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A REFORMATION REMEDY FOR EDUCATORS PROFESSIONAL LIABILITY INSURANCE POLICIES

ABSTRACT

Third-party liability insurance held by public school districts, including educators professional liability insurance and general commercial liability insurance, occupies a unique economic and political role. Coverage of tort claims against school districts and the regulatory effect of the scope of such coverage are important public policy issues. Nevertheless, the application of traditional insurance doctrine to school districts has received little attention, either from advocates for changes to the law of liability insurance or from those analyzing trends in tort liability in the public education context.

In light of public policy concerns, courts have traditionally resisted the application of insurance policy rescission to cases of application misrepresentations by school districts. Without an alternative remedy available, courts have turned to other theories, such as waiver or contra proferentem, often going so far as to decline to engage in any doctrinal analysis of the misrepresentation at issue. Furthermore, courts' attempts to avoid rescission come at the expense of insurers, who at times do not recover any of the costs incurred by even a fraudulent or material misrepresentation.

This Comment will propose a reformation remedy that acknowledges the public interest in ensuring compensation for injuries sustained by children as a result of misconduct in the course of education. A reformation remedy would clarify the body of law that has grown around school district misrepresentations by allowing courts to avoid the strained application of alternative legal theories. It would allow insurers to recover their actual losses while also providing coverage for the vulnerable plaintiffs of educational misconduct. Finally, it would ensure a more efficient liability insurance market for school districts by improving the accuracy of pricing for individual school districts and cost spreading across districts with wide disparities in resources.

INTRODUCTION

The Second Tentative Draft of the Principles of the Law of Liability Insurance was approved at the American Law Institute (ALI) Annual Meeting in May 2014.¹ In October 2014, the project was renamed the Restatement of the Law, Liability Insurance.² The ALI Council elected to rename the project because, as ALI Director Richard Revesz explained, Restatements “seek to provide guidance to courts . . . where there is a body of established positive law.”³ The project’s reporters revised the previously approved chapters to better reflect the nature of a Restatement as a distillation and refinement of existing common law, and circulated the revised draft for discussion at the ALI 2015 Annual Meeting.⁴

While not binding, ALI projects, including model codes, restatements, and principles, allow “leading representatives, from all parts of the country, of the bench, the bar, and the principal law schools,”⁵ to converse with courts and legislatures on the current state of the law and proposals for reform.⁶ While some ALI projects have been more widely adopted than others, ALI projects remain at the forefront of legal synthesis and reform.⁷

The Principles of the Law of Liability Insurance offered recommendations distilled from input across the industry: the Project’s advisors include judges, professors, and practitioners representing the insurance industry and policyholders.⁸ Former ALI Director Lance Liebman stated that the goal of the Principles was to draft “coherent doctrinal statements based largely on current

¹ Randy J. Maniloff, *Update: ALI’s Restatement of the Law of Liability Insurance*, LEXISNEXIS LEGAL NEWSROOM (July 15, 2015, 3:37 PM), <http://www.lexisnexis.com/legalnewsroom/insurance/b/insurancelaw/archive/2015/07/15/update-ali-s-restatement-of-the-law-of-liability-insurance.aspx#sthash.THOxZsFD.dpuf>.

² *Id.*

³ *Id.* Professors Peter Alces and Chris Byrne note that Principles projects are “more appropriate than Restatements in situations where the law is unsettled or where a more fundamental revision of the law is needed, especially in legal areas governed by both statutes and the common law.” Peter A. Alces & Chris Byrne, *Is It Time for the Restatement of Contracts*, Fourth?, 11 DUQ. BUS. L.J. 195, 200 (2009) (citing AM. LAW INST., MODEL CODE OF EVIDENCE viii (1942)).

⁴ Maniloff, *supra* note 1.

⁵ Alces & Byrne, *supra* note 3, at 198 (quoting 3 A.L.I. PROC. 59 (1925)).

⁶ *See id.* at 196–207 (summarizing the history of ALI projects and the trend away from model codes and toward principles projects).

⁷ Bennett Boskey, *The American Law Institute: A Glimpse at Its Future*, 12 GREEN BAG 2D 255, 261–62 (noting that ALI Principles projects are poised “to achieve substantial and timely law reform”).

⁸ Michael F. Aylward & Lorelie S. Masters, *A “Principled” Approach to Coverage? The American Law Institute and Its Principles of the Law of Liability Insurance*, 81 DEF. COUNS. J. 117, 117–18 (2014).

state law, but also grounded in economic efficiency and in fairness to both insureds and insurers.”⁹ Additionally, the project sought to reduce litigation over insurance coverage by providing a streamlined approach to policy interpretation.¹⁰ In summarizing the revisions made to adapt the Principles into a Restatement, the Reporters noted that “a few of these changes may result in the Institute supporting rules that it would not support were it writing on a blank slate,” but that these compromises were justified by the “persuasive” power of a Restatement “to contribute to the improvement of the law of liability insurance.”¹¹ Despite their reliance on prevailing applications of the law, Restatements are not devoid of prescriptive power; the ALI has noted that Restatements are “intended to reflect the flexibility and capacity for development and growth of the common law” and that a Restatement’s choice of individual rules “leads to more coherence in the law.”¹²

The Restatement’s Reporter, Tom Baker, and the Associate Reporter, Kyle Logue,¹³ have published extensively on the economic and policy contours of corporate Directors and Officers Liability (D&O) coverage,¹⁴ auto insurance,¹⁵ and legal malpractice, among other third-party insurance schemes, as well as on economic and political issues including the moral hazard effects of insurance¹⁶ and insurance discrimination.¹⁷ This Comment will analyze the relationship between the Restatement’s proposals and a less-understood area of liability insurance: educators professional liability insurance and commercial general liability insurance held by school districts. There has been considerable recent discussion of policy concerns undergirding tort liability for educators and school districts in specific contexts, including supervision of disabled

⁹ *Conference on the ALI’s Principles of the Law of Liability Insurance*, RUTGERS L. SCH. [hereinafter *ALI Conference*], <https://camlaw.rutgers.edu/conference-ali%E2%80%99s-principles-law-liability-insurance> (last visited Mar. 24, 2016).

¹⁰ See Aylward & Masters, *supra* note 8, at 119.

¹¹ RESTATEMENT OF THE LAW: LIAB. INS. xix (AM. LAW INST., Discussion Draft 2015).

¹² *Id.* at x–xi.

¹³ *Id.* at iv.

¹⁴ See, e.g., TOM BAKER & SEAN J. GRIFFITH, ENSURING CORPORATE MISCONDUCT: HOW LIABILITY INSURANCE UNDERMINES SHAREHOLDER LITIGATION 202 (2010).

¹⁵ Tom Baker & Rick Swedloff, *Regulation by Liability Insurance: From Auto to Lawyers Professional Liability*, 60 UCLA L. REV. 1412, 1427 (2013).

¹⁶ Omri Ben-Shahar & Kyle D. Logue, *Outsourcing Regulation: How Insurance Reduces Moral Hazard*, 111 MICH. L. REV. 197 (2012).

¹⁷ Ronen Avraham, Kyle D. Logue & Daniel Schwarcz, *Understanding Insurance Antidiscrimination Laws*, 87 S. CAL. L. REV. 195 (2014).

students and teachers' fiduciary duties to students.¹⁸ In contrast, existing scholarship on public education does not include an analysis of the application of third-party liability insurance principles to the unique economic and policy concerns inherent in public education.¹⁹

This Comment will address this gap by analyzing the application of liability insurance doctrine to school systems in the context of application misrepresentations. The Principles suggested a number of innovative approaches to traditional insurance doctrine, almost all of which were designed to foster economic efficiency and fairness in relationships between insurers and insureds, such as individual insureds in the case of auto insurance and large public companies in the case of D&O coverage.²⁰ Chapters 1 and 2, revised in 2015 and slated for consideration by the ALI's members at the 2016 annual meeting, cover Interpretation, Waiver and Estoppel, Misrepresentation, and the Insurer's Duty to Defend.²¹

This Comment addresses §§ 7–11 of the Principles and the corresponding §§ 7–9 of the Restatement, which set forth proposals for the treatment of misrepresentations made by insureds during the application process, particularly in regard to the availability of rescission as a remedy for insurers when the applicant has made a misrepresentation in the application for the

¹⁸ See, e.g., Lynn M. Daggett, *Reasonable Supervision of Special Students: The Impact of Disability on School Liability for Student Injury*, 43 J.L. & EDUC. 303 (2014); John E. Rumel, *Back to the Future: The In Loco Parentis Doctrine and Its Impact on Whether K-12 Schools and Teachers Owe a Fiduciary Duty to Students*, 46 IND. L. REV. 711 (2013).

