PERIL AND FORTUITY IN PROPERTY AND LIABILITY INSURANCE

Kenneth S. Abraham

Invoking an apparently self-evident legal proposition is a particularly effective rhetorical device, especially if that proposition has ancient roots. One such proposition often invoked by insurers is that both property and liability insurance cover only the risk of fortuitous loss. This proposition figures in many contemporary insurance disputes, including those involving major Y2K and toxic tort liabilities. This article examines this proposition and concludes that it is far less self-evident than often is supposed. This is not to say that the proposition is incorrect. But being correct is not the same as being self-evident. The purpose of this article is to identify the conditions under which the proposition is correct, and thereby to isolate the points at which the force of the fortuitity requirement runs out and necessarily becomes inapplicable.

It turns out that the fortuity issue often is implicated by express insurance policy provisions, but that these provisions sometimes address the issue only indirectly or by proxy. Property insurance policies, for example, incorporate not only provisions governing intentionally caused loss, but also those identifying insured and excluded perils. The first group of provisions deals with fortuity directly, the second only indirectly. Similarly, liability insurance policies of all sorts routinely contain provisions excluding coverage of liability for expected or intended harm. But commercial liability insurance policies also contain exclusions pertaining to losses resulting from certain business risks that are also related to nonfortuitous loss, but not directly. As a con-

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Kenneth S. Abraham is Professor of Law and Albert C. Tate Jr. Research Professor at the University of Virginia School of Law in Charlottesville.
sequence, the relation between policy provisions and any legal rule or principle regarding fortuity comes into question, and a jurisprudence of insurance policy interpretation is necessary to specify this relation.

This article concludes that the characteristic feature of insurance policies, their standard-form nature, strongly supports an interpretive approach that emphasizes the primacy of insurance policy language and relegates legal rules to a secondary position in the interpretive enterprise. For this reason, the courts should be wary of employing so-called rules regarding insuring against nonfortuitous loss. Rather, to determine whether there is coverage under an insurance policy whose provisions address the fortuity issue, the courts should apply the policy language.

1. THE ROLE OF RULES IN INSURANCE POLICY INTERPRETATION

No contract, even a detailed insurance policy, can ever be perfectly explicit about its application to every conceivable set of facts. So the crucial question is how to deal with the tension between the primacy of contract language and the potentially helpful interpretive role of rules when the scope of a contract is at issue. The distinction between “default” and “mandatory” rules can help to shed light on this tension, especially as it plays out in insurance law.

A. Default Rules

Modern contract theory has developed the notion of the default rule to address this tension. By analogy to a default setting on a computer, a default rule is one that applies by operation of law when the parties to a contract have not expressly opted out of the rule. Thus, in contrast to mandatory rules, default rules are optional. To opt out of a default rule the parties simply contract around the rule by providing for an arrangement different from what otherwise would be provided by the default rule. Much of commercial law is in fact composed of default rather than mandatory rules. For example, except for the few sections where they are mandatory, the provisions of the Uniform Commercial Code are merely defaults: they apply only if a commercial contract governed by the Code does not provide otherwise.

Default rules can serve either of two purposes. First, default rules can reduce the cost of contracting. A cost-reducing default rule provides a


5. See UCC 1–102(3) (permitting variation of the provisions of the Act by agreement, except as otherwise provided).

ready-made, off-the-rack contract provision that need not be specially drafted and need not even be incorporated in the contract if it is already satisfactory to the parties. If the contract is silent on the issue addressed by the default rule, the rule applies. Thus, default rules apply automatically unless the parties say otherwise. Good default rules of this sort attempt to reflect the arrangement that most contracting parties would adopt if they invested resources in doing so. By providing such default rules, the law in effect affords the parties an economy of scale by saving them the trouble of expressly contracting about a matter that is already satisfactorily addressed by an applicable default rule.

Second, and in contrast, default rules can force the production of information by one party to the contract. For example, the rule of Hadley v. Baxendale,7 that only those damages within the contemplation of the parties are available for breach of a contract, is an information-forcing default rule. The party that stands to suffer unusual damages can recover them only if the contract so provides, or if that party otherwise takes steps to bring anticipated but unusual consequences of breach within the other party's contemplation prior to execution of the contract.

Interestingly, insurance law contains few default rules of either the cost-reducing or the information-forcing variety. The explanation lies in the standard-form character of most insurance policies. Insurance law has had little need to generate cost-reducing default rules, because the insurance industry has already done so through the development of standard-form policy provisions. These standard provisions serve the same purpose as cost-reducing defaults. They save the parties the cost of preparing tailor-made policy provisions when, for powerful reasons, preexisting provisions are satisfactory, or at least necessarily uniform. Similarly, in insurance, most information forcing directed at the policyholder takes place through other means, most notably through the disclosures required on the policyholder's application for insurance. On the other hand, when something like information forcing on the part of the insurer is desirable, the coverage favoring doctrines of contra proferentem8 and reasonable expectations9 perform this task. Ambiguous policy provisions are construed in favor of coverage, thus providing through a default rule that there is coverage unless it is unambiguously excluded.10 In some jurisdictions, even unambiguous policy provisions have no force if they violate the reasonable expectations

7. See Scott & Leslie, supra note 3, at 77-78; Ayers & Gertner, supra note 3, at 94-95.
10. See id. at 538.
11. See Keeton & Widiss, supra note 2, § 6.3(a), at 628-29; Abraham, supra note 9, at 531-32.
of the insured. In effect, there is a pro-coverage default rule that can be displaced by the disclosure of information that dispels the expectation of coverage.

Thus, cost-reducing default rules are conspicuously and justifiably absent from insurance law, and the major information-forcing defaults are general principles of interpretation, not substantive rules of insurance law. The provisions of standard-form insurance policies are the substantive defaults within which insurance law operates. For this reason, there would be no particular advantage or benefit gained by developing independent rules about the scope and application of most policy provisions. Rather, standard-form policy provisions are insurance law’s default rules. Judicial decisions that might be thought to reflect independent rules are in fact typically just interpretations of particular policy language. In other words, each provision is the applicable default rule, displacable at the parties’ option by redrafting the provision. The fact that such redrafting only occasionally occurs because of the exigencies of the insurance markets does not in any way affect the core character of these provisions. Authoritative, binding judicial decisions about the meaning of particular policy provisions are only that, not independent legal rules about what insurance covers.

B. Mandatory Rules

In contrast to the situation with default rules, insurance law has developed a small number of mandatory rules that are not defaults and may not be set aside at the parties’ option. For example, the policyholder must have an insurable interest in the subject matter insured. The insured may not recover more than the amount of a loss because such recovery would violate the principle of indemnity. Also, when “other insurance” clauses conflict, they both are disregarded. These rules protect interests or further goals that are sufficiently important to supplant freedom of contract. Policy language violating these mandatory rules is of no effect.

