the sole basis of an exclusion or set of exclusions that render the coverage illusory, the court should require the insurer to provide coverage if and only if the policyholder had a reasonable expectation that the policy made such coverage available.

After explaining how the ICD works, I will discuss its relationship to the other doctrines that could be implicated by similar fact patterns—namely, *contra proferentum* and the doctrine of reasonable expectations—and explain why the ICD strikes a better balance than those alternative doctrines between the legitimate interests of policyholders and insurers.

I. WHAT THE DOCTRINE IS AND WHY IT EXISTS

A. *Enforceability, not Interpretation*

Several courts have incorporated the principle that insurance policies should not contain illusory coverage into their *interpretations* of policies' terms. The Superior Court of Delaware did this in a case in which the manufacturer of respiratory equipment sought coverage for its liability arising out of injuries that miners suffered when the equipment allegedly failed, causing the miners to inhale coal dust.[9] One of the general liability policies under which the manufacturer sought coverage contained an exclusion barring coverage for injuries arising out of the "'emission, discharge, seepage, release [or] escape'

8 Martinez v. Idaho Ctys. Reciprocal Mgmt. Program, 999 P.2d 902, 907 (Idaho 2000).

9 Mine Safety Appliances Co. v. AIU Ins. Co., No. CV N10C-07-241 MMJ, 2016 WL 498848, at *3-4 (Del. Super. Ct. Jan. 22, 2016).

of any 'pollutant.'"[10] The issue, therefore, was whether the coal dust floating around in coal mines as a result of the mining was a "pollutant."[11] The court compared the coal dust to "radiation used in medical x-rays" and "chlorine bleach used for cleaning" and concluded that such coal dust was not a pollutant because it was "in a place where [it] was reasonably expected to be" and the miners' exposure to it "was a necessary part of the job."[12]

However, perhaps sensing that such reasoning was vulnerable to criticism, the court added the following:

> Any other interpretation would render the coverage illusory. To permit the Insurers to deny coverage under these circumstances would mean that there could never be coverage for any alleged failure or defect in the respiratory safety equipment manufactured by [the policyholder]. The Insurers could not have been surprised by the fact that the [policyholder], Mine Safety Appliances Company, manufactured safety appliances."[13]

Mine Safety seemed to treat the fact that a certain interpretation of an exclusion's language would render coverage illusory as a reason to reject that interpretation. There is nothing wrong with such an approach. Indeed, to the extent that contract interpretation is about ascertaining the nature of the bargain the parties intended to make,[14] it makes sense to be somewhat suspicious of an illusory coverage–creating interpretation of an exclusion. This is especially so where, as in *Mine Safety*, such an interpretation would defeat a major purpose for purchasing the policy. Just as constitutional interpretation may presume that the founders did not intend to enact a suicide pact, the interpretation of liability insurance policies may, at least to some extent, presume that policyholders do not intend to throw their money down the drain on useless insurance policies and leave themselves exposed to risks that they cannot afford to bear (and that state insurance regulators do not intend to allow such ineffective and overpriced policies to remain on the market).

Note, however, that there is a difference between, on the one hand, disfavoring interpretations of *ambiguous* exclusions that would render coverage illusory, and, on the other hand, refusing to enforce *unambiguous* exclusions as they are written on the grounds that they would render coverage

10 *Id.* at *3.

11 *Id.*

12 *Id.* at *3-4.

13 *Id.* at *4 (footnote omitted).

14 *See* 11 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 32:2 (4th ed. 1993) ("Consistent with the notion that a contract represents the parties' private agreement as to their legal relationship, liabilities and rights, the primary purpose and function of the court in interpreting a contract is to ascertain and give effect to the parties' intention.") (footnotes omitted).

illusory. In some cases, courts have said they were doing the former, when they were actually doing the latter.[15]

The Supreme Court of Indiana did this in *American States Insurance Co. v. Kiger*, in which the owner of a Sunoco station sought coverage for his liability arising out of the leakage of gasoline from one of the station's underground tanks.[16] The owner had a comprehensive liability insurance policy—described by the court as a "garage policy"[17]—which contained an exclusion for liability "arising out of the . . . escape of 'pollutants.'"[18] The policy further stated that "Pollutants means any solid, liquid, gaseous, or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals, and waste."[19]

As a matter of interpretation, the gasoline obviously was a "chemical" and its leakage into the ground obviously constituted the "escape" of a "pollutant." Yet, the court presented a rather strained argument to the contrary.[20] The court began by stating that the policy's definition of "pollutants" "[c]learly . . . cannot be read literally as it would negate virtually all coverage. For example, if a visitor slips on a grease spill then, since grease is a 'chemical,' there would be no insurance coverage. Accordingly, this clause requires interpretation."[21] While it may be true that the exclusion would require interpretation as applied to a grease spill, that does not mean it requires interpretation as applied to the leakage of large amounts of gasoline into the ground, which is exactly the kind of occurrence that the pollution exclusion's language calls to mind.

Yet, the court proceeded to declare that since "the term 'pollutant' does not obviously include gasoline and, accordingly, is ambiguous, we . . . must construe the language against the insurer who drafted it."[22] It held that the "rule of construing exclusions strictly against the insurer and in favor of coverage . . . requires that coverage for the gasoline contamination which occurred be available" under the policy.[23]

---

15 *See, e.g.*, St. Mary's Area Water Auth. v. St. Paul Fire & Marine Ins. Co., 464 F. Supp. 2d 397, 411 (M.D. Pa. 2006), *order vacated on reconsideration sub nom.* St. Mary's Area Water Auth. v. St. Paul Fire & Marine Ins. Co., 472 F. Supp. 2d 630 (M.D. Pa. 2007) ("The rationale [for applying the ICD] often is that the conflict between the coverage language and the exclusion language creates an ambiguity that must be resolved in favor of the insured."); Isdoll v. Scottsdale Ins. Co., 466 S.E.2d 48, 50 (Ga. Ct. App. 1995) (reasoning that there was a "genuine ambiguity" in a policy because it's express coverage for assault was rendered illusory by a provision that limited coverage to the performance of law enforcement duties, since "[i]t could always be argued that assault . . . do[es] not arise out of the performance of one's duties").

16 662 N.E.2d 945, 946-47 (Ind. 1996).

17 *Id.* at 948-49.

18 *Id.* at 948.

19 *Id.*

20 *Id.* at 948-49.

21 *Id.* at 948.

22 *Id.* at 949.

23 *Id.*

Notwithstanding the court's strained interpretative analysis, it is clear from other lines in the opinion, which the court presented as if they were dicta, that the real reason behind the court's holding was that it would be terribly unfair to the owner of a *gasoline station* if his liability insurance policy—a "garage policy," which people generally expect to be well suited to such businesses' needs—turned out not to cover liability related to gasoline leaks. "[T]hat an insurance company would sell a 'garage policy' to a gas station when that policy specifically excluded the major source of potential liability," the court stated, "is, to say the least, strange."[24] The court later noted that it was "particularly troubled" by the interpretation of the policy that would mean that the policyholder "was sold a policy that provided no coverage for a large segment of the gas station's business operations."[25] Giving the game away even more clearly, the court declared that "[i]f a garage policy is intended to exclude coverage for damage caused by the leakage of gasoline, the language of the contract must be explicit."[26]

As far as contract interpretation is concerned, it should make no difference whether this exclusion for gasoline leaks was explicitly declared or, as was the case, unambiguously implied by the broader pollution exclusion. Rather, the difference between stating something explicitly and implying something unambiguously is relevant only to the question of procedural unconscionability. Thus, it is apparent that the court's holding was not really based on the *contra proferentum* cannon. Instead, its holding reflected a refusal to enforce the exclusion as it was written because the exclusion would render coverage that the policyholder reasonably expected to exist illusory.

Courts should distinguish between the task of interpreting policies' ambiguous exclusions and the task of determining whether or not an unambiguous exclusion should be enforced as written.[27] It is in the enforceability context, not the interpretation context, that the ICD stands as its own doctrine. Several courts have expressly recognized the ICD as a basis upon which to grant coverage that would be barred under an exclusion if it were enforced as written.[28] That is how courts should explain their holdings

24 *Id.* at 948.