¹⁹ Existing scholarship touches on the impact of liability insurance in shaping tort recovery; for example, Professor Lynn Daggett notes that a plaintiff is likely to sue when he or she sees a school as “a ‘deep pocket’ with significant financial resources and likely a liability insurance policy with high limits,” and that the insurers' frequent choice of defense counsel inexperienced in special education law may result in a plaintiff's disability being marginalized in a resulting judicial opinion. Daggett, *supra* note 18, at 307, 335–36. Other scholarship has discussed the role of liability insurance in waiving school district governmental immunity, which is explored in Part II. See also Basil Markesinis & Adrian R. Stewart, *Tortious Liability for Negligent Misdiagnosis of Learning Disabilities: A Comparative Study of English and American Law*, 36 TEX. INT'L L.J. 427, 455–57 (2001) (discussing whether the regulation of educator behavior through liability and liability insurance is desirable, but not addressing the operative effect on school districts of specific rules of insurance policy application and interpretation). Existing scholarship often cites the popularity and cost of liability insurance policies as indicators of the impact of the threat of litigation on educators. See, e.g., Brett G. Scharffs & John W. Welch, *An Analytic Framework for Understanding and Evaluating the Fiduciary Duties of Educators*, 2005 BYU EDUC. & L.J. 159, 159 (noting that purchases of liability insurance demonstrate that “[t]he law, it seems, is of increasing concern to teachers and educators”); Perry A. Zirkel, *Paralyzing Fear? Avoiding Distorted Assessments of the Effect of Law on Education*, 35 J.L. & EDUC. 461, 463 (2006).

²⁰ ALI Conference, *supra* note 9.

²¹ Maniloff, *supra* note 1.

insurance policy.²² Rescission, which has traditionally been available for a wide range of misrepresentations under state statutes and common law, is a comprehensive remedy; not only does it allow the insurer to “avoid any liability for benefits provided under the policy, even on pending claims,” it also voids the policy’s existence.²³ Sections 7 through 9 define the circumstances in which the Restatement would allow misrepresentation to permit the insurer to rescind the policy.²⁴ Section 11 of the Principles suggested a quasi-reformation remedy designed to “provide more transparent and predictable protection to insureds acting in good faith than the devices presently used to limit rescission.”²⁵ While acknowledging the validity of this policy concern, the Reporters determined that such an innovative approach to innocent misrepresentations was beyond the scope of a Restatement, noting that “there is not yet sufficient common-law authority to that effect despite the longstanding recognition of the unfairness of the strict-liability approach and the power of common-law courts to change common-law rules.”²⁶

The Principles originally argued that the availability of rescission when the insured has made an innocent misrepresentation that is not intentional or reckless was “unfair” and “draconian” because such a mistake is “among the sorts of risks for which the policyholder purchased insurance in the first place.”²⁷ Critics of the strict liability approach have pointed out that, in addition to the inherent unfairness of the approach, the “fact-driven and ad hoc” doctrines courts have developed to soften the harsh outcome of rescission in particular cases are inefficient and costly for parties.²⁸ This Comment will argue that the effects of this avoidance are particularly strong in the field of

²² RESTATEMENT OF LIAB. INS. §§ 7–9 (AM. LAW INST., Discussion Draft 2015); AM. LAW INST., PRINCIPLES OF THE LAW OF LIABILITY INSURANCE §§ 7–11 (Tentative Draft No. 1, 2013) [hereinafter PRINCIPLES]. The Reporters note that misrepresentation was “the topic that ha[d] the most significant revision” in the Restatement draft. RESTATEMENT OF LIAB. INS., at xvii.

²³ *Atmel Corp. v. St. Paul Fire & Marine*, 426 F. Supp. 2d 1039, 1044 (N.D. Cal. 2005) (“Where grounds for rescission exist and the insurer properly exercises its right to rescind, the insured’s contract rights are extinguished *ab initio* (as if the policy had never existed).”). Because the “purpose of rescission . . . is to return the parties to the status quo,” unlike in a claim for cancellation, the court may “condition the grant of rescission on the insurer’s compliance with the court’s order to tender to the insured the premiums paid.” *Tig Ins. Co. v. Reliable Research Co.*, 228 F. Supp. 2d 921, 929 (S.D. Ill. 2002), *aff’d*, 334 F.3d 630 (7th Cir. 2003).

²⁴ PRINCIPLES, *supra* note 22, §§ 7–10.

²⁵ RESTATEMENT OF LIAB. INS., at xvi.

²⁶ *Id.* § 7 cmt. j.

²⁷ PRINCIPLES, *supra* note 22, § 7.

²⁸ Brian Barnes, Note, *Against Insurance Rescission*, 120 YALE L.J. 328, 356–57 (2010).

educators professional liability policies and school districts' commercial general liability insurance policies, for which compensating those injured by the public education system is a pressing policy priority.²⁹

The Principles limited the mandatory reformation remedy to small commercial policyholders, designating the remedy as a waivable default for policyholders with assets of more than \$10 million.³⁰ The Principles explained that this exemption of large commercial policyholders was rooted in the sophistication of the parties, rather than the nature of the policyholder's business, noting that "[t]he vast majority of organizations, whether operated for profit or not, that have \$10 million in assets should be able to hire reasonably sophisticated advisors."³¹ The Restatement abolished the large and small commercial policyholder distinction on the grounds that such "a bright-line distinction . . . is more appropriate for a legislature or a regulatory agency."³² The Restatement's rescission remedy for innocent misrepresentations now applies to all policyholders, regardless of size.³³

This Comment will argue that school systems have little else in common with the other commercial policyholders the Restatement primarily addresses. School systems occupy a unique policy and economic position which demands specialized rules of policy interpretation. The application of the Restatement's standardized treatment to the unique case of school systems does not effectuate the goals of fostering economic efficiency and fairness to insurers and insureds, nor does it lead to coherence in the law. This Comment will argue

²⁹ See, e.g., Dawn A. Ellison, Comment, *Sexual Harassment in Education: A Review of Standards for Institutional Liability Under Title IX*, 75 N.C. L. REV. 2049, 2121 n.527 (1997) ("The educational process itself is founded upon the development of dependent, trusting relations between students and teachers Students of all ages are exceptionally vulnerable to the advances and sexual conduct of teachers, and are often incapable of either recognizing or objecting to the impropriety of their teachers' behavior." (quoting Stefanie H. Roth, *Sex Discrimination 101: Developing a Title IX Analysis for Sexual Harassment in Education*, 23 J.L. & EDUC. 459, 509–10 (1994))).

³⁰ PRINCIPLES, *supra* note 22, § 1 cmt. b. Under this approach, the quasi-reformation remedy would not have been mandatory for school system policyholders because the insureds under commercial general liability and educators professional liability policies are usually school districts or cooperatives of multiple school districts with high asset values. See, e.g., *Haley v. Cont'l Cas. Co.*, 749 F. Supp. 560 (D. Vt. 1990) (noting that the insured was a seven-district union).

³¹ PRINCIPLES, *supra* note 22, § 1 cmt. b.