The principle that insurance may cover only the risk of fortuitous loss has this kind of mandatory character. But this principle differs from most mandatory insurance law rules in an important way. Express provisions in both property and liability insurance policies virtually always address the fortuity issue by providing in a variety of ways that nonfortuitous loss is excluded from coverage. Standard homeowners’ policies exclude coverage

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12. For discussion, see the articles collected in a Symposium, The Insurance Law Doctrine of Reasonable Expectations After Three Decades, 5 CONN. INS. L.J. 1 (1998–99).
14. See Keeton & Widiss, supra note 2, § 3.1(a), at 134–35; Abraham, supra note 13, at 190–91.
where the insured possessed an intent to cause a loss,\(^{16}\) and standard comprehensive, or commercial general liability \(^{17}\) policies exclude coverage of liability for harm "expected or intended from the standpoint of the insured."\(^{18}\) Thus, this is not a situation in which an insurance policy is silent on an issue that is the subject of a mandatory rule, nor is it a situation in which the policy language violates such a rule. On the contrary, the parties to property and liability insurance policies have addressed the fortuity issue with express policy provisions that satisfy the principle of fortuity.

There are thousands of judicial decisions addressing the meaning and application of these policy provisions. Many of the decisions have enough in common to be distilled into what look like rules. For example, the dominant rule is that the test for whether a policyholder expected or intended harm is subjective. The question is not what the reasonable policyholder would have expected, but what the policyholder in question actually expected.\(^{19}\) But rules such as this are merely an aggregation of interpretations. The policy language dictates a subjective test, because expectation and intent are subjective states of mind. There is no independent rule dictating the scope and meaning of the exclusion.

For a rule regarding fortuity to have significance beyond such policy language would require the conclusion that the policy language does not go far enough, that it does not exclude all the coverage that must be excluded to satisfy the fortuity principle. In theory, this could be the case. Existing policy language might in fact capture some, but not all, of what is required as a matter of public policy regarding the prohibition against insuring nonfortuitous loss. So there is reason not to exclude absolutely the possible existence of a rule regarding fortuitous loss possessing a status independent of the language in standard-form property and liability insurance policies.

If this policy language does capture all that is required by the fortuity principle, however, then this principle does not demand that there be any separate rule to implement it. Certainly the fact that there are thousands of judicial decisions applying the "intent to cause loss" and "expected or intended" exclusions in property and liability insurance without ever making reference to a separate fortuity rule strongly implies that this language supplies all that the fortuity principle requires. Under these circumstances, treating the fortuity principle as if it had independent status as an insurance law rule would inevitably lead to confusion. To the extent that policy language already satisfactorily reflects the fortuity requirement, making ref-

\(^{16}\) See Abraham, supra note 13, at 176.
\(^{17}\) Hereinafter CGL.
\(^{18}\) See Abraham, supra note 13, at 395.
\(^{19}\) See, e.g., Stonewall Ins. Co. v. Asbestos Claims Management Corp., 73 F.3d 1178, 1205 (2d Cir. 1995).
ference to the requirement as if it were not entirely subsumed within applicable policy language could only risk implying incorrectly to decision makers that they had two decisions to make, one applying policy language and the other applying the separate and additional requirements of a legal rule regarding fortuity. In its least harmful form, such an approach would lead to needless duplication of effort. In a more harmful form, the approach could generate incorrect decisions. This risk of misleading duplication has prompted courts in other settings to be especially careful to avoid giving the impression that there are two sources of obligation when in fact there is only one.20

Consequently, one of the key questions to be addressed in considering the peril and fortuity provisions embodied in property and CGL insurance policies is whether these provisions do, in fact, properly and completely reflect the fortuity principle, or whether a separate and independent rule regarding fortuity is necessary. That question, and others, are addressed below.

II. PERIL AND BUSINESS RISKS: PARALLEL DEVELOPMENTS, CONVERGING ISSUES

Property insurance policies typically exclude coverage of loss resulting from specified perils, or causes of loss, whereas liability insurance policies typically exclude coverage of liability for specified risks, or bases for the imposition of liability on the insured. Because of differences in the structure of property and liability insurance policies, the concepts of an excluded peril and an excluded business risk play superficially different roles. But at a deeper level these concepts attend to similar issues: which risks of loss because of their very nature are better shouldered by the insured than shared by the community of policyholders. In this sense the concepts of peril and business risk are not only very similar to each other, but also serve purposes very different from many other limitations on coverage.

A. The Significance of "Peril" in Property Insurance

1. A Page of History

Two separate developmental strands of insurance are predecessors of modern coverage against the risk of suffering property damage. Insurance against damage to real property resulting from fire originated in England after the Great Fire of London in 1666.21 On this side of the Atlantic, fire

20. See, e.g., Meistrich v. Casino Arena Attractions, Inc., 155 A.2d 90 (1959) (in order to avoid misleading duplication, the defense of assumption of risk is to be subsumed within the concept of contributory negligence).

insurance first developed in the middle of the eighteenth century. The key point for our purposes is that this was insurance against only one cause of loss, or peril—fire. Over time other insured perils, such as wind and hail, were added. These insured perils were each specified in the insurance policy. For this reason, such insurance came to be known as "specified-risk" coverage. It insured property against the risk of damage or destruction resulting from specified causes of loss.

A second strand of development had a different starting point. Marine insurance developed over the centuries to cover the risk of loss to ships, and cargo, at sea. By the time Lloyd's Coffee House in London had become the principal site of marine insurance transactions, this form of insurance was not limited to particular causes of loss. Rather, marine insurance protected against loss caused by "perils . . . of the seas." In effect, this was all-risk coverage, in contrast to the specified-risk coverage afforded by policies insuring property on land.

Skipping a century and a half of insurance history brings this story to the point at which modern property insurers eventually recognized long-standing shortcomings in the specified-risk approach. As a consequence, by the middle of the twentieth century, insurers adopted the marine insurance approach by offering all-risk commercial and homeowners' property insurance. The operative phrase in such policies is contained in the section labeled "Perils Insured Against," and provides coverage against the risk of "direct physical loss" to covered property. This approach has many advantages, not the least of which is that a policy that can be described as all risk is attractive to prospective purchasers seeking broad coverage. Purchasers may or may not think that they are getting coverage against all risks, but they at least form the impression that they are obtaining as much coverage as is conventionally feasible.