25 *Id.* at 949.

26 *Id.*

27 For a good example of this distinction being drawn, see Danis v. Great Am. Ins. Co., 823 N.E.2d 59, 74 (Ohio Ct. App. 2004), in which the court stated "while the [policyholders] claim that the provision is ambiguous, what they really mean is that if the pollution exclusion is enforced as it reads, the policy will be rendered illusory."

28 *See, e.g.*, Nautilus Ins. Co. v. Sunset Strip, Inc., No. 1:14-01273, 2015 WL 4545876, at *6 (S.D. Ind. July 28, 2015) ("If the policy is illusory, a court will not enforce the policy as written; instead, the court must enforce the policy 'to satisfy the reasonable expectations of the insured.'") (citations omitted); Great N. Ins. Co. v. Greenwich Ins. Co., No. 05-635, 2008 WL 2048354, at *4 (W.D. Pa. May 12, 2008) (interpreting Pennsylvania law to hold that "if an exclusion provision would

in cases like *Kiger*, where they effectively reform unambiguous language to protect policyholders from the unfairness of illusory coverage.

B. *Procedural Unconscionability, not Public Policy*

Having established that the ICD is a doctrine of enforceability rather than interpretation, the next issue to discuss is what justifies the doctrine's use. Some courts have dubiously characterized illusory coverage as a violation of public policy.[29] Usually, however, the only "public policy" that can appropriately serve to invalidate the terms of an insurance contract is that which derives from federal or state constitutions, legislation, or the common law.[30] Thus, for instance, an exclusion in an auto liability insurance policy that renders statutorily mandated coverage illusory may violate public policy. Such an exclusion would bring about a situation that the statute was enacted to prevent—namely, one in which victims of car accidents can have difficulty collecting compensation from negligent,

effectively preclude coverage for all risks reasonably anticipated by the parties under a particular coverage provision (i.e., an illusory coverage provision), the coverage provision should be enforced in a way that would protect the reasonable expectations of the insured"); Jostens, Inc. v. Northfield Ins. Co., 527 N.W.2d 116, 118 (Minn. Ct. App. 1995) ("The illusory coverage doctrine . . . operates to qualify the general rule that courts will enforce an insurance contract as written."); Gillund v. Meridian Mut. Ins. Co., 778 N.W.2d 662, 669 (Wis. Ct. App. 2009) ("Where coverage is illusory, we have concluded that the contract should be reformed so that it comports with the insured's reasonable expectations.").

29 *See, e.g.*, Pompa v. Am. Family Mut. Ins. Co., 520 F.3d 1139, 1145 (10th Cir. 2008) (stating that "exclusions that render coverage illusory . . . . violate public policy" in Colorado) (citations omitted); Monticello Ins. Co. v. Mike's Speedway Lounge, Inc., 949 F. Supp. 694, 699 (S.D. Ind. 1996) ("Indiana courts have . . . held that insurance policies providing illusory coverage violate public policy."); Roylance v. John Alden Life Ins. Co., No. CV 2006 9218, 2008 WL 4202018, at *2 (Idaho Dist. Ct. Aug. 22, 2008) ("When a policy provides only an illusion of coverage for its premiums, the policy will be considered void for violating public policy."); Nat'l Union Fire Ins. Co. of Pittsburgh v. Glenview Park Dist., 632 N.E.2d 1039, 1046 (Ill. 1994) (Bilandic, C.J., dissenting) (arguing that because an "exclusion deceptively affects the general liability risks that the endorsement purports to assume, the . . . exclusion violates public policy and should not be enforced").

30 One prominent insurance law treatise states that public policy comes only from "legislation (state and federal statutes) and constitutions," "administrative regulations especially including the regulations promulgated by state departments of insurance," and "judicial opinions enforcing the statutes and regulations and their public policy foundation though judicial construction of the statutes and regulations." 15-114 APPLEMAN ON INSURANCE LAW & PRACTICE ARCHIVE § 114.2 (2d ed. 2011); *see also* Zeigler v. Ill. Tr. & Sav. Bank, 91 N.E. 1041, 1045-46 (Ill. 1910) ("The public policy of the state . . . is to be found in its Constitution and its statutes, and, when cases arise concerning matters upon which they are silent, then in its judicial decisions . . . . Courts will not look to other sources to determine the public policy of a state."); Heller v. Pa. League of Cities & Municipalities, 32 A.3d 1213, 1220 (Pa. 2011) ("Public policy is to be ascertained by reference to the laws and legal precedents and not from general considerations of supposed public interest." (quoting Burstein v. Prudential Prop. & Cas. Ins. Co., 809 A.2d 204, 207 (Pa. 2002)); State Farm Gen. Ins. Co. v. Emerson, 687 P.2d 1139, 1142 (Wash. 1984) ("[W]e have been hesitant to invoke public policy to limit or avoid express contract terms absent legislative action." (citations omitted)).

judgment-proof drivers.[31] In fact, many courts have refused to enforce exclusions in auto liability insurance policies merely because they "narrow[] or restrict[] statutorily-mandated coverage."[32]

But no court has suggested that the ICD only applies to policies whose exclusions eviscerate the kind of coverage that is mandatory under legislation or the common law. In fact, such a limitation would mean that the ICD is completely swallowed by the broader public policy rule against exclusions that merely narrow or restrict such mandatory coverage.[33] Thus, the only way to justify the ICD as a matter of public policy would be to point to statutes that specifically seek to prohibit policies that contain illusory coverage (which, if they exist at all, are not common) or to argue that the rule against illusory coverage is clearly enshrined in the common law (which, at least as of now, would be hard to do).

Another problem with rooting the ICD in public policy is that courts tend to conceive of the doctrine as a means of protecting policyholders from getting ripped off by their insurers, rather than protecting third parties from insurance policies' negative externalities.[34] As Judge Richard Posner has explained, "The basic difference is that between a contract in which the parties combine to harm

31 A situation similar to this arose in *Martinez v. Idaho Ctys. Reciprocal Mgmt. Program*, 999 P.2d 902 (Idaho 2000). There, the Supreme Court of Idaho found that an exclusion that rendered underinsured motorist coverage illusory also violated public policy because it deprived the policyholder of coverage that, pursuant to a state statute, could only be excluded from an auto insurance policy if the policyholder affirmatively rejects it in writing. *Id.* at 906-08. The court found that the underinsured motorist coverage must be available to the policyholder notwithstanding the exclusion, both because holding the policy void would defeat the purpose of the statute and because the insurer "is estopped from denying coverage because of the illusion of coverage it has created." *Id.* at 908.

32 Marcus v. Hanover Ins. Co., 740 So. 2d 603, 606 (La. 1999) (citing Block v. Reliance Ins. Co., 433 So. 2d 1040, 1044 (La. 1983)). *Marcus* held a "business use exclusion" in an auto liability insurance policy to be unenforceable because it undermined a statutory scheme that was "intended to attach financial protection to the vehicle regardless of the purpose for which the vehicle is being operated." *Id.* at 608. Most jurisdictions have also held that auto liability insurance policies' "family member exclusions"—which remove coverage for claims that arise when policyholders injure their own family members—are also unenforceable because they contravene the purpose of statutes that make auto insurance mandatory. *See* Nat'l Cty. Mut. Fire Ins. Co. v. Johnson, 879 S.W.2d 1, 3 (Tex. 1993) ("The majority of jurisdictions with mandatory insurance laws hold family member exclusions invalid because they are contrary to public policy.") (citing several cases); *see also* 15-114 APPLEMAN ON INSURANCE LAW & PRACTICE ARCHIVE § 114.2 (2d ed. 2011) ("An insurance contract term is not void as against public policy simply because the term narrows circumstances under which the insurance coverage applies, but only *if the term directly limits statutorily mandated benefits*." (emphasis added)).