³² RESTATEMENT OF LIAB. INS. xvii (AM. LAW INST., Discussion Draft 2015). The regulatory nature of the distinction is underscored by the fact that the Principles distinguished between large and small commercial policyholders by tracking the U.S. Securities and Exchange Commission's registration requirements. PRINCIPLES, *supra* note 22, § 1 cmt. b.

³³ RESTATEMENT OF LIAB. INS. § 7.

that the reformation remedy originally envisioned by the Principles should be available to courts in the case of school system policyholders because school systems face a different regulatory environment, have different behavioral incentives, and require different policy considerations than other policyholders.

Part I will discuss the current state of insurance doctrine as applied to school districts. It will address the key provisions set forth in §§ 7–11 of the Principles and §§ 7–9 of the Restatement in light of state statutes and the common law. It will then analyze how courts have struggled to apply traditional insurance doctrine to educators liability insurance policies in light of policy concerns unique to the public education system. In cases of material misrepresentation by school districts, courts have eschewed addressing the statutory elements of the misrepresentation defense at all, turning instead to alternative doctrines that ensure coverage. The judiciary's consistent emphasis on policy considerations suggests that a policy reformation remedy would ensure fairness for insurers and insureds by allowing courts to avoid rescission, ensuring coverage for vulnerable education claimants, and enabling insurance companies to recover losses that result from misrepresentation.

Part II will argue that school districts should not be treated like other commercial policyholders because the Reporters' emphasis on the policyholder's sophistication and freedom of contract does not adequately justify the unduly harsh outcomes for school systems that would result under the Restatement's approach to misrepresentations. The Restatement's standardized approach elides the substantive differences between school districts and other commercial policyholders, including lack of profit incentive for risk-taking and different regulatory contexts. Furthermore, the unique public interest in compensating vulnerable student plaintiffs renders coverage more critical for school districts than public companies.

Part III will propose a reformation remedy tailored to the policy concerns undergirding school district liability. By applying in cases of both innocent and intentional misrepresentations, this remedy will provide a legal framework for ensuring compensation for victims of school district negligence without undercutting the rights of insurers in the manner of past judicial approaches to the problem.

I. RESCISSION OF INSURANCE POLICIES HELD BY SCHOOL DISTRICTS UNDER CURRENT INSURANCE DOCTRINE

The Principles couched several of its most innovative provisions as new rules, which would have been mandatory as applied to small policyholders, while serving as default rules that large commercial policyholders and insurers could alter by contract.³⁴ One of these rules provided a quasi-reformation remedy to small policyholders who made innocent misrepresentations, allowing courts to avoid the harshness of rescission for innocent insureds while compensating insurers for bearing the increased risk the policyholder created through the misrepresentation.³⁵ The Restatement rejected this reformation remedy and the intentionality standard for rescission, allowing insurers to rescind any insurance policy in the event of material misrepresentation on which the insurer relied.³⁶

This Part will discuss rescission as it has been available under state law for both innocent and intentional misrepresentations. It will address the Principles' proposed reforms, including the quasi-reformation remedy for innocent misrepresentations, and the Restatement's treatment of those reforms. It will then show that courts have sought alternative doctrines to avoid rescinding educators professional liability insurance and general commercial liability insurance policies held by school districts, and that these doctrines lead to decreased coherence and do not protect the rights of insurers and insureds.

A. State Law Approaches to Misrepresentation Remedies

In what the Principles referred to as innovative "incremental law reforms,"³⁷ § 7 limited the possibility of policy rescission to misrepresentations that are intentional or reckless, material, and upon which the insurer reasonably relied.³⁸ One of the most dramatic changes to current law was the Principles'

³⁴ PRINCIPLES, *supra* note 22, § 1 cmt. b.

³⁵ *Id.* § 7 cmt. b.

³⁶ RESTATEMENT OF LIAB. INS. § 7.

³⁷ *Id.* § 7 cmt. b.

³⁸ *Id.* The materiality and reliance requirements, outlined in §§ 9 and 10, are largely consistent with state law. *Id.* § 9 reporters' note a (describing reliance as a "well-settled part of the doctrine of misrepresentation"); *id.* § 10 reporters' note a (describing the "increased-risk standard of materiality" as adopted by law in several states).

exclusion of innocent misrepresentations that fail to meet the intentional or reckless standard.³⁹

As the Reporters note in the Restatement, this approach presented a notable departure from existing law, under which rescission is frequently afforded for innocent misrepresentations.⁴⁰ In ordering rescission for “inaccuracies in financial statements attached to a policy application,” the Eleventh Circuit noted that the Florida statute at issue “contain[ed] no knowledge or intent element; unintentional or unknowing misstatements bar recovery under a policy if they alter the risk or the likelihood of coverage.”⁴¹ Similarly, the District Court for the Eastern District of California ordered rescission where an insured accidentally used a broker-recommended template that did not disclose the information.⁴² The court held that “even an unintentional non-disclosure is sufficient to support rescission of an insurance contract, if the non-disclosed information was material to the contract.”⁴³ In rescinding a policy as to a director who was not involved in the preparation of the insurance application, the District Court for the Southern District of New York explained that while “leaving an allegedly innocent outside director without D&O coverage may seem harsh,” recognition of the policy would also injure “the innocent insurance company which was deceived.”⁴⁴

The Restatement’s approach to innocent misrepresentations closely tracks insurance law as codified in a number of states, in which rescission has long

³⁹ Section 8 defines “intentional” misrepresentations as those in which “the policyholder knows or believes the statement is false” and “reckless” misrepresentations as those in which “the policyholder is wilfully indifferent to whether the statement is true or false.” *Id.* § 8. For a discussion of the history and economic principles undergirding the problem of innocent misrepresentations, see PRINCIPLES, *supra* note 22, § 7 reporters’ note b; Ronen Avraham, *The Economics of Insurance Law—A Primer*, 19 CONN. INS. L.J. 29, 53–59 (2012–2013); Barnes, *supra* note 28, at 332–35.

⁴⁰ RESTATEMENT OF LIAB. INS. xvii, § 7 cmt. i.

⁴¹ Nat’l Union Fire Ins. Co. v. Sahlen, 999 F.2d 1532, 1536 (11th Cir. 1993).

⁴² Admiral Ins. Co. v. Debber, 442 F. Supp. 2d 958, 967 (E.D. Cal. 2006), *aff’d*, 295 Fed. App’x 171 (9th Cir. 2008).

⁴³ *Id.* (espousing a permissive definition of materiality, stating that “where specific questions are asked of the insured, the answers to those questions are normally deemed material to the contract”).

⁴⁴ Am. Int’l Specialty Lines Ins. Co. v. Towers Fin. Corp., No. 94 Civ. 2727 (WK)(AJP), 1997 U.S. Dist. LEXIS 22610, at *30 (S.D.N.Y. Sept. 12, 1997) (quoting Mazur v. Gaudet, 826 F. Supp. 188, 195 (E.D. La. 1992)); see also Bird v. Penn Cent. Co., 341 F. Supp. 291, 294 (E.D. Pa. 1972) (“While we sympathize with movants’ position, and recognize that innocent officers and directors are likely to suffer if the entire policy is voidable because of one man’s fraudulent response, it must be recognized that plaintiff insurers are likewise innocent parties.”).

been available for insurers for a wide range of misrepresentations.⁴⁵ Mississippi law, for example, allows a misrepresentation to bar recovery when it “materially affected either the acceptance of the risk or the hazard assumed by the insurer,” regardless of whether the insured is aware of the misrepresentation.⁴⁶ Similarly, under Virginia law, recovery may be denied when the insurer can demonstrate by clear proof that the representation was both untrue and material to the risk.⁴⁷ Under Oklahoma law, the insurer need only demonstrate that the misrepresentation was fraudulent or material “to the acceptance of the risk, or to the hazard assumed by the insurer.”⁴⁸