The disadvantage to the insurer of the term "all risk," of course, is that it can also be used against the insurer. In a close case, the fact that a policy is described as "all risk" may count in favor of coverage. In the last two decades the insurance industry has therefore taken to referring to the policy

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24. Raines, supra note 21, at 63.
26. For example, a common version of the standard homeowners' policy states that "We insure against risk of direct loss to property . . . only if that loss is a physical loss to property." Abraham, supra note 13, at 173. The standard commercial property policy uses the phrase "direct physical loss." See Alliance of American Insurers, Insurance Professionals' Policy Kit 182 (2000).
as an "Open Peril" as distinguished from a "Named Peril" policy. Whatever name is used to describe such a policy, the approach is the same. It covers all loss falling within the terms of its simple grant of coverage, "direct physical loss to property," except loss that is specifically excepted. Obviously this approach places great pressure on the exclusions and limitations to coverage. If a particular form of direct physical loss to property is not excluded, it is covered.

2. The Internal-Cause Provisions
Exclusions in property insurance policies serve a variety of purposes. A number of exclusions in open peril policies, however, relate directly to the peril-based history of property insurance. These are the exclusions and limitations concerning latent and design defects, inherent vice, mechanical breakdown, and ordinary wear and tear. To consider these exclusions and limitations together is itself an act of aggressive interpretation because the provisions are scattered throughout the policy. In standard-form homeowners' policies, for example, some of these exclusions are stated as qualifications to the grant of open peril coverage, whereas others are contained in a section expressly entitled "Exclusions." In the standard-form Commercial Property Insurance Policy, the provisions are all contained in a section labeled "Exclusions," but they are not listed together or consecutively. Rather, they are dispersed and separated by other, unrelated exclusions.

It nonetheless is useful to treat these provisions as if the drafters of the policy had placed them all together, in an effort to convey a unitary message. The substantive link between these provisions is that each identifies a cause of loss that is internal to the property in question. That is, the losses excluded can each occur without the intervention of any outside force. Virtually all of the other peril-based exclusions, which typically are sprinkled in with these provisions, preclude coverage of loss that is in fact caused by an outside force. This link among the provisions in question is not stated anywhere in the policy. Indeed, such a link can barely be discerned from the extensive literature on property insurance. But taken together, the internal-cause provisions reflect the heritage of property insurance as peril-based coverage. When property breaks down, ceases to

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27. In fact, homeowners' and commercial property insurance policies both cover real and personal property. Coverage of the former typically is provided on an open peril or all-risk basis, whereas coverage of the latter is provided on a named peril or specified-risk basis. See Abraham, supra note 13, at 166, 173–74.

28. The vast majority of exclusions serve one or more of the following purposes: combating adverse selection or moral hazard; reducing the risk that the insurer will be liable for correlated losses, such as those suffered simultaneously by many policyholders; and avoiding duplication or overlaps with other forms of coverage. See id. at 223.

29. Id. at 173–76.
function, or merely deteriorates, loss has occurred without the occurrence of any evident peril.

Why would property insurance contain a set of exclusions each of which is directed at precluding coverage of loss resulting from causes internal to the property insured? The most attractive explanation is that such exclusions limit the insurer's exposure to the risk that a loss will be suffered because of the low quality of the property insured. Low-quality property, real or personal, is more likely to suffer mechanical breakdown or wear and tear than higher-quality property. Property containing a latent or design defect or an inherent vice is by definition of lower quality than otherwise identical property without such defects.

Insurers are likely to want to avoid insuring the risk of loss resulting from low quality because of the risk of adverse selection. Those who know that their property is of below-average quality are more likely to want to insure it and to insure it for more than those whose property is of average or higher quality. If property insurance did insure against loss of property resulting from its low quality, policyholders would be more likely to purchase such property. Conversely, policyholders that purchase average- or high-quality property would not want to subsidize policyholders that purchase low-quality property. But for the problem of adverse selection, however, policyholders might well wish to purchase insurance covering the risk of property loss resulting from low quality. Insurers could combat adverse selection through risk classifications distinguishing between the quality of property and pricing accordingly. The very existence of commercial and consumer product warranties confirms both the existence of demand for this kind of protection and the possibility of price differentiation in this respect.

The connection between these exclusions and the fortuity principle is clear, but attenuated. The exclusions decrease the probability that nonfortuitous losses will be covered. They do so only very indirectly, however, by reducing the policyholder's incentive to purchase property of low quality. In this sense the exclusions are proxies for concern about fortuity, but proxies only. It would therefore be a mistake to read the fortuity principle into these exclusions in any operative way. The principle is one of the reasons that the exclusions exist, but the exclusions do not directly apply the principle. The fortuity principle thus does not provide, and cannot provide, a rationale for the precise line that these exclusions trace between covered and excluded loss.

This insight is confirmed by the fact that the internal-cause provisions do not exclude coverage of all loss resulting from the deficient quality of insured property. Rather, the effect of these provisions is merely to pre-

30. On adverse selection, see Abraham, supra note 13, at 3–4.
clude coverage of loss to property of deficient quality only if the loss is caused exclusively by a deficiency in that property. Thus, if insured property of deficient quality is damaged by an external force because of its deficient quality, such loss is often covered. For example, wind-related damage to a roof that would not have occurred if the roof had not prematurely weakened because of its low quality probably would be covered. Similarly, if certain insured property damages other insured property because of the deficient quality of the former, damage to the latter is covered. If a commercial freezer used in making frozen vegetables malfunctions because of a defect in design, loss of the product is covered.

Consequently, any notion that the threat of adverse selection renders it infeasible for property insurance to cover loss resulting from deficiencies in the quality of covered property would be overbroad. Some such losses are covered and some are not. Concern about insuring against deficiencies in the quality of insured property explains those limitations on coverage that have been incorporated in property insurance policies, but not all losses resulting from such deficiencies are excluded by any means.

It follows that there can be no general rule concerning loss resulting from internal causes or insurance of quality deficiencies. Such a rule could not specify the scope of the coverage actually provided by a property insurance policy. As noted earlier, in a very real sense the policy language is the rule governing coverage and exclusion of such losses. Because the point where the force of the internal-cause notion runs out is embodied in the policy language, the language of the relevant policy provisions is the touchstone of coverage. To identify a rule that could resolve actual coverage disputes would be to mistake a summary of judicial decisions about the meaning of the exclusions for an independent source of legal authority about the scope of coverage.

B. Business Risks in Commercial Liability Insurance

There are a number of striking parallels between the development of property and liability insurance. Just as property insurance began by covering only specified perils but eventually evolved into all-risk coverage, business liability insurance began by covering specified hazards, or activities generating liability. Early on, there was separate coverage for the operations hazard, the products and completed operations hazard, the elevator hazard, and the landlord’s, owner’s, and tenant’s hazard, among others. By 1940, however, a single, multipurpose insurance instrument was developed for

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31. The complication here involves application of the doctrine of concurrent causation, under which losses caused simultaneously by a covered and an excluded peril may fall within coverage. See Abraham, supra note 13, at 227.