33 See *supra* note 29 for cases applying this broader public policy rule.

34 *See, e.g.*, Truck Ins. Exch. v. Ashland Oil, Inc., 951 F.2d 787, 790 (7th Cir. 1992) (explaining that illusory coverage contracts, while they may not violate public policy, can be exploitative of a party); Buck v. Am. Family Mut. Ins. Co., 921 S.W.2d 96, 99 (Mo. Ct. App. 1996) (characterizing an interpretation of a policy that would create illusory coverage as one that would "take away on the one hand what it purports to offer with the other"); Badger Mut. Ins. Co. v. Schmitz, 647 N.W.2d 223, 227, 238 (Wis. 2002) (affirming a lower court's finding that an insurance policy was "illusory and therefore unenforceable" in part because the policies' language sent "several false signals" and violated "the insured's reasonable expectation of coverage").

others . . . and a contract in which one party exploits the other. The former is the domain of the public policy defense, the latter of fraud, incapacity, and related defenses."[35] Accordingly, Judge Posner concluded that "[c]ontracts that are 'illusory' in the sense of hopelessly or deceptively one-sided fail, if at all, on . . . grounds[] such as fraud, unconscionability, or undue influence."[36]

Of course, third parties may be harmed by the sale of insurance policies, especially liability insurance policies, that contain illusory coverage. Most obviously, if an exclusion renders certain coverage illusory, thus eliminating the insurer's obligation to indemnify its policyholders for certain third-party tort claims, the injured victims who bring those claims may be unable to collect compensation for their injuries. However, the same could be said of *all* exclusions, whether they render coverage illusory or not, since exclusions, by definition, reduce the amount of coverage available under a policy.[37] Thus, courts must maintain that, while exclusions in liability insurance policies make it more difficult for injured tort victims to receive compensation, they are not *ipso facto* contrary to public policy.[38]

Since the most salient purpose of the ICD is to protect policyholders who unwittingly purchase insurance policies that provide much less coverage than they expected, the ICD is more related to procedural unconscionability[39] and the doctrine of reasonable expectations than it is to public policy. The principle that came to be known as the doctrine of reasonable expectations was articulated by Professor Robert E. Keeton in a 1970 article as follows: "The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations."[40] Since it relies on a distinction between features of insurance policies that are readily apparent to the policyholder and those that would go

---

35 *See Ashland Oil*, 951 F.2d at 790.

36 *Id.*

37 *See* RESTATEMENT OF THE LAW OF LIAB. INS. § 32(1) (AM. LAW INST., Proposed Final Draft 2017).

38 *See* Kelly v. Figueiredo, 610 A.2d 1296, 1299-1301 (Conn. 1992) (rejecting the argument that an exclusion in a liability insurance policy violated "the public policy goal of assuring that the innocent victims of injuries caused by intoxicated persons be able to recover compensation for those injuries" because they found no such public policy embodied in a statute (internal quotation marks omitted)); Mendoza v. Rivera-Chavez, 999 P.2d 29, 36 (Wash. 2000) (stating in an analysis of the enforceability of a liability insurance policy's exclusion that "[i]t is well established that insurance companies may limit their liability unless the limitation is contrary to public policy" (citation omitted)).

39 "Procedural unconscionability" refers to unfairness in the formation process that deprives a party of a "meaningful choice about whether and how to enter into the transaction" by, for example, burying terms in "fine print or legal 'gobbledygook.'" 8 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 18:10 (4th ed. 1993).

40 Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 967 (1970).

unnoticed without "painstaking study" of the policy's language, the doctrine of reasonable expectations can be understood as a protection against certain procedurally unconscionable terms. As discussed in Part III, the ICD can provide narrower and more predictable rules for determining whether an exclusion is so procedurally unconscionable as to render it unenforceable.

II. How the Doctrine Works

This Part will discuss some variations in how different courts have formulated and applied the ICD, and will offer my own views on which versions should prevail. Sections A and B will discuss the scope and degree, respectively, of an exclusion's impact on coverage that is necessary in order to find that the exclusion renders coverage illusory, thus "triggering" the ICD. Section C will discuss what the courts should do to protect policyholders after they have found that a policy contains illusory coverage.

A. *Scope in the Trigger Test: How Big Must the Shadow Be?*

The best position on the scope issue was displayed by a district court interpreting Pennsylvania law in *Great Northern Insurance Co. v. Greenwich Insurance Co.*[41] *Great Northern* involved a policy with an insuring clause purporting to offer coverage for several kinds of losses, including "property damage . . . arising out of blowout or cratering."[42] "[B]lowout" and "cratering" were both defined in the policy.[43] "[B]lowout" was defined as "an uncontrollable flow of gas, oil, drilling mud, water, well fluids, well materials, or a combination of any of them, from the wellhead or borehole, into the atmosphere, surface land or surface water or subterranean strata."[44] After the policyholder suffered property damage from a blowout, it sought coverage under the policy.[45] The insurer attempted to deny coverage under the policy's "Pollution Exclusion," which provided that "[t]his insurance does not apply [to] property damage [caused by] alleged or threatened discharge, dispersal, seepage, migration, release or escape of pollutants at any time."[46] The policy defined "pollutants" as "any solid, liquid, gaseous, or thermal irritant or contaminant including smoke, vapor, soot, fumes, acid, alkalis, chemicals and waste."[47]

---

41 No. 05-635, 2008 WL 2048354, at *5 (W.D. Pa. May 12, 2008).

42 *Id.*

43 *Id.*

44 *Id.*

45 *Id.* at *1.

46 *Id.* Technically, the insurer did not try to completely "deny" coverage, but rather tried to use the exclusion to reduce the coverage's limit from $1,000,000 to $100,000. *Id.* at *2. For these purposes, however, this would be the same as denying coverage.

47 *Id*. at *2.

The policyholder argued that the pollution exclusion rendered the policy's coverage of blowouts illusory, since a "blowout, by definition, is a pollution event."[48] The insurer responded by pointing out that, even if the pollution exclusion eviscerated coverage for blowouts, it left coverage for cratering intact.[49]

The court held that "[t]he question [of whether the ICD is triggered] is whether a *particular* coverage provision is swallowed-up by an exclusion, not whether the policy *as a whole* provides some degree of coverage despite the existence of an exclusion."[50] Under this formulation, the exclusion in question does not need to cast a shadow over *all* of a policy's coverage in order to trigger the ICD, but rather only over any single "coverage provision." The court went on to clarify that a "coverage provision" is any single kind of risk that an insuring clause describes as being covered:

> The policy language separates the words "blowout" and "cratering" with the disjunctive "or," thereby providing coverage for two alternative risks. Greenwich's insured payed a premium surcharge . . . for blowout *or* cratering coverage, and Greenwich cannot reasonably argue that the [pollution exclusion] does not render *blowout* coverage . . . illusory simply because the [coverage] is nevertheless available to cover *cratering*.[51]

This tells us that the text purporting to cover "property damage . . . arising out of blowout or cratering"[52] is actually *two* coverage provisions: one covering the risk of blowouts and another covering the risk of cratering.

Under the court's approach, there is no unit of coverage within a policy that is too small for the ICD to protect. If an exclusion casts a shadow on *any single risk* that any insuring clause purports to cover, the ICD can be triggered (as long as the shadow is dark enough). The court found that there was a genuine issue of material fact as to whether the shadow cast by the pollution exclusion upon the blowout coverage was dark enough to trigger the ICD.[53]

If the illusory coverage argument in *Great Northern* had been governed by Minnesota law, however, it almost certainly would have been defeated at summary judgment. This is because Minnesota's courts have adopted the view that the ICD should only be triggered if *all of the coverage to which a portion of the premium was specifically allocated* is rendered illusory.[54] Under the Minnesota rule,

48 *Id*. at *6.

49 *Id.* at *5.

50 *Id.* (emphases added).

51 *Id.* at *5 n.3.

52 *Id.* at *5.

53 *Id.* at *7.