In contrast, several states have adopted a knowledge or intent requirement analogous to the one originally proposed by the Principles.⁴⁹ Texas common law provides that in addition to falsehood, materiality, and reliance, an insurer must prove “the intent to deceive on the part of the insured in making the misrepresentation.”⁵⁰ Similarly, Louisiana law prohibits voidance of a policy unless the misrepresentations were made “with the intent to deceive,”⁵¹ and Arizona law requires that misrepresentations be “fraudulent” to justify rescission.⁵² Washington law requires that the insured knowingly made the misrepresentations and intended to deceive the insurer.⁵³

⁴⁵ Deborah F. Cohen, Timothy E. DeMasi & Aaron Krauss, *Uberrimae Fidei and Reinsurance Rescission: Does a Gentlemen’s Agreement Have a Place in Today’s Commercial Market?*, 29 *TORT & INS. L.J.* 602, 604 (1994) (explaining that “the grounds for rescission” of reinsurance policies under various state laws “may include fraudulent misrepresentation, concealment, innocent misrepresentation, nondisclosure, breach of contract, and mutual or unilateral mistake”); Joseph K. Powers, *Pulling the Plug on Fidelity, Crime, and All Risk Coverage: The Availability of Rescission as a Remedy or Defense*, 32 *TORT & INS. L.J.* 905, 905 (1997) (noting that the “common law of contract has long recognized that where one party to a contract has been induced by false representations made by the other party, regardless of whether such representations are made with the intent to deceive, the misled party may treat the contract as voidable”).

⁴⁶ MISS. CODE ANN. § 83-9-11(3) (West 1999).

⁴⁷ VA. CODE ANN. § 38.2-309 (West 2016).

⁴⁸ OKLA. STAT. ANN. tit. 36, § 3609(A) (West 2011).

⁴⁹ John Dwight Ingram, *Misrepresentations in Applications for Insurance*, 14 *U. MIAMI BUS. L. REV.* 103, 106 (2005) (explaining that the costs of the heightened standard are “borne by the diligent or lucky insurance buyers who do not unintentionally misrepresent, or do not have a claim, or whose misrepresentation is not discovered”).

⁵⁰ *Bates v. Jackson Nat’l Life Ins. Co.*, 927 F. Supp. 1015, 1018 (S.D. Tex. 1996).

⁵¹ LA. STAT. ANN. § 22:860 (2011) (except in the cases of “life, annuity, or health and accident insurance”).

⁵² ARIZ. REV. STAT. ANN. § 20-1109 (2010).

⁵³ *Ki Sin Kim v. Allstate Ins. Co.*, 223 P.3d 1180, 1189 (2009) (noting a presumption of intent to deceive when insured “knowingly makes a false statement”).

Several states have codified additional standards giving rise to rescission. Under the doctrine of concealment, the policy may be rescinded upon failure of the insured to proactively disclose material information.⁵⁴ Rescission for concealment is codified in a number of states, in which it is permitted under the same conditions as rescission for misrepresentations.⁵⁵ In contrast, the contribute-to-the-loss approach, codified in several states, presents a heightened standard for rescission. Under a contribute-to-the-loss requirement, a misrepresentation may serve as the basis for rescission only if it actually plays a role in causing the harm giving rise to the claim at issue.⁵⁶ Massachusetts law incorporates an intention or causation-of-the-loss requirement into the definition of materiality, noting that the policy cannot be avoided unless the misrepresentation “is made with actual intent to deceive” or the subject of the misrepresentation “increased the risk of loss.”⁵⁷

The Principles and the Restatement have rejected both of these alternative standards. The Reporters place the onus of discovery on insurers, noting that insurers “have learned to ask questions about the risk factors that they regard as material.”⁵⁸ The Restatement also rejects the contribute-to-the-loss doctrine on grounds that it does not address the problem of adverse selection,⁵⁹ presents evidentiary problems that ineffectively spread the cost of losses among

⁵⁴ Barry Zalma, *Rescission*, 37 UWLA L. REV. 204, 205 (2004) (defining concealment as “neglect to communicate that which a party knows, and ought to communicate” (quoting CAL. INS. CODE §§ 331, 359 (1935))).

⁵⁵ See, e.g., FLA. STAT. ANN. § 627.409(1) (West Supp. 2015); OKLA. STAT. ANN. tit. 36, § 3609(A) (West 2011).

⁵⁶ See, e.g., KAN. STAT. ANN. § 40-418 (West 2008) (stating that misrepresentation is not material “unless the matter misrepresented shall have actually contributed to the contingency or event on which the policy is to become due and payable”). In contrast, several states, like the Principles, have specifically rejected the contribute to the loss doctrine. See, e.g., *Tig Ins. Co. v. Reliable Research Co.*, 228 F. Supp. 2d 921, 927 (S.D. Ill. 2002) (“The misrepresentation on the application through which the insurer seeks rescission need not be related to the claim for which the insured eventually seeks coverage.”).

⁵⁷ MASS. GEN. LAWS ANN. ch. 175, § 186 (West 2011).

⁵⁸ RESTATEMENT OF LIAB. INS. § 7 cmt. g (AM. LAW INST., Discussion Draft 2015).

⁵⁹ *Id.* § 9 cmt. b. “A theoretical concept first appearing in the late nineteenth century, adverse selection describes the phenomenon of high-risk parties who, knowing their ‘type,’ seek more insurance coverage than low-risk parties.” Avraham, *supra* note 39, at 44. Professor Avraham also notes the possibility of “reverse adverse selection,” in which insureds are not sufficiently informed to distinguish between low- and high-quality insurers, resulted in a market dominated by low-quality insurers offering lower premiums. *Id.* at 61.

insureds in different factual situations; and is not as efficient as the intentional or reckless standard in screening out “arbitrary” outcomes.⁶⁰

B. The Principles and Restatement Approaches to Misrepresentation Remedies

In light of its rejection of alternative statutory standards for rescission, the Principles proposed a bifurcated “quasi-reformation” remedy for innocent misrepresentations by small commercial policyholders.⁶¹ Under the Principles’ approach, the type of policy reformation available would have depended on whether the insurer would have issued the policy had the misrepresentation not occurred.⁶² If the insurer would have issued the policy even in light of the true facts, the Principles would have allowed the insurer to collect or “deduct from the claim payment the additional premium that would have been charged.”⁶³ In contrast, if the insurer would not have issued the policy if it had known the truth, then the Principles would have permitted the insurer to collect “a reasonable additional premium for the increased risk.”⁶⁴ The insurer would also have been permitted to prospectively cancel the policy upon innocent misrepresentation “within a reasonable time of the discovery.”⁶⁵

While the Principles’ quasi-reformation remedy addressed many of the problems of inconsistency and inequity inherent in the rescission scheme, it also increased the potential for abuse by insureds seeking “to insure an uninsurable risk or obtain lower premiums.”⁶⁶ Rescission may allow insurers to

⁶⁰ RESTATEMENT OF LIAB. INS. § 9 cmt. b. For a discussion of the inefficiencies created by the contribute-to-the-loss doctrine, see Barnes, *supra* note 28, at 354–55 (stating that the doctrine “invites a similarly amorphous judicial inquiry” that tempts courts to “stretch the facts” to make use of them”).

⁶¹ PRINCIPLES, *supra* note 22, § 11 cmt. a. In addressing the definitional limits of “innocent misrepresentations,” the Principles explain that “[t]he misrepresentations to which this Section applies are, at worst, examples of negligent behavior on the part of the policyholder.” *Id.*

⁶² *Id.* § 11.

⁶³ *Id.* By compensating the insurer for the detrimental reliance of charging lower premiums, reformation in this case solves a problem inherent in insurance policies: rescission cannot put the parties back into the position they would have been in without the contract. *Id.* § 11 cmt. b (“It is too late to buy another insurance policy.”); see also Barnes, *supra* note 28, at 344–45 (2010) (“[T]he plaintiff cannot use [rescission] to recover the benefit of his bargain or his reliance interest.”).

⁶⁴ PRINCIPLES, *supra* note 22, § 11.