32. See General Liability Insurance, in Donald S. Malecki et al., Commercial Liability Risk Management and Insurance 238 (2d ed. 1986).
both marketing purposes and convenience. The CGL policy promulgated by the property and casualty insurance industry that year covered all risks of liability for physical damage, except those excluded. Like the all-risk property insurance policy, the concept in the title of the CGL policy came to stand for a greater breadth of coverage than insurers intended, and a name with a more neutral connotation was eventually substituted. Thus, in 1986, the policy became the "commercial general liability" insurance policy.

Like the exclusions in the standard property insurance policy, the exclusions in the CGL policy tell an interesting story. In the beginning, there were only five exclusions, although the number has since proliferated. Some are unrelated, but like the internal-cause exclusions in property insurance policies, several CGL exclusions that are linked in purpose and effect shed considerable light on the deep structure of CGL insurance.

These business-risk exclusions preclude coverage of liability for damage to the policyholder’s own product and own work. In addition, coverage of liability for damage to property into which the policyholder’s product or work has been incorporated—impaired property—is excluded, unless such damage results from "sudden and accidental" injury to the policyholder’s product or work. Finally, allied with the business-risk exclusions is the "owned-property" exclusion, which precludes coverage for, among other things, liability for damage to property owned by the insured.

The combined effect of these provisions is to create a requirement that liability be incurred for damage external to the policyholder’s products, work, and property. This requirement is the converse of the internal-cause requirement in property insurance. In property insurance there is no coverage unless the peril causing damage comes from the outside-in, so to speak. In contrast, in CGL insurance there is no coverage unless the damage for which the insured is held liable comes from the inside-out. As long as an insured’s product or work causes damage to other property or causes bodily injury, the business-risk exclusions do not preclude coverage of liability for that damage or injury. If there is a condition on the insured’s property that causes harm to a third party or to third-party property, the cost of remedying that condition is not excluded by the owned-property exclusion. But under the business-risk exclusions in CGL policies, coverage is excluded if damage is only internal to the insured’s product, work, or property.

33. These precluded liability assumed under contract; arising out of aircraft, watercraft, or motor vehicle operation; statutory liability to employees; damage to property owned or occupied by the insured; and water damage liability. Id. at 239.
34. See Abraham, supra note 13, at 398.
1. The Received View of the Business-Risk Exclusions

The received view of the purpose behind these exclusions is at most only partially helpful in explaining them. It is said, for example, that the purpose of the business-risk exclusions is to ensure that there is coverage of tort liability for physical damage, but not of contractual liability for economic loss resulting from the deficient quality of the insured's product or work.\(^{35}\) It is said that only third-party injury and damage are the proper subject of risk sharing because these are entirely unpredictable.\(^{36}\) It is also said that the risk of suffering damage to one's own property is properly the subject of property, not liability, insurance.\(^{37}\)

The question, however, is why CGL insurance is not designed to cover these risks. The implication of the received view is that predictable risks are not covered by insurance. Thus, in *Weedo v. Stone-E-Brick, Inc.*,\(^{38}\) the seminal case on the issue, the court noted that third-party losses are covered because they are entirely unpredictable. From this it would follow that liability for damage to the insured's products, work, or property is excluded because such liability is highly predictable.

But this rationale is based on two premises, each of which turns out to be unsupportable. The first is that liability for damage to a policyholder's own product or work is not only predictable, but significantly more predictable than liability for harm suffered by third parties as a result of such damage. This premise is incorrect. It is true that businesses are likely to have track records regarding the frequency of defects in their products and work. But businesses also are likely to have track records regarding the frequency of liability incurred for third-party damage resulting from defective products or work. So there is no reason to suppose that the losses excluded by the business-risk and owned-property exclusions are significantly less predictable than those that are not excluded.

The second premise on which the received view is based is that insurance can cover only unpredictable losses. This premise is also incorrect. Without some predictability, the phenomenon that we know as commercial insurance would consist merely of pure risk pooling, without any individualization of premiums. In fact, predictability is at the core of modern insurance. Premiums are calibrated to take account of the predicted liability experience of the policyholder, based on its overall risk profile, including its past loss experience.\(^{39}\) The modern business buys insurance precisely to

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guard against the risk that its loss experience will vary from what is predicted. Because liability for third-party damage caused by the insured's product or work is in fact predictable, the unpredictability of such damage cannot serve as a basis for distinguishing what is and what is not excluded by the business-risk and owned-property exclusions.

2. An Alternative View

What, then, is the explanation for these exclusions? One possibility is that the exclusions are designed to address the problem at the heart of adverse selection and moral hazard. The problem is not the unpredictability of loss itself, but the incentives created by the very availability of insurance against particular categories of loss. When insurance is available, those at an above-average risk of suffering an insured loss adversely select coverage, that is, they disproportionately seek insurance. Insurers are therefore always in a struggle to price coverage so that it adequately distinguishes among insureds with different risks of suffering loss. Similarly, moral hazard, the tendency of those that are insured to exercise less care to avoid loss, also undermines insurers' efforts to price coverage accurately.40 Insurers may believe that adverse selection and moral hazard more severely affect the tendency of insureds to manufacture products or produce work that is safe but of low-quality than to manufacture or produce low-quality products or work that simultaneously risks causing injury or damage to third parties. Although this belief would not appear to be accurate, to the extent that insurers hold the belief, it may help to explain the exclusions.

Another possible explanation is that, even if adverse selection and moral hazard do not have the foregoing differential effect, damage to the insured's product or work alone is likely to be more frequent and of lower cost than third-party injury or damage. It costs less to replace a defective chain saw than to pay damages to a consumer whose hand has been injured by the defective saw. Because it costs proportionately more to insure against small than large losses, the exclusions may function as a kind of deductible that saves administrative costs and thereby disproportionately lowers premiums.

Finally, the business-risk exclusions may reflect the recognition that the insured is in the best position to remedy defects that cause physical damage to the insured's product or work alone. As the author of the product or work, the insured has a comparative advantage because of its familiarity with the product or work. The insured can best decide whether to make repairs, provide a replacement, or pay the purchaser for the costs of repair or replacement. The insurer is not as well situated to make this decision as the insured. In contrast, after there is bodily injury or damage to other

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40. On moral hazard, see Abraham, supra note 13, at 4.
property as a result of a defect in the insured's product or work, the insured has no comparative advantage over the insurer in deciding how to remedy this injury or damage.