54 *See* Jostens, Inc. v. Northfield Ins. Co., 527 N.W.2d 116, 119 (Minn. Ct. App. 1995) ("We believe that the doctrine of illusory coverage is best applied . . . where part of the premium is specifically allocated to a particular type or period of coverage and that coverage turns out to be functionally nonexistent."); *accord* United Fire & Cas. Co. v. Fid. Title Ins. Co., 258 F.3d 714, 719

even if the pollution exclusion in *Great Northern* had completely eliminated coverage for *blowouts*, the ICD would not have been triggered so long as it left the coverage for *cratering* intact, since the policyholder only paid one surcharge that was allocated to both blowout coverage and cratering coverage.[55] Thus, under that rule, the ICD would have only been triggered if there was a surcharge allocated exclusively to the blowout coverage.

An argument in favor of an approach like Minnesota's—in which a shadow cast upon some coverage can fail to trigger the ICD because there is enough other coverage outside the shadow's reach—was offered by a district court interpreting Indiana law in *Nautilus Insurance Co. v. Sunset Strip, Inc.*[56] The court criticized the *Great Northern* approach—in which a shadow cast upon some coverage can trigger the ICD irrespective of how much other coverage remains outside the shadow's reach—on grounds that it

> proves too much, as accepting this argument would allow *any* insured who has been denied coverage to prevail on an illusory coverage claim by drawing arbitrary lines in the insured's policy. The insured, that is, could always argue that the relevant claims in the underlying case only pertain to a specific coverage provision, such that the Court should only analyze whether that specific provision is illusory and ignore any analysis pertaining to other provisions. By hypothesis, however, the insurer would have already determined that the claim at issue was *not* covered by the specific provision, such that the Court would necessarily conclude that coverage would not exist. This would automatically render that provision illusory, and . . . would thus effectively allow *any* insured to negate the effect of *any* coverage exclusion simply by ignoring the context of that exclusion in the insurance policy as a whole.[57]

This argument overlooks the difference between two separate issues: (1) whether coverage for the specific occurrence that happened is barred by an exclusion; and (2) whether so many *other* occurrences, with different characteristics than the one that actually happened, would *also* be barred that the coverage must be rendered illusory. Just because the shadow cast upon a particular coverage provision is dark enough to eliminate coverage for the

(8th Cir. 2001); *see also* Great W. Cas. Co. v. Gen. Cas. Co. of Wis., 734 F. Supp. 2d 718, 738-39 (D. Minn. 2010) (finding the ICD to not be triggered because there was no specifically priced portion of the policy that was useless to the policyholder); Kabanuk Diversified Invs., Inc. v. Credit Gen. Ins. Co., 553 N.W.2d 65, 73 (Minn. Ct. App. 1996) (rejecting a policyholder's argument that it deserved certain coverage under the ICD because "[n]o evidence was presented that any premium was specifically allocated to [the] coverage" the policyholder sought).

55 *Great N.*, 2008 WL 2048354, at *5 n.3.

56 No. 1:14-01273, 2015 WL 4545876, at *17 (S.D. Ind. July 28, 2015).

57 *Id.* (quotation marks and alterations omitted).

actual occurrence that happened does *not* mean the shadow is dark enough to render that provision's coverage illusory.

In *Great Northern*, for instance, it was undisputed that the particular blowout for which the policyholder sought coverage constituted pollution, and thus would be barred from coverage if the pollution exclusion were enforced as written.[58] But that did not mean that the blowout coverage was illusory. Rather, the policyholder had to show that *almost all possible* blowouts that could occur would also constitute pollution and be barred from coverage.[59] Thus, it is not the case that, if the only coverage provisions that are relevant to the ICD's triggering test are those that fall under the exclusion's shadow, then a finding that coverage for a particular occurrence is barred by an exclusion would automatically trigger the ICD.[60]

Moreover, the *Nautilus* court's concern that policyholders could use the ICD to gain undeserved coverage by "drawing arbitrary lines"[61] in the policy gets the problem backwards. The real problem of arbitrary line-drawing is the one that exists under approaches like Minnesota's, where the ICD's triggering test looks beyond the exclusion's shadow to see how much other coverage remains intact. If the test required that the shadow extend to all of the coverage within a discretely priced piece of the policy—as Minnesota's test does—then an insurer could avoid triggering the ICD by manipulating where it places the lines between those discretely priced pieces.

For example, suppose that the insurer from *Great Northern* had started out with a policy that allocated, say, $1000 of the premium to blowout coverage and another $1000 of the premium to cratering coverage. Now suppose that a court found that the pollution exclusion rendered the blowout coverage, but not the cratering coverage, illusory. If the Minnesota rule applied, the insurer would be able to get around the ICD in the future by simply erasing the line between blowout coverage and cratering coverage and allocating $2000 of the premium to coverage for both blowouts and cratering. Why should that be? Is a person who pays $1000 in exchange only for blowout coverage entitled to more protection than a person who pays $2000 in exchange for both blowout coverage

58 *Great N.*, 2008 WL 2048354, at *7.

59 The court ruled that the factual issue was whether non-pollution property damage resulting from a blowout can fairly be said to constitute a "reasonably expected set of circumstances." *Id.* (internal quotation marks omitted) (quoting St. Mary's Water Auth. v. St. Paul Fire & Marine Ins. Co., 464 F. Supp. 2d 397, 412 (M.D. Pa. 2006)).

60 This can be seen even more clearly through the campgrounds hypothetical from the Introduction. Obviously, a Lightning Exclusion would not render a Weather Clause's grant of coverage for weather-related injuries illusory, since such coverage would still be available for injuries related to any other weather-related phenomenon besides lightning, such as extreme temperatures, heavy precipitation, and violent winds.

61 No. 1:14-01273, 2015 WL 4545876, at *17 (S.D. Ind. July 28, 2015).

and $1000's worth of cratering coverage? Surely not.[62] Thus, tests that look beyond the shadow to see how much other coverage remains beyond its scope are the tests that allow arbitrary line-drawing to bring about unfair outcomes.

There is no good reason for the ICD's trigger test to look beyond the shadow to see how much coverage remains unaffected by the exclusion in question. In other words, there should be no such thing as a shadow that is "too small" to trigger the ICD.[63] The ICD's test should focus, then, not on the *scope* of the exclusion's effect on the policy's coverage, but only on the *degree* to which the exclusion reduces the possibility that a given piece of coverage will actually come in handy to the policyholder.[64]

B. *Degree in the Trigger Test: How Dark Must the Shadow Be?*

The next issue in the ICD's trigger test is the question of degree. How dark of a shadow must an exclusion (or multiple exclusions[65]) cast upon coverage in order to render the coverage illusory and trigger the ICD?

One conceivable answer is that the coverage is only illusory if it is impossible for *any* occurrence to fall within the coverage without also falling within the exclusion. The simplest way for this to happen would be for an insuring clause to say "X" is covered and for an exclusion to say that "X" is excluded from coverage. Yet, since the statement "X and not-X" *is*

62 *See* W. Reserve Mut. Cas. Co. v. Holland, 666 N.E.2d 966, 969 (Ind. Ct. App. 1996) (finding the ICD to be triggered because an auto insurance policy's *under*insured motorist coverage was illusory, even though the premium paid for that coverage also paid for non-illusory *un*insured motorist coverage, because "[a]n insurer cannot charge a premium for two conceptually distinct types of coverage, at a presumably higher rate than would be charged for one type of coverage, if both types of coverage do not actually exist"); *see also* Ile v. Foremost Ins. Co., 809 N.W.2d 617, 625-26 (Mich. Ct. App. 2011) (quoting *Holland*, 666 N.E. 2d at 969), *rev'd sub nom.* Ile *ex rel.* Estate of Ile v. Foremost Ins. Co., 823 N.W.2d 426 (Mich. 2012).

63 This position may seem unfair to insurers, who may innocently add exclusions to their insurance forms that incidentally happen to render coverage illusory for one little risk in one little insuring clause. However, as discussed in Section II.C, the most appropriate safeguard for insurers' interests in such situations is a rule whereby, once an exclusion is found to have triggered the ICD, it should only be reformed to the extent that it is contrary to the policyholder's reasonable expectations. That way, the only (tiny) pieces of coverage that the ICD would protect against ICD-triggering exclusions would be those that the policyholder reasonably expected to possess.