⁶⁵ *Id.*

⁶⁶ *Id.* § 11 cmts. b, f; see also Eugene R. Anderson, Richard G. Tuttle & Susannah Crego, *Draconian Forfeitures of Insurance: Commonplace, Indefensible, and Unnecessary*, 65 FORDHAM L. REV. 825, 827 (1996) (calling forfeiture of insurance policies a “massive and disproportionate penalty in relation to the policyholder’s . . . noncompliance”).

engage in “post-claim underwriting,” in which the insurer postpones a full investigation into insurability until an insured makes a claim.⁶⁷ Post-claim underwriting also presents an acute risk in the context of quasi-reformation, in which the insurer is asked to estimate a reasonable premium for the risk that has already occurred.⁶⁸ However, the Reporters argued that the provision would foster better information gathering among insurers because “[t]he better [a] policyholder is informed of how to fill out the insurance application . . . the more likely any misrepresentation would be deemed to be reckless or intentional.”⁶⁹ Citing policy concerns grounded in the sophistication of the parties, the Principles explained that the quasi-reformation remedy available for innocent misrepresentations under §§ 7–11 need not be mandatory in the case of large commercial policyholders.⁷⁰ The Restatement eliminates the quasi-reformation remedy altogether, placing all policyholders in the position of the most sophisticated policyholders under the Principles scheme.⁷¹ Despite the fact that school districts are often just as sophisticated as other commercial policyholders, the Restatement’s rescission scheme is ill-suited to educators professional liability insurance because of the unique policy concerns inherent in school district liability.

C. Judicial Efforts to Avoid the Application of Rescission to School Districts

Courts have struggled to apply a strict doctrinal approach to misrepresentation rescissions in the case of educators professional liability insurance. This section will discuss two cases in which courts have skirted the doctrinal elements of insurance law to avoid rescinding policies based on misrepresentations in the insurance application. It will also show that courts have prioritized policy concerns over the doctrinal elements of the misrepresentation defense by avoiding rescission of educators professional liability policies even when the elements of the misrepresentation defense are met. It will then suggest how and why such cases would be better resolved through policy reformation.

When faced with material misrepresentations by school districts, courts have extended coverage through alternative doctrines. These courts have

⁶⁷ Barnes, *supra* note 28, at 339–41.

⁶⁸ PRINCIPLES, *supra* note 22, § 11(2).

⁶⁹ *Id.* § 11 cmt. e.

⁷⁰ *Id.*

⁷¹ RESTATEMENT OF LIAB. INS. § 7 (AM. LAW INST., Discussion Draft 2015).

declined to analyze the statutory elements of misrepresentation at all, ignoring whether a school district's misrepresentations were material, whether they were innocent or fraudulent, or whether they met any heightened statutory standards for rescission.⁷² Instead, courts have bypassed the misrepresentation analysis entirely, looking directly to alternative doctrines to ensure coverage in light of policy preferences for coverage of school districts' claims.⁷³

One doctrine that has allowed courts to avoid rescission is *contra proferentem*. In the insurance context, *contra proferentem*, the "contra-insurer rule," "provides that where an insurer drafts a policy 'any ambiguity in [the] . . . policy should be resolved in favor of the insured.'" ⁷⁴ The flexibility of this rule, and its posture favoring the insured, allow courts to search for implausible ambiguities that permit a finding that the insured did not in fact make a misrepresentation, or that such a representation was not material. For example, in *Stratford School District v. Employers Reinsurance Corp.*, the First Circuit, applying *contra proferentem*, affirmed the district court's finding that the school district did not make a material misrepresentation on its insurance application.⁷⁵ Stratford's errors-and-omissions policy application contained the question, "Are there any circumstances indicating the probability of a claim or action known by any person to be covered by this insurance?"⁷⁶ Stratford answered in the negative.⁷⁷ The policy contained a corresponding exclusion for claims for which "the Insured ha[d] become aware of a proceeding, event or development which has resulted in or could in the future result in the institution of a claim against the Insured."⁷⁸

⁷² See Ingram, *supra* note 49, at 104–06 (laying out the statutory elements in various jurisdictions).

⁷³ See, e.g., *Haley v. Cont'l Cas. Co.*, 749 F. Supp. 560, 565–69, 571 (D. Vt. 1990) (turning to waiver to establish coverage in light of "policy considerations in favor of attracting citizens to serve on community school boards"), *aff'd without opinion* by *Haley v. Cont'l*, 927 F.2d 593 (2d Cir. 1991).

⁷⁴ *Jefferson Block 24 Oil & Gas, L.L.C. v. Aspen Ins. UK Ltd.*, 652 F.3d 584, 589 (5th Cir. 2011) (alteration in original) (quoting *McCotis v. Home Ins. Co.*, 31 F.3d 110, 113 (2d Cir. 1994)). While *contra proferentem* is a canon of general contract law construing ambiguous language against the drafter, it "has historically been regarded as a last resort." *Econ. Premier Assurance Co. v. W. Nat'l Mut. Ins. Co.*, 839 N.W.2d 749, 754 (Minn. Ct. App. 2013). In contrast, "the rule has assumed a more prominent role in American insurance law and is now the analytical starting point for courts interpreting ambiguous insurance language." *Id.* at 755.

⁷⁵ 105 F.3d 45, 46 (1st Cir. 1997).

⁷⁶ *Id.* at 46.

⁷⁷ *Id.*

⁷⁸ *Id.* at 47 (emphasis omitted).

Stratford applied for the policy four days after receiving a subpoena related to an investigation for criminal sexual misconduct of one of its former teachers.⁷⁹ While at Stratford, the teacher had been reprimanded by the Board because he “had inappropriately hugged and kissed female students”; however, Stratford did not report the incident.⁸⁰ The investigation pertained to contact with students that occurred while the teacher was employed in another school district.⁸¹ The First Circuit found that a failure to warn claim against Stratford by subsequent victims of the teacher’s misconduct was improbable at the time of the application⁸² and that such a claim likely would be “wholly frivolous.”⁸³ Applying *contra proferentem*, the court concluded that the “probability” standard in the application governed the exclusion, rather than the “could . . . result” standard in the policy itself.⁸⁴

In light of the timing of the insurance application, it is difficult to avoid the conclusion that the misrepresentation was both material to the insured risk and intended to deceive the insurer: the entire policy was obtained to ensure coverage for the very risk Stratford denied anticipating.⁸⁵ Nevertheless, the court rejected the plain language of the policy exclusion in part to further a policy interest in favor of coverage, concluding that “[i]t is because there are possibilities that people take out insurance.”⁸⁶ This tortured result under traditional liability insurance doctrine is the one that would occur under the Restatement’s scheme, in which the threat of rescission would remain and *contra proferentem* would provide one of the only alternatives.⁸⁷ In contrast, under the Principles’ quasi-reformation approach, the court could have avoided this strained application of *contra proferentem* without granting rescission to the insurer by allowing the school district to maintain coverage while paying a reasonable additional premium.⁸⁸

Similarly, when the material nature of the misrepresentation is undeniable, courts have found tenuous grounds to uphold claims that insurers waived their

⁷⁹ *Id.* at 46.

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² Although the claim, of course, did occur, giving rise to the coverage dispute. *Id.*

⁸³ *Id.* at 47.

⁸⁴ *Id.*

⁸⁵ *Id.* at 46.

⁸⁶ *Id.* at 47.

⁸⁷ See PRINCIPLES, *supra* note 22, § 1 cmt. b.