Thus, the business-risk exclusions appear designed to serve a number of purposes, no one of which is necessarily or obviously sufficient to explain or justify their presence in the CGL policy. Like the internal-cause exclusions in property insurance, they are partly directed at reducing the risk that nonfortuitous loss will be covered. But they accomplish this aim only indirectly, by proxy, and incompletely. For this reason, it would be a mistake to apply these exclusions as if a single objective lies behind them. The exclusions draw a bright line, requiring that injury or damage must be external to the insured's product or work. However, this bright line reflects a combination of considerations rather than one discernible and dominant principle. For the same reason, it would be a mistake to suppose that there is any independent legal rule about which business risks are or are not covered by CGL policies. The risks covered are those not excluded by the particular language of the business-risk exclusions. These exclusions state the only rule that can resolve actual coverage issues.

III. FORTUITY

The message of the preceding section is that the internal-cause and business-risk exclusions address fortuity only indirectly, and simultaneously address other considerations as well. These exclusions thus represent a compromise among a series of considerations. In contrast, other provisions in both property and liability insurance policies address fortuity directly and exclusively. One of the main issues that these provisions pose is whether they reflect all the concerns of the fortuity principle, thus exhausting any need for an independent legal rule governing fortuity.

A. Inevitability and Risk in Property Insurance

Property insurance covers only the risk of loss, not loss that is certain to occur, or so a long-standing axiom provides.\(^{41}\) The insuring language of property insurance policies makes crystal clear what it does cover, referring to the "risk of direct loss to property."\(^{42}\) But such policies do not always make equally clear what they do not cover. For example, these policies do not contain a "certain loss" exclusion. Rather, the risk-based nature of property insurance is reflected in the above-quoted insuring language and in exclusions addressing moral hazard. Thus, in the standard homeowners' policy, loss resulting from the insured's "intent to cause a loss" is ex-

\(^{41}\) See, e.g., Milford L. Landis, All Risk Insurance, 1951 Ins. L.J. 709, 714.
\(^{42}\) See Abraham, supra note 13, at 176.
cluded. 43 Were such provisions not included in property insurance policies, public policy would nevertheless preclude insurance recovery for loss that the insured intended or that resulted from actions that the insured knew were substantially certain to occur. 44  

But when a property insurance policy does contain provisions limiting coverage to loss caused by risk and excluding coverage of intentionally caused loss, the actual source of these limitations on coverage is not a legal rule. The source is the policy itself. There are any number of requirements and prohibitions that form the corpus of public policy. Contracts must conform to these requirements and may not violate these prohibitions. When a contract is in compliance with the demands of public policy, however, the courts look to the terms of the contract to determine its scope and application. Thus, contracts of enslavement are against public policy. But no one would say that the source of the limits of the employee’s duties under an employment contract is the public policy against enslavement, because this public policy places limits on what duties the employment contract may place on the employee. The source of the duties of the parties under the contract is the contract terms, not a public policy that would prohibit enslavement provisions if they happened to be included in the contract.  

So it is with fortuity. What public policy requires is that the insurance policy not reward the insured for intentionally destroying the subject matter insured, or acting with knowledge that loss is substantially certain to occur. Thus, public policy contains limits, or a floor, on what may be insured. Insurance policies must comply with these limits, and may set even more stringent ones if the parties so agree. As long as these requisite minimum limits are complied with, however, the source of legal obligation and the source of the limits on coverage are the insurance contract itself. Because the provisions of standard property insurance policies quoted above satisfy the fortuity requirement, they are the source of parties’ obligations. Nonfortuity, however, can be mistakenly confused with inevitability, with unfortunate results. From time to time this confusion has infected understanding of the internal-cause exclusions of property insurance policies. Thus, the courts and commentators sometimes state that loss resulting from ordinary wear and tear or a latent defect in insured property is not covered because that loss was bound to happen. 45 This is wrong. An event may be both inevitable and fortuitous. It is true that in common parlance

43. Id.  
44. See Keeton & Widiss, supra note 2, § 5.3(a), at 475; Koppers Co. v. Aetna Cas. & Sur. Co., 98 F.3d 1440, 1447 (3d Cir. 1996).  
45. See, e.g., Gulf Transp. Co. v. Fireman’s Fund Ins. Co., 83 So. 730 (1920) (“The purpose of the policy is to secure an indemnity against the accidents which may happen, not against mishaps which must happen.”); Gorman, supra note 25, at 352.
an event that is "bound" to happen is not a risk but a certainty. The sun is bound to rise tomorrow and the tides are bound to be affected by the moon. The reason that these events are not insurable, however, is not merely that they are bound to happen, but that we know that they are bound to happen.

In the absence of knowledge that an event, even an inevitable one, is substantially certain to occur, its occurrence is a fortuity and insuring against it is unobjectionable. For example, loss caused by a latent defect in insured property is fortuitous; that, in fact, is the essence of a latent defect. One does not know about it. With hindsight many things seem certain to have occurred, including loss from a latent defect. But certainty of occurrence does not violate the fortuity requirement, only certainty of occurrence when it is linked with conscious awareness of that certainty.

B. "Known Loss" in Liability Insurance

Insuring against liability prior to the late nineteenth century would have been considered violative of public policy, on the ground that being insured would promote what is now called moral hazard. But that legal posture changed with the introduction of liability insurance in the late nineteenth century, when businesses began to purchase insurance against the risk of incurring liability to their employees. Over time, employers' liability insurance came to cover the risk of liability to members of the public as well.\(^{46}\) When these policies were challenged as being violative of public policy, the courts consistently held that insuring against liability for negligence was permissible.\(^{47}\)

With the advent of workers' compensation, and its elimination of liability of employers to employees, the name of these policies was changed and their function was transformed. They first came to be known as public liability insurance. Then, in 1940, they became comprehensive general liability insurance. As noted earlier, in 1986, they became commercial general liability insurance. Other forms of liability insurance—auto liability, directors and officers liability, and malpractice liability, for example—developed during the same period.

There can be little doubt that it is against current public policy to insure against liability for intentionally caused loss. In most instances this prohibition also extends to loss that is not intended, but that the policyholder knows is substantially certain to occur. The courts rarely have the opportunity to rule on this issue directly, however, because virtually all liability insurance policies contain express limitations on coverage that address this issue. The modern CGL insurance policy, for example, excludes coverage of liability for harm that is expected or intended from the standpoint of

\(^{46}\) See C. Arthur Culp, Casualty Insurance 23 (1928).

the insured. 48 Most of the decisions addressing the liability insurance analog to the "fortuity" issue in property insurance involve interpretations of policy provisions such as this.