64 *See* TIG Ins. Co. v. Tyco Int'l Ltd., 919 F. Supp. 2d 439, 466 (M.D. Pa. 2013) ("The relevant inquiry is 'whether a particular coverage provision is swallowed-up by an exclusion, not whether the policy as a whole provides some degree of coverage despite the existence of an exclusion.'" (quoting Great N. Ins. Co. v. Greenwich Ins. Co, No. 05-635, 2008 WL 2048354, at *5 (W.D. Pa. May 12, 2008))).

65 I add "or multiple exclusions" here to point out that it does not matter whether a policy contains only *one* exclusion that casts a shadow of a certain darkness over a certain area of coverage, or *multiple* exclusions that *collectively* cast a shadow of the same darkness over that same area. For example, a group of twenty-six exclusions—one for "A," one for "B," and so on all the way through "Z"—should be analyzed as if it were a single exclusion for "the letters A through Z." *See, e.g.*, Martinez v. Idaho Ctys. Reciprocal Mgmt. Program, 999 P.2d 902, 906-07 (Idaho 2000) (holding that the cumulative effect of three different exclusions rendered coverage illusory).

ambiguous[66]—does it mean X, not-X, or something else?—it seems that *contra proferentum* could be employed to interpret the policy in the policyholder's favor, rendering the ICD unnecessary.

More often, however, such complete elimination of coverage will arise because an exclusion is *broader* than an insuring clause. For instance, *Purrelli v. State Farm Fire & Casualty Co.*[67] involved a liability insurance policy that had an insuring clause providing coverage for "personal injury" and that explicitly included "invasion of rights of privacy" in its definition of that term.[68] However, the policy also had an exclusion for personal injuries that were "expected or intended" by the insured.[69] The court found that "invasion of privacy [is] an intentional tort" and that it "can only be actionable if done intentionally."[70] In other words, the court found that a specific thing in an insuring clause (invasion of rights to privacy) belonged to a more general class of things (personal injuries that are expected or intended) that was subject to an exclusion.

Here, too, the ICD is unnecessary. But what makes it unnecessary is not *contra proferentum*; rather, it is another black letter principle of contract interpretation under which, "[t]o the extent of any conflict, specific provisions control over more general ones."[71] Pursuant to this principle, the term that addresses how to handle the specific issue of invasions of privacy should be construed as an exception to the term that addresses how to handle the more general issue of expected or intended personal injuries. Thus the policy would be construed to grant coverage for invasions of privacy notwithstanding the exclusion for expected or intended injuries before the ICD entered into the analysis.[72]

Since the ICD seems unnecessary where an exclusion makes coverage under an insuring clause completely impossible, the real question is whether the ICD should be applicable to exclusions that diminish coverage to a less-than-absolute degree. In other words, should there be shadows that are not quite "pitch-black" but that are nonetheless dark enough to trigger the ICD? A few courts have discussed this issue in ways that could be taken to suggest that their answer is

66 *See* Bailer v. Erie Ins. Exch., 687 A.2d 1375, 1380 (Md. 1997) ("If the exclusion totally swallows the insuring provision, the provisions are completely contradictory. That is the grossest form of ambiguity . . . .").

67 698 So. 2d 618, 619-20 (Fla. Dist. Ct. App. 1997).

68 *Id.* at 619.

69 *Id.*

70 *Id.* at 620.

71 Grynberg v. Grey Wolf Drilling Co., 296 S.W.3d 132, 137 (Tex. App. 2009); *accord* DCV Holdings, Inc. v. ConAgra, Inc., 889 A.2d 954, 961 (Del. 2005) ("Specific language in a contract controls over general language, and where specific and general provisions conflict, the specific provision ordinarily qualifies the meaning of the general one.").

72 Notably, this specific-trumps-general principle of contract interpretation would give the policyholder more protection than the ICD, because the (specific) coverage would override the (general) exclusion no matter what. Under the ICD, however, as discussed in the next Section, the coverage would only override the exclusion insofar as the insurer had a reasonable expectation of coverage.

no.[73] However, none of those courts actually held that the ICD could only be triggered by exclusions that completely eliminate coverage; rather, they were saying that such pitch-black shadows are sufficient to trigger the ICD, without deciding whether they are necessary.[74]

The prevailing view is that the ICD can be triggered by exclusions that do not completely eliminate the possibility of the policyholder benefiting from the coverage in question.[75] Courts have varied, however, in how they describe the degree to which an exclusion must eliminate coverage in order to trigger the ICD. One common—though, as I will explain, imperfect—formulation of this non-absolutist standard is that coverage is illusory when there is no "reasonably

---

73 *See, e.g.*, Bagley v. Monticello Ins. Co., 720 N.E.2d 813, 817 (Mass. 1999) ("[I]f the policy still provides coverage for some acts, it is not illusory simply because of a potentially wide exclusion."); Danis v. Great Am. Ins. Co., 823 N.E.2d 59, 74 (Ohio Ct. App. 2005) ("An insurance contract is not illusory where the insured obtains some benefit."); *see also, e.g.*, Titan Indem. Co. v. Cameron, No. 01-5435, 2002 WL 1774059, at *18 (E.D. Pa. July 30, 2002) (quoting *Bagley*), *aff'd*, 77 F. App'x 91 (3d Cir. 2003); Associated Cmty. Bancorp, Inc. v. St. Paul Mercury Ins. Co., 989 N.Y.S.2d 15, 16 (N.Y. App. Div. 2014) (same).

74 In *Bagley*, the court held that an exclusion for illegal acts did not render a general liability policy illusory, because the policy still covered plenty of liability arising out of legal acts. 720 N.E.2d at 818. In *Danis*, the court held that a pollution exclusion in a directors' and officers' liability policy did not create illusory coverage because it left coverage available for pollution-related shareholder derivative suits, which are not all that unlikely. 823 N.E.2d at 74. In *Titan*, the court found that coverage in a law enforcement officer's liability insurance policy for civil rights violations was not rendered illusory by an exclusion for expected or intended harm, because there would still be coverage in the highly plausible scenario in which a civil rights violation was committed without knowledge or intent (*e.g.*, by using objectively unreasonable force). 2002 WL 1774059, at *19. In *Associated Cmty. Bancorp*, the court held that coverage under a "Bankers Professional Liability Insuring Agreement" was not rendered illusory by an exclusion for claims for "the actual loss of money, securities, property or other items of value in the custody or control of [the bank]" because the exclusion left a "broad range of coverage" in place "that may arise in connection with plaintiffs' provision of ordinary banking services." 989 N.Y.S.2d at 16. Thus, none of these cases held that even the slightest possibility of coverage benefiting a policyholder is enough to make it non-illusory.

75 *See* Monticello Ins. Co. v. Mike's Speedway Lounge, Inc., 949 F. Supp. 694, 701 (S.D. Ind. 1996) ("[A]n insurer cannot avoid an illusory coverage problem by simply conceiving of a single hypothetical situation to which coverage would apply[, because] illusory coverage is a matter of degree, not absolutes."); Chase v. State Farm Fire & Cas. Co., 780 A.2d 1123, 1131 (D.C. 2001) (finding that coverage was not illusory because it was not "non-existent or de minimis"); Martinez v. Idaho Ctys. Reciprocal Mgmt. Program, 999 P.2d 902, 907 (Idaho 2000) (holding that coverage is illusory if "it is extremely minimal and affords no realistic protection to any group or class of injured persons," even if "there might be some small circumstance where coverage could arguably exist"); Davidson v. Cincinnati Ins. Co., 572 N.E.2d 502, 507 (Ind. Ct. App. 1991) (holding that coverage is illusory if it "will not [yield] benefits under any reasonably expected set of circumstances"); Pressman v. Aetna Cas. & Sur. Co., 574 A.2d 757, 759 (R.I. 1990) (holding coverage to be illusory because it would be precluded "in almost any circumstance" aside from the highly unlikely scenario in which "the insured had his own generator located inside the building"); Gillund v. Meridian Mut. Ins. Co., 778 N.W.2d 662, 668 (Wis. Ct. App. 2009) ("Coverage is illusory when an insured cannot foresee any circumstances under which he or she would collect under a particular policy provision.").

expected set of circumstances" under which the policyholder would be able to collect benefits from the policy.[76]