⁸⁸ *Id.* § 11 cmt. a.

right to the misrepresentation defense.⁸⁹ In *Haley v. Continental Casualty Co.*, the District Court for the District of Vermont and the Second Circuit Court of Appeals upheld coverage in the face of a material misrepresentation under such a theory.⁹⁰ The plaintiffs were officers of the policyholder Southwest Vermont Supervisory Union (SVSU), which consisted of seven school districts.⁹¹ One of the member school districts sued SVSU for incurring a deficit under both a negligence theory and a Vermont statute, which prohibited such deficits.⁹² Two years prior to the suit, SVSU had applied to renew its board of education liability insurance policy, a duty to reimburse policy.⁹³ The insurance application was made during the four-year period in which the deficits were incurred.⁹⁴ In its application, SVSU stated that it had no “current expected deficit” or “total accumulated deficit,” and that the Board had no “knowledge of any potential claim against the school district.”⁹⁵ At the time of the application, however, SVSU “had a deficit of more than \$1.2 million.”⁹⁶ When SVSU reported the application error to the insurer, it stated that “a bookkeeper had made a mistake.”⁹⁷ After alleging that the claim fell under several other policy exclusions, the insurer moved for summary judgment on the grounds that the policy be rescinded as void *ab initio* because SVSU’s answers to the application questionnaire constituted material misrepresentations.⁹⁸

The district court did not reach the question of whether the mistake was innocent or fraudulent. Instead, the court found that the insurer’s statement that it shortly would advise the insureds as to coverage “encourage[d] the insureds to defend themselves diligently, confident in the knowledge that they [we]re insured.”⁹⁹ In addition to construing the insurer’s ambiguous statement as an

⁸⁹ Waiver occurs when the insurer is aware of its right and has an “actual intention to relinquish it or conduct so inconsistent with the intent to enforce the right as to induce a reasonable belief that it has been relinquished.” *Holt v. Aetna Cas. & Sur. Co.*, 680 So. 2d 117, 128–29 (La. Ct. App. 1996). Waiver may also arise out of a failure to investigate; when “the insurer becomes aware of facts which would cause a reasonable person to inquire further, the insurer is then subject to a duty of investigation. Failure to do so, constitutes a waiver of all powers or privileges which a reasonable search would have uncovered.” *Id.*

⁹⁰ 749 F. Supp. 560, 561–62 (D. Vt. 1990).

⁹¹ *Id.* at 562.

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Id.* at 562–63.

⁹⁷ *Id.* at 563.

⁹⁸ *Id.* at 563–65.

⁹⁹ *Id.* at 568.

assurance to the insured, the court found that the insurer waived the claim because the claim representative knew “not only was there a deficit, but that some of the members of the school board were alleged to have concealed it” before sending letters to SVSU suggesting that coverage might still have been available.¹⁰⁰ The court grounded its holding in public policy, noting that Vermont’s “unwavering public policy against operating school districts at a deficit” was outweighed by “countervailing policy considerations in favor of attracting citizens to serve on community school boards that might warrant coverage in this case.”¹⁰¹

The district court’s rule construes any communication made after the insurer has discovered any facts giving rise to a suspicion of wrongdoing as an immediate waiver of the rescission remedy.¹⁰² Application of such a rule would require that an insurer not issue any communications to insureds, however vague and innocuous, until the insurer had fully investigated the facts, decided whether to pursue the defense, developed its theory, and finalized coherent company-wide communication strategy regarding the issue. Such a requirement would be commercially impracticable, especially in light of the fact that in many cases, communications with the insured might be necessary to obtain the information needed to complete these steps. This paralyzing outcome, when applied indiscriminately as a strained alternative to rescission, would prevent insurers from effectively dealing with material factual uncertainties and would not accomplish the goals of ensuring fairness for insurers and insureds.

As in *Stratford*,¹⁰³ a reformation remedy would have allowed the insurer to recover some of the loss it incurred as a result of the material misrepresentation while allowing the court to accommodate the pressing policy concerns it recognized. Because the misrepresentation was material (the insurer stated that “it would not have issued the renewed policy or would have issued it on different terms if it had known of the deficit situation”¹⁰⁴), under the Principles’ reformation provisions, an insurer would be entitled either to collect or “deduct from the claim payment the additional premium that would

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at 571.

¹⁰² *Id.* at 568.

¹⁰³ See *supra* notes 87–88 and accompanying text.

¹⁰⁴ *Id.* at 565.

have been charged”¹⁰⁵ or to collect “a reasonable additional premium for the increased risk.”¹⁰⁶ Either outcome would have provided the opportunity for market-based streamlining of the school’s risk-taking in light of the insurer’s substantive expertise.¹⁰⁷

Application of a reformation remedy to school districts would allow courts to preserve coverage for the insured in response to policy concerns without denying the insurer recovery for the actual losses it has suffered. Such a remedy would help clarify and streamline the law of misrepresentation as it has been applied to educators professional liability insurance and would protect the rights of insurers injured by school districts’ misrepresentations.

II. SCHOOL DISTRICTS AS DISTINCT FROM OTHER COMMERCIAL POLICYHOLDERS

This Part will argue that public school systems should not be treated in the same manner as other commercial policyholders under the Principles’ misrepresentation framework. First, this Part will address fundamental reasons why school districts should not be treated under the Restatement’s uniform approach to all policyholders in light of the Restatement’s grounding in liability concerns typical of commercial policyholders, specifically public companies. It will then analyze the importance and singularity of the policy concerns inherent in school system liability insurance, with a focus on how those concerns differ from the policy issues that attend the commercial policyholders at issue in D&O and other liability insurance cases.

Treatment of school districts as equivalent to large public companies under the Restatements’ misrepresentation framework would not provide a satisfactory outcome for educators professional liability policy disputes in light of courts’ deference to the public policy concerns inherent in educators

¹⁰⁵ PRINCIPLES, *supra* note 22, § 11.

¹⁰⁶ *Id.* §§ 1 cmt. e, 11. Section 11 also provided for prospective cancellation of the policy upon innocent misrepresentation “within a reasonable time of the discovery.” *Id.* § 11.

¹⁰⁷ For an example of liability insurer expertise in the educators professional liability context, see Juhi Kaveeshvar, Comment, *Kicking the Rock and the Hard Place to the Curb: An Alternative and Integrated Approach to Suicidal Students in Higher Education*, 57 EMORY L.J. 651, 657 (2008) (relying on the opinion of an “analyst for the insurance company United Educators” on the risks faced by universities pursuing various courses of action in response to suicidal students).

professional liability policies.¹⁰⁸ The gap between the sophisticated party rationale espoused in the Principles and embodied in the Restatement and the application of the Restatement's approach to educational policyholders stems from key differences in incentives and moral hazard between typical commercial policyholders and school districts. A reformation remedy, in contrast to the rescission attendant upon all policyholders under the Restatement, would allow courts to address these specific policy considerations while preserving fairness to the insurer and maintaining the regulatory effects of insurance pricing and coverage.

A. The Nature of School District Insurance Policies

Subjecting school districts to the rescission remedy set forth in the Restatement would deny coverage for a wide range of potential claims falling under several available policies.¹⁰⁹ A school district's errors and omissions policy, also known as educators professional liability insurance, covers claims "arising out of the mistakes inherent in the practice of that particular profession or business."¹¹⁰ While coverage varies between policies, a typical policy also extends to wrongful acts arising from "any actual or alleged breach of duty, neglect, error . . . or omission committed solely in performance of duties for the School District."¹¹¹ As discussed below, a professional liability policy may extend to such claims as employment discrimination, negligent hiring and supervision, sexual harassment, or civil rights claims by students.¹¹²

¹⁰⁸ See *supra* note 101 and accompanying text for discussion of the *Haley* court's deference to the public policy concerns at issue.

¹⁰⁹ See *supra* note 45 (discussing the range of circumstances in which rescission may be available under traditional insurance doctrine).

¹¹⁰ *Watkins Glen Cent. Sch. Dist. v. Nat'l Union Fire Ins. Co.*, 732 N.Y.S.2d 70, 72 (App. Div. 2001) (quoting *Albert J. Schiff Assoc. v. Flack*, 417 N.E.2d 84 (N.Y. 1980)) (noting that "[e]rrors and omissions policies are common in the field of education" (citing *St. Paul Fire & Marine Ins. Co. v. Mo. United Sch. Ins. Council*, 98 F.3d 343 (8th Cir. 1996); *Bd. of Pub. Educ. of Sch. Dist. of Pittsburgh v. Nat'l Union Fire Ins. Co.*, 709 A.2d 910 (Pa. Super. Ct. 1998); and *Edinburg Consol. I.S.D. v. INA*, 806 S.W.2d 910 (Tex. Ct. App. 1991))).