In recent years, however, some courts have addressed the fortuity issue without reference to policy language in decisions explicating what has come to be known as the "known-loss" defense. Based on the principle that only fortuitous loss may be insured, this defense holds that liability insurance may not cover losses of which the insured knows when insurance is purchased. 49

1. What the Defense May Add to the Insurer's Arsenal

Whether this defense adds anything useful to policy language that already precludes coverage of liability for expected or intended harm is far from clear. Although few courts have addressed this question, one possible explanation is that the expected or intended exclusion is applicable only to losses that have not already occurred at the time that a policy takes effect. Considering this view, a loss that has occurred cannot be expected or intended because expectations and intentions are directed at future rather than present events or conditions. Nevertheless, the argument goes, a loss that is known to have occurred at the time that a policy is purchased is not fortuitous and therefore should not be covered, even in the absence of an applicable exclusion. 50

This explanation of the known-loss defense is plausible in the abstract, but the explanation gets into trouble when the effort is made to apply the defense. Until final judgment in an action seeking civil damages is entered, there is always risk rather than certainty associated with even a known loss. To put it another way, when there is known damage for which the insured may or may not be liable, whether liability will be imposed and the extent

48. See Abraham, supra note 13, at 395.
50. Two other possibilities are less plausible. First, it might be thought that whereas the expected or intended issue is ordinarily a question of fact, the known-loss defense poses an issue for the court. Since both depend on wholly factual predicates, however, to the extent that this is actually the case, it is an unfortunate development. In any event, leading decisions appear to treat the defense as posing a question of fact. See, e.g., Stonewall Ins. Co., 73 F.3d at 1216. Second, if a loss has already occurred at the time that a policy has been issued, then under some conceptions of the "trigger of coverage" under liability insurance policies, the event that activates coverage, injury, or damage during the policy period has occurred under the prior policy period and does not activate the current policy. To the extent that this is the case, however, a separate "known-loss defense" is unnecessary. Coverage is not triggered, whether the insured knows of the loss or not, and the law governing the trigger of coverage wholly takes care of the problem, without the need for an additional, wholly redundant, defense.
of liability are both uncertain and therefore fortuitous.\textsuperscript{51} The requirement that loss be fortuitous in order to be insurable is not violated merely because the insured knew that the loss had occurred at the time that a policy was issued.

What is actually objectionable about insuring a known loss is that the insured, but not the insurer, knows of the loss when the insurer decides whether to issue the policy and what premium to charge. Where there is mutual knowledge, public policy does not, and should not, prohibit insuring against the fortuitous feature or features of a known loss. Consequently, to the extent that the known-loss defense is directed at something objectionable, it is directed at the problem of asymmetric information, that is, surprise on the part of the insurer.

But insurers already have both a suitable mechanism for dealing with asymmetric information and strong legal support for that mechanism: the application for coverage and the law of misrepresentation. The questions on an application can require the insured to disclose information about known losses that may ripen into liabilities. The failure to disclose material information in response to such questions constitutes a misrepresentation that precludes coverage of liability for the loss if the insurer justifiably relied on the misrepresentation to its detriment.\textsuperscript{52} Moreover, even in the absence of a direct question about known losses, under the law of fraudulent concealment, the insurer could properly deny coverage of liability for an undisclosed known loss that the insured knew would have been material to the insurer if the other prerequisites to a fraud defense are proved.\textsuperscript{53}

This combination of the application questionnaire and the law governing misrepresentation and concealment would seem to be completely adequate protection for the insurer. If the known-loss defense adds anything at all to this protection, it is by eliminating the elements of materiality and justifiable reliance from the insurer's defense. Although these are essential elements of a conventional defense of misrepresentation or concealment, they are apparently irrelevant to a known-loss defense.

2. Is the Defense Justified?

Without question, this feature of the known-loss defense is independent of the expected or intended exclusion and the law of misrepresentation and concealment. That is, this feature extends the defense beyond what these sources of obligation exclude from coverage. The question, however, is whether this independent feature of the known-loss defense, the feature

\textsuperscript{52} See Keeton & Widiss, supra note 2, § 5.7, at 570–72.
\textsuperscript{53} Id. § 5.8, at 573.
that sets it apart from the two existing defenses that it otherwise merely duplicates, can be justified. In effect, this feature of the defense precludes coverage even if a known loss has a fortuitous component, even if knowledge of the loss would have been immaterial to the insurer, and even if the insurer did not justifiably rely on the implied representation that the loss did not exist.

Why a general fortuity requirement should not automatically preclude insuring against a known loss has been addressed above. Even when a loss is known, it still may have risk associated with it. Thus, the crux of the issue is whether dispensing with the materiality and justifiable reliance requirements is sensible. Doing so would reinstate Lord Mansfield's old, and long-overruled, maritime law rule governing insurance warranties, under which a false representation of fact that the insured warranted to be true automatically voided coverage, regardless of the materiality of the misrepresentation.\(^{54}\) What might have been an appropriate rule for the close community of underwriters and shippers at Lloyd's Coffee House in eighteenth century London, however, soon became an inappropriate one for ordinary commercial and consumer policyholders. Because of its harshness, Lord Mansfield's warranty rule has been eliminated by statute in most jurisdictions for well over a century.\(^{55}\)

These statutes reflect the principle that materiality and justifiable reliance are relevant in cases involving asymmetric information. Under the statutes, if an insurer would have issued the same policy to the insured even if all the facts known by the insured were also known by the insurer, then the insurer has suffered no harm whatsoever and should have no defense.\(^{56}\) Given this general principle that materiality and reliance are relevant in cases involving asymmetric information, why should they nonetheless be dispensed with as elements of proof under the known-loss defense?

The best argument for doing so would have to be that the existence of a known loss would almost always be material and justifiably relied upon by the insurer if the existence of the loss were also known by the insurer at the time that it issued the policy. If this were the case, then requiring proof of these elements would usually be unnecessary. It seems unlikely, however, that all or even almost all known losses would be material and justifiably relied upon if disclosed to insurers. The relevance of information about known losses undoubtedly varies, depending on the potential size of the known loss, the probability that the insured will be held liable for it, and the frequency and severity of other losses that the insured can be


\(^{55}\) See Abraham, supra note 13, at 11–13.

\(^{56}\) Id.
expected to suffer during the policy period, among other factors. To conclusively presume materiality and justifiable reliance in the insurer's favor under these circumstances would therefore be unjustified. Yet that is precisely what a known-loss defense that is independent of the law of misrepresentation and concealment accomplishes.

In short, the known-loss defense exemplifies the danger of misleading duplication that was identified by my earlier discussion of the role of rules in insurance policy interpretation. The expected or intended exclusion and the law of misrepresentation and concealment adequately satisfy all the requirements of public policy regarding coverage of only fortuitous loss. The known-loss defense not only adds a layer of unnecessary duplication, but, to the extent that it is not mere duplication, the defense goes farther than public policy requires, and farther than public policy needs to or should require. In this latter respect, the known-loss defense does create an independent legal rule by rendering materiality and justifiable reliance irrelevant. But precisely to this extent, the known-loss defense is unjustifiable.