A revealing illustration of what this "reasonably expected set of circumstances" standard actually means was provided by *Haag v. Castro*.[77] That case involved a business auto liability insurance policy that covered liability for injuries arising out of accidents with rented vehicles, but only while the rented vehicle was "being used in the business of the Named Insured."[78] The named insured was the Indiana Youth Soccer Association ("IYSA").[79] After an IYSA-certified soccer coach got into an accident while driving his team around in a rented car on a team-building whitewater rafting trip, the insurer denied coverage on the basis that the vehicle was not being used "in the business" of the IYSA at the time of the accident.[80] The Supreme Court of Indiana agreed that the vehicle's use was not in the business of the IYSA, because the IYSA's business was limited to "(1) promoting soccer or (2) regulating leagues, teams, players, and referees or (3) conducting specific events."[81]

The court also found that the business use restriction did not render coverage for rental car accidents illusory.[82] It reiterated Indiana's rule that "[c]overage under an insurance policy is not illusory unless the policy would not pay benefits under any reasonably expected set of circumstances."[83] And it reasoned that there *were* circumstances in which the coverage would be valuable:

> In the course of traveling to promote youth soccer or in transporting a celebrity guest—perhaps a member of our national team like Lauren Cheney or Lori Lindsey—to an IYSA sponsored event, an employee or volunteer might be involved in an auto accident while using a rented vehicle. The coverage is not illusory.[84]

---

76 *See* Meridian Mut. Ins. Co. v. Richie, 540 N.E.2d 27, 30 (Ind. 1989), *vacated on reh'g*, 544 N.E.2d 488 (Ind. 1989); *see also* Hanover Ins. Co. v. Vemma Int'l Holdings Inc., No. 16-01071, 2016 WL 4059606, at *8 (D. Ariz. July 29, 2016) (interpreting Arizona law to hold that coverage is illusory if it "would result in no payment of benefits under any reasonably expected circumstances"); Great N. Ins. Co. v. Greenwich Ins. Co., No. 05-635, 2008 WL 2048354, at *5 (W.D. Pa. May 12, 2008) (quoting *Meridian* as a representation of the rule under Pennsylvania law); Link v. Gen. Cas. Co. of Wis., 518 N.W.2d 261, 263 (Wis. Ct. App. 1994) (same for Wisconsin law).

77 959 N.E.2d 819 (Ind. 2012).

78 *Id.* at 821.

79 *Id.*

80 *Id.*

81 *Id.* at 824-25. Reasonable people can disagree over this, as did a dissenting judge. *See id.* at 826-27 (Dickson, J., dissenting) ("[A] reasonable construction of the hired auto endorsement supports coverage . . . ."). However, for these purposes, let us suppose that the majority was correct that the business use restriction would preclude coverage for the claim at issue if enforced as written.

82 *Id.* at 824.

83 *Id.* (internal quotation marks and citations omitted).

84 *Id.*

The Indiana Supreme Court's ICD analysis in *Haag* reveals that its "reasonably expected set of circumstances" formulation does not clearly express its true standard. The set of circumstances that prevented the ICD from being triggered—namely, circumstances under which a rental car is being used in the IYSA's business—did not need to be *expected* (let alone *reasonably* expected) to arise. Rather, the court found it was sufficient that such circumstances *"might"* arise. Thus, it seems as though what the court is looking for are not circumstances that are reasonably expected, but possible circumstances that are simply not far-fetched.

Accordingly, the "reasonably expected set of circumstances" formulation should be jettisoned and replaced with formulations that more straightforwardly convey that the probability of the coverage ever benefiting the policyholder needs to be very close to zero.[85] One court offered the following helpful guidance in this vein: "'[A]n insurer cannot avoid an illusory coverage problem by simply conceiving of a single hypothetical situation to which coverage would apply.' A plaintiff relying on the [ICD] can prevail by showing that the likelihood of coverage is 'sufficiently remote to be deemed illusory.'"[86]

But, setting aside quibbles about how best to articulate the standard, the prevailing view among American courts that have adopted the ICD is that it can be triggered by exclusions that do not absolutely eliminate coverage, as long as they come close. The shadows have to be very dark, but not necessarily pitch-black.

C. *Reforming Policies That Have Illusory Coverage*

Once a court determines that the ICD has been triggered—which is to say that the policy contains illusory coverage—the next question is, so what? Should the illusory coverage–creating exclusion be automatically struck from the policy

85 For good examples of these plausibility-themed formulations, see *Colo. Intergovernmental Risk Sharing Agency v. Northfield Ins. Co.*, 207 P.3d 839, 843 (Colo. App. 2008) ("Exclusions impermissibly render coverage illusory when they in effect allow the insurer to receive premiums when realistically it is not incurring any risk of liability." (quoting O'Connor v. Proprietors Ins. Co., 696 P.2d 282, 285 (Colo. 1985))); *Chase v. State Farm Fire & Cas. Co.*, 780 A.2d 1123, 1131 (D.C. 2001) (finding that coverage was not illusory because it was not "non-existent or de minimis"); *Martinez v. Idaho Ctys. Reciprocal Mgmt. Program*, 999 P.2d 902, 907 (Idaho 2000) (holding that coverage is illusory if "it is extremely minimal and affords no realistic protection to any group or class of injured persons," even if "there might be some small circumstance where coverage could arguably exist"); *Pressman v. Aetna Cas. & Sur. Co.*, 574 A.2d 757, 759 (R.I. 1990) (holding coverage to be illusory because it would be precluded "in almost any circumstance" aside from the highly unlikely scenario in which "the insured had his own generator located inside the building").

86 Great N. Ins. Co. v. Greenwich Ins. Co., No. 05-635, 2008 WL 2048354, at *5 (W.D. Pa. May 12, 2008) (quoting Monticello Ins. Co. v. Mike's Speedway Lounge, Inc., 949 F. Supp. 694, 701 (S.D. Ind. 1996) and Meridian Mut. Ins. Co. v. Richie, 540 N.E.2d 27, 30 (Ind. 1989)); *see also* Nautilus Ins. Co. v. Sunset Strip, Inc., No. 1:14-01273, 2015 WL 4545876, at *6 (S.D. Ind. July 28, 2015) ("Indiana courts have phrased this inquiry as whether the hypothetical coverage is so sufficiently remote [as] to be deemed illusory." (quoting *Monticello Ins. Co.*, 949 F. Supp. at 701)).

entirely? To my knowledge, no court has applied such an approach. Instead, following Indiana's lead, courts typically hold that an illusory coverage–creating exclusion should be reformed only insofar as it contradicts the policyholder's reasonable expectations regarding the coverage available under the policy.[87] The clearest articulation of this rule in the case law is as follows:

> [An] illusory coverage argument . . . requires a two-part analysis: The Court must first determine whether the policy is in fact illusory. If the policy is *not* illusory, then the unambiguous terms of the policy control . . . . If the policy *is* illusory, then the Court must then determine whether [the policyholder] had a reasonable expectation that claims such as [the] cause of action [for which the policyholder is seeking coverage] would be covered by the policy.[88]

A helpful illustration of this rule's application can be found in the case described in this Comment's opening sentence, *Monticello Ins. Co. v. Mike's Speedway Lounge, Inc.*[89] There, an insurance company sold a tavern a general commercial liability insurance policy that contained an "absolute liquor" exclusion that barred coverage for claims "arising out of or in connection with the manufacturing, selling, distributing, serving, or furnishing of any alcoholic beverages."[90] When the tavern was sued for failing to prevent one of its intoxicated patrons from killing another patron and sought coverage from its insurer, the insurer tried to deny coverage on the basis of the absolute liquor exclusion.[91] The court found that the exclusion was so broad that it rendered the tavern's commercial general liability coverage illusory.[92]

87 *See, e.g.*, St. Paul Mercury Ins. Co. v. F.D.I.C., 774 F.3d 702, 709 (11th Cir. 2014) ("[A] court must not interpret a policy to allow an insurer to provide largely illusory coverage. In other words, 'Georgia public policy disfavors insurance provisions that permit the insurer, at the expense of the insured, to avoid the risk for which the insurer has been paid *and for which the insured reasonably expects it is covered*.'" (emphasis added) (quoting Barrett v. Nat'l Union Fire Ins. Co. of Pittsburgh, 696 S.E.2d 326, 330 (Ga. Ct. App. 2010))); *Monticello Ins. Co.*, 949 F. Supp. at 704 (denying an insurance company's motion for summary judgment under Indiana law because the coverage that it sold its insured was illusory, and the insured had raised a genuine issue of material fact as to whether it had reasonably expected the claim in question to be covered when it bought the policy); Davidson v. Cincinnati Ins. Co., 572 N.E.2d 502, 508 (Ind. Ct. App. 1991) ("Provisions in an insurance policy, which are unambiguous when read within the policy as a whole, but in effect, provide only illusory coverage, should be enforced to satisfy the reasonable expectations of the insured."); Gillund v. Meridian Mut. Ins. Co., 778 N.W.2d 662, 669 (Wis. Ct. App. 2009) ("Where coverage is illusory, we have concluded that the contract should be reformed so that it comports with the insured's reasonable expectations.").