¹¹¹ *Bd. of Pub. Educ. of the Sch. Dist. of Pittsburgh*, 709 A.2d at 913 (alteration in original); see also *Peerless Ins. Co. v. Pa. Cyber Charter Sch.*, 19 F. Supp. 3d 635, 654 (W.D. Pa. 2014) (noting that the School Leaders Errors and Omissions Liability Insurance Policy at issue covered wrongful acts committed "in the course of performing 'educational institution' duties").

¹¹² See, e.g., *Watkins Glen Cent. Sch. Dist.*, 286 A.D.2d at 51 (holding that while sexual misconduct committed by a teacher was an intentional act that would "generally" not be covered by an errors and omissions policy, the risk incurred by "negligent hiring and supervision" of the teacher fell "squarely within" the school district's professional liability coverage).

A majority of jurisdictions have denied a cause of action for general educational malpractice.¹¹³ Liability does not extend to “negligence in the educational process” resulting in such events as students’ failure to learn.¹¹⁴ For example, in *Key v. Coryell*, the Arkansas Court of Appeals explained that policy considerations weighing against recognition of educational malpractice include “the absence of a workable rule of care against which the defendant’s conduct may be measured, the inherent uncertainty in determining the cause and nature of any damages, and the extreme burden that would be imposed on the resources of the school system and the judiciary.”¹¹⁵ However, causes of action for negligent failures to provide specific educational opportunities to which a student is entitled may fall under a professional liability policy.¹¹⁶

In contrast to its professional liability policy, a school district’s commercial general liability policy covers third-party property damage and personal injury claims.¹¹⁷ Claims against school districts for intentional employment discrimination may be covered under either commercial general liability policies or professional liability policies.¹¹⁸ Similarly, claims against school districts for teachers’ sexual misconduct and abuse have been covered under

¹¹³ See, e.g., *Key v. Coryell*, 185 S.W.3d 98, 106 (Ark. Ct. App. 2004) (rejecting the cause of action, noting the majority approach and citing rejection in Michigan, Alabama, Alaska, Louisiana, Connecticut, and Florida). For recent analysis of substantive educational malpractice law in contexts of contemporary concern, see Stijepko Tokic, *Rethinking Educational Malpractice: Are Educators Rock Stars?*, 2014 BYU EDUC. & L.J. 105.

¹¹⁴ *Key*, 185 S.W.3d at 106–07 (rejecting mother’s claim for breach of contract, breach of fiduciary duty, negligence, and gross negligence when her son was dismissed from private school as a result of his behavior).

¹¹⁵ *Id.* at 106–07.

¹¹⁶ See, e.g., *Sain v. Cedar Rapids Cmty. Sch. Dist.*, 626 N.W.2d 115 (Iowa 2001) (allowing a cause of action when a high school counselor falsely advised a student that a particular English course would be approved as one of the core classes required by the NCAA for freshman basketball participation). While upholding the state’s previous refusal to recognize a cause of action for educational malpractice, the court found that the “specific act of providing specific information requested by a student under circumstances in which the school knew or should have known the student was relying upon the information to qualify for future educational athletic opportunities” did not implicate the policy concerns behind the rejection of the tort and was thus “more compatible with other claims for misrepresentation against professionals by clients who have sought out their expertise.” *Id.* at 122.

¹¹⁷ See, e.g., *Ill. Sch. Dist. Agency v. Pac. Ins. Co.*, 571 F.3d 611 (7th Cir. 2009) (general liability insurance policy covered claims when student brought mercury home from school).

¹¹⁸ *Compare Indep. Sch. Dist. No. 697 v. St. Paul Fire & Marine Ins. Co.*, 515 N.W.2d 576 (Minn. 1994) (holding that the terms of an errors and omissions policy that did not expressly exclude intentional acts covered a claim of intentional age discrimination), *with Sch. Dist. for Royal Oak v. Cont’l Cas. Co.*, 912 F.2d 844 (6th Cir. 1990) (applying Michigan law, holding that public policy did not prevent coverage for intentional religious discrimination under a commercial general liability insurance policy).

commercial general liability policies,¹¹⁹ although claims against the school district for the negligent hiring and supervision of such teachers also are commonly covered under educators professional liability policies.¹²⁰

B. The Sophisticated Party Rationale as Applied to School Districts

Large commercial policyholders, as defined in §§ 1(4) and 1(7) of the Principles, were permitted to contract out of mandatory quasi-reformation for innocent misrepresentations.¹²¹ The Reporters explained that such large companies should be able to afford sophisticated counsel to “explain the terms of the policies” and negotiate with insurers.¹²² Small commercial policyholders, in contrast, would have required the same level of protection as individual consumers because “the operators of small businesses or other organizations are not likely to be substantially more sophisticated, or to have any greater ability to bargain over terms, than the average homeowner or auto owner.”¹²³ In eliminating the large and small commercial policyholder distinction in the Restatement, the Reporters highlight the inappropriateness of promulgating a “bright-line” rule in a Restatement but do not address the ramifications of expanding the underlying sophisticated-party rationale to all policyholders under the new, unified misrepresentation scheme.¹²⁴ Under the Restatement, all policyholders are treated in the same manner as the most sophisticated policyholders under the Principles. Even if the majority of policyholders are sophisticated commercial entities, this expansion of the Principles’ approach is unjustified because the Principles’ treatment of large commercial policyholders was primarily grounded in concerns specific to public companies.

The inappropriateness of the Restatement’s unified approach does not stem from any lack of sophistication on the part of school districts. Most school

¹¹⁹ See *Worcester Ins. Co. v. Fells Acres Day Sch., Inc.*, 558 N.E.2d 958 (Mass. 1990) (analyzing claims for sexual abuse on the part of educators and negligence and vicarious liability against the school district under a commercial general liability policy); *Wayne Twp. Bd. of Sch. Comm’rs v. Ind. Ins. Co.*, 650 N.E.2d 1205 (Ind. Ct. App. 1995) (holding that the school district’s Comprehensive General Liability Insurance Coverage covered sexual molestation by the principal, but the Educational Errors and Omissions policy did not, because the student’s emotional distress constituted “bodily injury” under the policy’s terms).

¹²⁰ See *supra* note 112.

¹²¹ PRINCIPLES, *supra* note 22, § 7 cmt. j.

¹²² *Id.*

¹²³ *Id.*

¹²⁴ RESTATEMENT OF LIAB. INS. xvii, § 7 (AM. LAW INST., Discussion Draft 2015).

districts are more similar in sophistication to companies with counsel than to “the average homeowner or auto owner.”¹²⁵ In fact, school districts are represented by general counsels and, frequently, substantial legal departments, and these districts retain outside counsel for litigation and high-stakes matters.¹²⁶ While the steep costs of school district legal fees frequently incite calls for reform,¹²⁷ defenders of the expenses point to the importance of sophisticated legal representation in the face of the complex issues faced by school districts.¹²⁸

Although, at first glance, school districts appear to be analogous to most other commercial policyholders under the sophisticated-party rationale, this fact alone does not justify their treatment under the uniform Restatement approach because the sophisticated-party rationale never fully explained the Principles’ treatment of large commercial policyholders in the misrepresentation context. The Principles’ treatment of commercial policyholders, as adopted and expanded by the Restatement, grew out of substantive regulatory concerns uniquely pertinent to large public companies rather than uniformly applicable to any sophisticated party.¹²⁹

The sophisticated-party rationale is eclipsed by regulatory concerns unique to public companies, as demonstrated by the Principles’ original choice of the SEC standard specifically, as opposed to another financial threshold reflecting the sophistication of the company, for its large commercial policyholder

¹²⁵ *Id.* § 1 cmt. b.