IV. THE PROPER ROLE OF PRINCIPLES AND PURPOSES IN INSURANCE POLICY INTERPRETATION

The contention that we should not be misled by rules that have no source independent of insurance policy language that they interpret is not blind to the context-dependent nature of insurance policy provisions. The author does not contend that policy provisions must always be interpreted literally or that they may be understood without reference to surrounding considerations. On the contrary, identifying the purpose of a provision or the principle that motivates use of a particular policy provision is often an aid to interpretation. But these are efforts to determine the meaning of policy provisions, not to construct rules that exist apart from the meaning of policy language.

My analysis of the way in which property insurance and liability insurance have developed in parallel reveals that they have arrived at similar points in the history of their interpretation and application. Important policy provisions in both forms of insurance are now sufficiently mature and stable that it is possible to identify the general principles that figure in their continuing application.

A principle, however, is not a contract. Inevitably, insurance policies draw a line where the force of the purpose or principle behind a policy provision runs out, or bumps up against a competing purpose or principle. These are the lines between losses that are and are not covered. Perhaps the most general, and therefore least helpful, insurance law principles are those based on notions of what the essence of insurance is or is not. In-
urance as we know it is no simple instrument, but a complex and varying mixture of risk transfer, risk sharing, and risk allocation.\textsuperscript{57} There is no essence of insurance that is sufficiently distinct and precise to serve as the basis for deducing what is and is not covered by an insurance policy. Even when the decision maker is appropriately informed and assisted by theory, the task of interpretation is practical, not philosophical.

Decisions relating to the concepts of peril and fortuity in property and liability insurance are especially susceptible to this failing. Identifying the essence of the perils or risks insured, or the essence of what insurance is designed to protect against, is a poor and misleading substitute for doing the hard work of interpreting policy language. The outcomes of disputes over peril and fortuity are likely to be far more satisfactory in the long run if decision makers focus more carefully on the details of policy language and on principles couched concretely enough to help draw the fine distinctions on which just results should hinge.

To illustrate how this can be accomplished, two contemporary and important insurance problems raising issues of peril and fortuity are addressed below. The first involves coverage of so-called Y2K remedial expenses under commercial property insurance policies. The second involves the question of whether liability arising from ordinary business activities is covered by CGL insurance policies.

A. Y2K Remediation

A number of major policyholders have made claims for coverage under their property insurance policies for the cost of preventing losses that would have been caused by Y2K computer failures, had reprogramming prior to January 1, 2000, not been undertaken.\textsuperscript{58} Such policies contain a "Sue and Labor" clause or a similar provision that is the basis of these claims. Sue and Labor clauses tend to cover the insured against the cost of preventing imminent loss, to the extent that such loss would have been covered by the policy if it had occurred.\textsuperscript{59}

A sensible analysis of this problem begins with the notion that, had they occurred, these losses would for the most part have been fortuitous. Although the risk that Y2K losses would occur was known, it was not substantially certain that they would occur at all, nor were the particular losses that would have occurred substantially certain. No policyholder could have

\textsuperscript{57} See id. at 2-3.

\textsuperscript{58} For a catalogue of major claims in suit, see Joanne Wojcik, \textit{Y2K Bug Is Still Biting}, \textit{Bus. Ins.}, July 17, 2000, at 1, 70.

\textsuperscript{59} A typical Sue and Labor clause provides that "[i]n case of misfortune hereunder, it shall be lawful for the insured to sue, labor, and travel for the defense, safeguard, and recovery of the insured property . . . ." Roland A. Anderson, \textit{15 Couch on Ins. 2d} § 55:124 (rev'd ed. 1984).
predicted with any precision what would have happened if reprogramming had not been undertaken. Merely because, in retrospect, it might have been possible to say that certain losses had been inevitable would not have made the losses any less fortuitous.

On the other hand, a Y2K loss that was prevented through computer reprogramming might nevertheless have been uninsured if it would have been caused by an excluded peril. If such a loss would not have been covered had it occurred, then the cost of preventing its imminent occurrence ordinarily would not be covered by a Sue and Labor clause. For example, the Y2K date contamination at the heart of the problem may be the product of a latent or design defect, or of inherent vice. The answer will depend at least in part on technical facts and, if the cases go to trial, expert testimony.

The uncertainty about whether one or more of these exclusions applies underscores the sense in which the all-risk or open-peril character of modern property insurance is a double-edged sword for insurers. Outside of the list of excluded perils, there is no express limit on the causes of loss that are covered. Insurers may want to argue that, although there is no limit on the causes of loss that are covered, their policies still implicitly limit coverage to loss caused by some peril or other, and that Y2K malfunctions would not have been caused by any outside peril at all. Rather, the argument would go, these malfunctions would have been the result of computers operating in precisely the manner that they were originally programmed to operate.

The trouble with this argument is that it relies on a putative principle that is nowhere enshrined in the language of the policy. As noted earlier, there is no express requirement in the language of property insurance policies that loss be caused by a peril, let alone by an outside peril. It would not be surprising, therefore, to see insurers turn also to nonfortuity as a basis for their defense to claims of coverage for Y2K prevention costs. But this would be to make the mistake of confusing inevitability with nonfortuity.

Because there is no general principle that can resolve this entire issue, however, does not mean that there is coverage of Y2K prevention costs. Rather, the question is on what battleground the dispute should be resolved. Three questions seem critical. The first is whether the losses prevented were imminent within the meaning of the Sue and Labor clause. The purpose of the imminence requirement is to ensure that ordinary maintenance and loss prevention costs are not covered by insurance. These

regularly recurring costs are more efficiently shouldered by the policyholder than the insurer. Losses that are imminent are much less likely to have been preventable by ordinary maintenance than regularly recurring losses. Imminence is therefore a concrete though only partially accurate proxy for extraordinariness, which in turn reflects at best a vague distinction between what is and what is not most efficiently covered by property insurance.

But because it is a proxy, imminence must be measured by reference to urgency of prevention, rather than by the extraordinariness of what is to be prevented. Time is obviously an element of urgency. But it is only an element, other things being equal. Just as a loss that will occur in a minute if a switch is not thrown is imminent, a loss that will take a week of effort to prevent is imminent a week before it will occur. Most Y2K remedial activities took months and, for some companies, years to accomplish. At least in the sense just described, whether Y2K losses were imminent months or years before January 1, 2000, because of the time that it took to prevent them is the first issue that must be resolved. No doubt the notion that a loss is imminent months or more before it occurs stretches the concept of imminence, but perhaps not to the breaking point.

Second, under the typical Sue and Labor clause, the loss prevented must be one that would have been covered had it occurred. The clause does not insure against the cost of preventing uninsured losses. The point of the clause is to encourage, or at least not to discourage, the insured from making loss-prevention expenditures in the short run that may save the insurer money in the long run. So the question is, what losses would have been prevented by Y2K remediation expenditures? Answering this question requires the difficult kind of counterfactual inquiry that often is undertaken under the rubric of “cause in fact” in tort actions. Whether and to what extent it will be possible to pinpoint the losses that Y2K remediation has prevented is uncertain.