88 *Nautilus*, 2015 WL 4545876, at *6.

89 949 F. Supp. 694.

90 *Id.* at 696.

91 *Id.*

92 *Id.* at 702 ("[W]hile there might be some possibility of claims against a tavern that cannot be said to have arisen out of . . . the business of selling, distributing, serving, or furnishing alcoholic beverages, the prospect seems to be 'sufficiently remote' as to warrant the conclusion that this coverage was illusory.").

Yet, the finding that the absolute liquor exclusion rendered coverage illusory was not sufficient to make that exclusion unenforceable against the claim for which the tavern sought coverage. Rather, the court also had to find, as a factual matter, that the tavern's owner had reasonably expected claims like the one at issue to be covered by the policy at the time he purchased it.[93] The court summarized its analysis of this factual issue as follows:

> [The tavern] has raised a genuine issue of material fact on the question of its reasonable expectation of coverage. [Its owner] contracted to buy commercial general liability coverage for a tavern. His affidavit provides evidence that he aimed to obtain insurance against the risk that patrons would suffer injury on the premises. [The owner] explains that he purchased insurance in order to protect [the tavern] from liability resulting from the business of furnishing alcoholic beverages to patrons. The policy on its face purports to provide commercial general liability coverage for a tavern, yet also purports to exclude from coverage any personal injury and property damage claims "connected with" the selling, distributing, manufacturing, or furnishing of alcoholic beverages. The policy language in and of itself is sufficient to create a genuine issue of material fact as to [the owner's] reasonable expectation of insurance coverage.[94]

Mike's Speedway also involves another issue related to how courts should reform policies once they have been found to contain illusory coverage. We can think of it as the issue of "multiple sufficient shadows." Suppose there are two separate exclusions that each casts its own shadow on the same coverage. And suppose either of those exclusions would be independently sufficient to deny coverage for the claim brought by the policyholder. What if one of those shadows is dark enough to trigger the ICD, while the other shadow is not? Should the policyholder's reasonable expectations override the effects of *both* of those exclusions, so that the claim is deemed to be covered? Or should the exclusion that casts the fainter, non-illusory coverage–creating shadow remain enforceable, regardless of the policyholder's reasonable expectations, so as to deny the claim?

In *Mike's Speedway*, there were two additional exclusions that did *not* create illusory coverage and that, if enforced, would have provided a sound basis for denying the tavern's claim—an "assault and battery" exclusion and a "dram shop" exclusion.[95] "The issue here," the court stated, "is whether, as a matter of law, [the insurer] may rely on these other exclusions to defeat coverage under a policy that provided only illusory liability coverage from

93 *Id.* at 702-04.
94 *Id.* at 704.
95 *Id.* at 696-97, 703.

the beginning."[96] It held that "Indiana courts would not permit [the insurer] to take advantage of these other exclusions" because "Indiana courts treat illusory insurance coverage as a violation of public policy" and "[f]rom that perspective, an insurance company that has sold illusory coverage is not likely to receive a sympathetic audience for its arguments that other exclusions nevertheless still bar coverage."[97] Thus, the *Mike's Speedway* court effectively held that, if *any* exclusion casts a shadow over a piece of coverage that alone is dark enough to trigger the ICD, then *all* exclusions that cast separate shadows on that same piece of coverage are unenforceable to the extent that they conflict with the policyholder's reasonable expectations.

Other courts disagree. For example, in *DISH Network Corp. v. Arch Specialty Insurance Co.*, the court held that a "Satellite Exclusion" in DISH Network's liability insurance policy was unenforceable because the court could "envision no scenario in which the exclusion would not apply."[98] However, the court nonetheless allowed the insurer to rely on "another, legally sound exclusion" as a basis upon which to deny coverage for DISH Network's claim.[99] Likewise, in *Gillund v. Meridian Mutual Insurance Co.*, the court held that, even if an insurance policy's limitation of coverage to "accidents" rendered its purported coverage for invasions of privacy illusory, the insurer could still rely on a valid exclusion for violations of penal laws to deny coverage to a policyholder whose invasion of privacy amounted to such a violation.[100]

I agree with the approach taken in *DISH Network* and *Gillund*, under which the fact that one exclusion's enforcement would render certain coverage illusory has no effect on the enforceability of other non-illusory coverage–creating exclusions with respect to that same coverage. The contrary approach taken in *Mike's Speedway* could create unfair windfalls for policyholders and put insurers in excessive danger of being forced to cover more risk than they intended to underwrite. That approach would also unduly complicate coverage disputes, since it would give policyholders a reason to challenge various *arguably* illusory coverage–creating exclusions in their policies that otherwise would have been totally irrelevant to a dispute.

---

96 *Id.* at 703.

97 *Id.*

98 989 F. Supp. 2d 1137, 1153-54 (D. Colo. 2013), *aff'd sub nom.* Dish Network Corp. v. Arrowood Indem. Co., 772 F.3d 856 (10th Cir. 2014). The Satellite Exclusion stated that "This insurance does not apply to Bodily Injury, Property Damage, Personal Injury or Advertising Injury arising out of the ownership, operation or use of any satellite." *Id.* at 1153. Since DISH Network is "in the subscription satellite television business," the exclusion, if enforced, would apply to virtually all of DISH Network's claims. *Id.* at 1153-54.

99 *Id.* at 1154. The "legally sound" exclusion was a "Business Exclusion" that barred coverage for "'[a]dvertising injury' arising out of . . . an offense committed by an insured whose business is advertising, broadcasting, publishing or telecasting." *Id.* at 1146-47.

100 778 N.W.2d 662, 669 (Wis. Ct. App. 2009).

The *Mike's Speedway* approach appears to be motivated by a desire to deter insurers from issuing policies with exclusions that trigger the ICD. But sufficient deterrence would be created by overriding those "bad" exclusions with the policyholder's reasonable expectations, even if all the other exclusions remained fully enforceable. For these reasons, the only exclusions that should be overridden by policyholders' reasonable expectations pursuant to the ICD should be those that actually trigger the ICD.[101]

III. HOW THE DOCTRINE COMPARES TO ITS ALTERNATIVES

Given the background principle that insurance policies should generally be construed as they are written,[102] any doctrine whose purpose is to require insurers to provide coverage that is excluded by the unambiguous language of their policies could seem adverse to the interests of the insurance industry. Thus, it is worth noting that the ICD is friendlier to the insurance industry than the alternative doctrines that could be implicated by the same fact patterns, namely *conta preferentum* and the doctrine of reasonable expectations.

A. *The ICD and* Contra Proferentum

If a court looks at an exclusion that casts a dark shadow over coverage and sees *ambiguity*, the court will apply *contra proferentum* and resolve the ambiguity in the policyholder's favor, even if the policyholder had no reasonable expectation of coverage. If, on the other hand, the court looks at the same policy and instead sees *illusory coverage*, the court will only grant coverage if the policyholder can show that he or she reasonably expected the coverage to be available.

---

101 Notice the difference between (1) the situations discussed here, in which there is one illusory coverage–creating exclusion and one non-illusory coverage–creating exclusion, and each is independently sufficient to deny the policyholder's claim, and (2) situations in which illusory coverage is created by the cumulative effects of multiple exclusions. An example of the former would be a policy with both an exclusion for "A" and an exclusion for "A-Z," while an example of the latter would be a policy with twenty-six exclusions, one for each letter of the alphabet. If a policyholder brings a claim for "A," and reasonably expects "A" to be covered, his coverage should be denied if he has the former policy, because the illusory coverage–creating "A-Z" exclusion should not invalidate the "A" exclusion that is independently sufficient to deny the claim. But coverage for "A" should be granted if he has the latter policy, because the cumulative effect of the "A" exclusion combined with the twenty-five other exclusions effectively creates an "A-Z" exclusion that triggers the ICD.

102 *See* RESTATEMENT OF THE LAW OF LIAB. INS. § 3 (AM. LAW INST., Proposed Final Draft 2017) (stating that there is a "presumption in favor of plain meaning" in insurance policy interpretation); *see also* 16 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 49:14 (4th ed. 1993) (stating that the terms of insurance policies, like those in other kinds of contracts, should be "accorded their plain and ordinary, popular or commonly accepted meaning, unless it appears from the policy itself or by usage that the parties intended to use the words in a special or technical sense" (footnotes omitted)).

This difference can be neatly illustrated by comparing *Kiger* and *Mike's Speedway*. In *Kiger*, a gas station's "garage policy" had a pollution exclusion that "excluded the major source of potential liability."[103] The same could be said of the absolute liquor exclusion in the policy sold to the tavern in *Mike's Speedway*.[104] Yet, the court in *Kiger* saw ambiguity and held that the "rule of construing exclusions strictly against the insurer and in favor of coverage . . . requires that coverage for the gasoline contamination which occurred be available."[105] In contrast, the court in *Mike's Speedway* saw illusory coverage and held that the policyholder could only receive the coverage he sought upon establishing that he reasonably expected such coverage at the time the policy was issued.[106]

Thus, conceiving of illusory coverage as a special issue governed by its own doctrine, and not as a form of ambiguity, would be an insurer-friendly move.

B. *The ICD and the Doctrine of Reasonable Expectations*

The ICD is also far friendlier to insurers than the doctrine of reasonable expectations. The crux of the doctrine of reasonable expectations is that "[t]he objectively reasonable expectations of [policyholders] regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations."[107] This is obviously a more expansive, pro-policyholder doctrine than the ICD, which requires that coverage be rendered illusory *and* that it be reasonably expected by the policyholder.

The reasonable expectations doctrine's leading case is *C & J Fertilizer, Inc. v. Allied Mutual Insurance Co.* There, the policy at issue offered coverage for "burglary" but contained what the court described as an "exclusion . . . masking as a definition."[108] Buried in "fine print," the exclusion removed coverage for burglaries from which there were no "visible marks made by tools, explosives, electricity or chemicals upon, or physical damage to, the exterior of the premises at the place of such entry."[109] The policyholder brought a claim for a burglary that left such visible marks on a door in the interior of the premises, but not the exterior, which was where the policy's fine print required the marks to be.[110] The Iowa Supreme Court held that, notwithstanding the exclusion "bur[ied]" in the written policy, the

103 Am. States Ins. Co. v. Kiger, 662 N.E. 2d 945, 948 (Ind. 1996).

104 Monticello Ins. Co. v. Mike's Speedway Lounge, Inc., 949 F. Supp. 694, 702 (S.D. Ind. 1996).

105 662 N.E.2d at 949.

106 949 F. Supp. at 704.

107 Keeton, *supra* note 40, at 967. For a review of the doctrine of illusory expectations, see generally Roger C. Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L.J. 823 (1990).

108 227 N.W.2d 169, 177 (Iowa 1975).

109 *Id.* at 171.

110 *Id.*

policyholder had a reasonable expectation that burglaries such as the one that occurred would be covered under the policy.[111] On that basis, the court held that "the doctrine [of reasonable expectations] demands" that the burglary be deemed covered by the policy.[112]

Analyzing the same facts under the ICD, however, would have led to victory for the insurer. Clearly, the possibility of a burglary leaving the visible marks of force and violence on a premises' exterior, as required for coverage under the policy, is not so remote as to render the coverage illusory. Thus, the ICD would not have been triggered by the policy, and the analysis would never have reached the reasonable expectations prong, so coverage would have been validly denied.

The ICD can therefore be viewed as a narrowing of the doctrine of reasonable expectations. It restricts the circumstances under which a policyholder's reasonable expectations should override a policy's clear terms to those in which the insurer seeks to rely on exclusions that *not only* eliminate coverage for the specific claim being brought by the policyholder, but that *also* render certain coverage illusory. In other words, the ICD puts an illusory-coverage "filter" on the doctrine of reasonable expectations.[113]

This filter ameliorates the doctrine of reasonable expectations' main drawback, which is that it leaves insurers so uncertain about what risks they will actually be required to bear under their policies that they have trouble pricing them efficiently. Replacing the doctrine of reasonable expectations with the ICD would dramatically reduce insurers' uncertainty, because it is much easier for insurers to predict whether their policies will be held to contain illusory coverage than whether their policies will be held to violate a policyholder's reasonable expectations.

While there is obviously some vagueness in the standard for illusory coverage—how dark of a shadow is too dark?—there is far more vagueness in the doctrine of reasonable expectations. For one thing, a court's judgment as to the reasonableness of a policyholder's expectations turns on the amount of effort the court determines the policyholder should have made to read and understand the policy—a difficult determination for parties to predict in advance. The illusory-coverage "filter" would give insurers a "safe harbor": if insurers want to avoid the risk that a court will find it reasonable for a

111 *Id.* at 177.

112 *Id.*

113 This way of looking at the ICD fits nicely with the *Nautilus* court's "two-part analysis" for the ICD—the first part looking at whether the coverage sought by the policyholder is illusory, and only the second part looking at whether the policyholder had a reasonable expectation of such coverage being available under the policy. Nautilus Ins. Co. v. Sunset Strip, Inc., No. 1:14-01273, 2015 WL 4545876, at *6 (S.D. Ind. July 28, 2015).

policyholder to expect coverage notwithstanding unambiguous exclusions, they can do so by making sure those exclusions do not render the coverage illusory. Or, going the other way, if insurers are nervous that an exclusion might trigger the ICD, they can protect themselves by taking care to clearly explain the effect of that exclusion to their applicants, so that their policyholders could never hold reasonable expectations that conflict with the exclusion.

CONCLUSION

This Comment has attempted to explain what the ICD is, how it works (and should work), and how it compares to related doctrines pertaining to insurance contracts' interpretation and enforceability. In summary, the ICD is a doctrine of insurance contract enforceability, as opposed to interpretation, that serves to protect policyholders from procedurally unconscionable exclusions that almost completely wipe out the coverage purportedly available under their policies. If any coverage purportedly offered by the policy—no matter how "small" that coverage is in comparison with the remainder of the policy—is so restricted by an exclusion that the policyholder's chance of actually benefiting from that coverage drops to almost zero, the coverage is rendered illusory, and the ICD is triggered. The exclusions that trigger the ICD—and *only* those exclusions—should be reformed to the extent that they conflict with the policyholder's reasonable expectations. Thus, if a policyholder had a reasonable expectation for coverage that was rendered illusory by an exclusion, the policy should be enforced, contrary to that exclusion's unambiguous meaning, so as provide that coverage.

The ICD is certainly a pro-policyholder exception to the general principle that insurance contracts should be construed as they are written. But compared to the other doctrines that could be invoked in similar circumstances, the ICD provides policyholders with narrower protection and insurers with greater certainty of what risks they will ultimately be required to bear. The ICD requires policies to be enforced contrary to the meaning of their terms only when they are procedurally unconscionable—which insurers should be able to foresee when they draft the policies—and only to the extent that they deprive policyholders of coverage they reasonably expected. In this way, the ICD strikes a satisfying balance between the interests of policyholders and insurers.