The third question is whether such losses, if they can be pinpointed, fall within coverage. Some losses that would have resulted from Y2K computer failures would have been to other property. For example, if a sprinkler system would have malfunctioned and caused water damage, determining whether such damage would have been covered will probably be a relatively straightforward matter. But suppose that the only damage would have involved the failure of computers and the consequent economic losses associated with these failures. Then the critical question would be whether the failure of a computer because of Y2K date contamination itself is a physical injury within the meaning of the insuring language of the policy, and whether, if it is, any exclusions nevertheless apply.

The former is a technical, engineering question. The latter question depends upon the exclusion at issue. For example, it might be argued that
Y2K date contamination is the product of an excluded design defect. Presumably not every feature of a design that falls short of perfection is a defect. Merely because a Pontiac is not as crashworthy as a Mercedes does not mean that the Pontiac has a design defect. The state of the art at the time that the software was installed may have rendered a design that avoided a Y2K flaw cost ineffective or technically infeasible. On the other hand, if a design can become defective as time progresses, by the time that policyholders began remediying Y2K-flawed software, its design may already have been defective.

The point of this analysis is not to answer these questions but to demonstrate that whether Y2K remediation expenses fall within the Sue and Labor clause of property insurance policies must be answered by reference to particular policy provisions and the purposes that they serve, rather than to putative general principles that are substitutes for careful application of these policy provisions.

B. Coverage of Liability for Damage Resulting from Routine Business Activities

The CGL insurance policy can be searched in vain for policy language precluding coverage of liability for damage resulting from routine business activities. Yet it is common to find insurers arguing that routine business expenses are not covered by CGL policies. This argument seems to rely on the principle that only fortuitous losses may be covered by insurance. The factual premise of the argument is that routine business expenses are not fortuitous because it can be anticipated that they will be incurred.

For example, spills of hazardous materials in the course of the policyholder’s routine activities may have resulted in environmental contamination for which the policyholder is later held liable. Whether this liability is excluded depends on whether the damage was “expected or intended” from the standpoint of the insured. The fact that the insured intended to engage in the routine activities that caused the damage, however, does not render the damage expected or intended. The unexpected and unintended results of an intentional act are still accidental and therefore are not expected or intended.62

The insurance significance of the fact that damage is caused by routine activities would seem to be evidentiary. The more routine and therefore the more recurring an activity that frequently causes damages, the more likely it is that the policyholder actually expects the activity to cause damage. If there is evidence that on three mornings out of four a person spills cereal while pouring it into a bowl, a finder of fact could reasonably determine that he or she expected to spill cereal in the morning. Depending on the facts, summary judgment or a directed verdict for the insurer on

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62. See Keeton & Widiss, supra note 2, § 5.3, at 475.
the issue might even be appropriate. But the basis for ruling as a matter of law on the issue would not be that the damage at issue was caused by routine activities; it would be that, in part because of this fact, reasonable people could not disagree that the person expected or intended the damage.

On the other hand, it is perfectly possible for damage to be caused by routine activities without the policyholder expecting it. If a person spills cereal on rare occasions, he or she does not expect to do so, because spillage is not substantially certain to occur. Similarly, if a policyholder whose trucks unload hazardous material on a daily basis knows that on rare occasions the material spills, a spill is not expected.

The insurer's rejoinder to this conclusion might be that, as long as it is substantially certain that on rare occasions a spill will occur, then a spill at some point in time is "expected or intended." This rejoinder is certainly a long way from the argument that liability for the spill is not covered because it results from a routine business activity. If a spill results only on rare occasions from a routine business activity, the fact that the activity is routine has ceased even to be evidentiary on the issue of what the insured expected or intended.

The insurer's rejoinder makes a second fundamental error as well. The core of the rejoinder is that, even if an event occurs only rarely, if it is highly likely to occur, then it is expected. This cannot be the case. Even though a person expects to die, that person can insure against death because neither the insurer nor the person knows when death will occur. When rare but highly likely events are insured against, the risk transferred to the insurer is the risk that the event will occur during the insurer's policy period. If the insurer argues after the event occurs that liability for damage resulting from the event is not covered because the policyholder expected the event to occur, the insurer has reneged on its bargain. It is true that, when the policyholder knows of the risk that the event will occur and the insurer does not, the bargain is not explicit. But, as explained earlier, this is a problem of asymmetric information that is best dealt with by the application for insurance and the law of misrepresentation. Distorting the concept of expected or intended harm is a misleading way to address the problem.

This analysis resolves the two scenarios at extreme ends of the continuum: frequent damage caused by routine, recurring activities, and the rare loss that is nonetheless highly likely to occur at some point. What of the situations that fall somewhere in between? Suppose that a policyholder has experienced between four and ten lawsuits a year for damage caused by its products every year for the last fifteen years? Is the damage alleged in these suits expected or intended?

The damage is not expected or intended on the basis of the policyholder's knowledge of these statistics. The policyholder has paid a pre-
mium equal to its predicted loss, between four and ten suits a year, plus what might be called an uncertainty premium to cover the risk that this year’s loss will exceed what both the policyholder and the insurer predict. The predicted loss is not excluded on the ground that it is expected or intended. On the contrary, the transaction transfers to the insurer both the upside and downside risk that the policyholder’s loss will not be what is expected. If what is expected occurs, then the transaction is an economic wash. To deny coverage when what is expected occurs would be to give the insurer a massive profit under what it anticipated would be break-even circumstances.

There are other devices that could be employed to handle this quotient of statistically expectable, or predicted, but not expected loss. The policy can be made subject to a deductible roughly equal to the amount of the loss that is predicted. Or the policy can provide that a statistically predicted level of loss is excluded, but that losses in excess of this level are covered. When these devices are not employed, however, statistically predictable losses are not “expected or intended” merely by virtue of the fact that they are statistically predictable. On the contrary, the very purpose of the policy is to cover these losses, as well as additional unpredicted losses. A rule that statistically predictable losses are expected and are therefore excluded from coverage under liability insurance policies would confound this purpose.

V. CONCLUSION

The concepts of peril, business risk, and fortuity play an important role in property and liability insurance. But the role that these concepts play is reflected first and foremost in the language of insurance policies. To mistake legally authoritative interpretations of standard policy provisions for legal rules about what property and liability insurance does and does not cover would be to let the tail wag the dog. For the most part, insurance policies, not legal rules divorced from what the policies mean, dictate the perils, business risks, and fortuitous losses that insurance policies cover or exclude.