¹²⁶ See Jeffrey Robb, *Bill Aimed at Schools’ Legal Fees Advances: The Judiciary Committee Adds a Requirement that Districts Seek Bids from Attorneys*, OMAHA WORLD-HERALD, Feb. 22, 2007, at B1 (discussing the approach of metro-area school districts in Omaha to selecting and retaining outside counsel).

¹²⁷ See, e.g., Mensah M. Dean, *Why Such High Pay for School-District Lawyers?*, PHILLY.COM (May 19, 2008), http://articles.philly.com/2008-05-19/news/24990404_1_school-employees-school-attorneys-high-salaries (reporting that the Philadelphia School District’s Office of General Counsel included nineteen attorneys with a budget of \$13.5 million in fiscal year 2009, including almost \$3 million in outside counsel fees); Morgan Smith, *In School Finance Battle, Legal Fees Accumulate*, TEX. TRIB. (Sept. 8, 2014), <http://www.texastribune.org/2014/09/08/school-finance-battle-legal-fees-accumulate/> (noting that plaintiff school districts had accumulated “more than \$8.5 million” in attorney’s fees for “the four teams of lawyers representing them” in their suit against the state “challenging the constitutionality of the state’s school finance system”).

¹²⁸ Dean, *supra* note 127 (quoting Philadelphia School District General Counsel Sherry Swirsky’s argument that “[s]chool districts are the most highly regulated institutions that exist” and require highly experienced lawyers who can grapple with “very technical compliance issues”).

¹²⁹ The nexus between the treatment of commercial policyholders and regulatory concerns is evidenced by the fact that the Principles’ large commercial policyholder definition “adopt[ed] the same asset-value bright-line rule” as SEC regulatory disclosure requirements. PRINCIPLES, *supra* note 22, § 1 cmt. b.

definition.¹³⁰ While the Restatement has eliminated its bright-line standard, the connection between the misconduct-curbing disclosures required of SEC registrants and the threat of corporate wrongdoing under insurance policies remains. The choice of SEC registration grew out of the Reporters' deep roots in the field of shareholder liability, where many of the activities deep regulated through the insurance contract may be simultaneously addressed through SEC disclosures.¹³¹ Baker and Swedloff point out that research has returned "decidedly mixed conclusions" about the success of insurers in "manag[ing] the moral hazard of public company D&O insurance."¹³² SEC disclosure requirements under federal law ostensibly provide more nuanced, standardized, and policy-driven regulation.¹³³ By expanding a framework originally designed for large public companies to all policyholders, the Restatement creates a system under which entities that do not share the same moral hazards and regulatory conditions as public companies will suffer remedies that do not address the underlying reasons for their misconduct.

C. Incentives for Misconduct in Public Companies and School Districts

The public accountability prong of the SEC disclosure threshold also underscores a key difference between school systems and large public companies: school districts' lack of the profit incentive for misconduct possessed by public companies.¹³⁴ In the context of shareholder liability, insurance policy provisions should protect the public from corporate misconduct incentivized by insulation from the cost of the corporation's actions.¹³⁵ Baker and Griffith's work has revealed a number of deficiencies in

¹³⁰ See *id.* In explaining this choice of standard, the Reporters note that the SEC has set its threshold for registration because in the case of large companies, "the benefits to society of registration outweigh the burden to the company." *Id.*

¹³¹ See Baker & Swedloff, *supra* note 15, at 1426–27 (explaining that securities regulation and D&O insurance operate on parallel tracks because D&O insurers "do not typically engage with public regulation of corporate governance or with financial disclosure, for example through government relations efforts targeted at the Securities Exchange Commission or at Delaware law reform").

¹³² *Id.* at 1424.

¹³³ See *id.* at 1426 (noting that "D&O insurance companies do not engage in significant loss prevention research and education efforts").

¹³⁴ See BAKER & GRIFFITH, *supra* note 14, at 90–91 (noting that risk-taking incentives in public companies result from "pressures to manipulate results . . . throughout the firm" and may take the form of excessive executive compensation, fraudulent revenue recognition procedures, and "channel stuffing," a strategy of "forc[ing] more inventory through a distributor than the distributor can handle").

¹³⁵ See Baker & Swedloff, *supra* note 15, at 1424 (explaining that "risk-based pricing mitigates the moral hazard of D&O insurance by providing a modest incentive for avoiding claims" but that these effects are

the ability of current insurance doctrine to effectively regulate corporate misconduct.¹³⁶

In the context of shareholder liability, Baker and Swedloff found that D&O insurance coverage effectively operates as an income-smoothing blank slate rather than a permission slip for specific activities, allowing insureds a wide berth of activity free from governance intrusion on the part of insurers.¹³⁷ This freedom from governmental intrusion allows companies to pursue risky or potentially unethical courses of action to reap higher profits.¹³⁸ Negligent misrepresentations pose a salient moral hazard for large commercial policyholders, especially in light of the income-smoothing effect of D&O liability insurance, to which there are few stringent governance requirements attached.¹³⁹ This moral hazard, however, is unlikely to arise in the context of educators professional liability insurance, where risky behavior is unlikely to be profitable for the institution and performance is governed by substantive state regulation.¹⁴⁰

In contrast to public companies, failure to prevent misconduct among educators—or excessive risk-taking at the supervisory level—stems from incentives and circumstances quite apart from a desire to maximize profits. Certain schools may be more prone to teacher and administrator incompetence and misconduct because local demographic factors may make a school more

limited by the fact that “insurers do not provide discounts for companies that undertake specific loss prevention activities”).

¹³⁶ BAKER & GRIFFITH, *supra* note 14, at 202.

¹³⁷ Baker & Swedloff, *supra* note 15, at 1425 (“[A]ll but the most extraordinary securities class actions will be a ‘nonevent’ in the life of a publicly traded company.” (quoting BAKER & GRIFFITH, *supra* note 14, at 126–27)).

¹³⁸ See BAKER & GRIFFITH, *supra* note 14, at 86–87 (explaining that “virtually all shareholder litigation stems from investment loss” and that the profit-producing risk-taking sought out by investment analysts concerns insurers, who “do not look favorably on high-growth companies” and “do not favor highly volatile earnings”).

¹³⁹ Baker & Swedloff, *supra* note 15, at 1424.

¹⁴⁰ School districts also are governed by an alternative regulatory scheme, one that defines the parameters of their existence and operations. A wide variety of mechanisms exists for states to regulate educator misconduct. See Karen J. Krogman, *Protecting Our Children: Reforming Statutory Provisions to Address Reporting, Investigating, and Disclosing Sexual Abuse in Public Schools*, 2011 MICH. ST. L. REV. 1605, 1612–20; Aaron Lawson, *Educational Federalism: A New Case for Reduced Federal Involvement in K–12 Education*, 2013 BYU EDUC. & L.J. 281, 283–84; Richard C. Herrera, Note, *Policing State Testing Under No Child Left Behind: Encouraging Students with Disabilities to Blow the Whistle on Unscrupulous Educators*, 80 S. CAL. L. REV. 1433, 1457–59 (2007).

difficult to staff.¹⁴¹ Research has demonstrated that “schools with the largest numbers of low-income and minority students are much more likely than other schools to report that they have difficulty filling vacancies.”¹⁴² Moreover, “[t]hese schools are also more likely to fill vacancies with unqualified teachers, substitutes, or teachers from other fields, or to expand class sizes or cancel course offerings when they cannot find teachers.”¹⁴³ Conversely, incompetence and misconduct may also arise from motives completely unrelated to resources. For example, “some districts hire unqualified teachers for reasons other than shortages, including out-and-out patronage . . . and beliefs that more-qualified teachers are more likely to leave and less likely to take orders.”¹⁴⁴

In addition to staffing challenges, administrative and regulatory complexity often leads to poor management. One research team has noted that “urban school systems are vastly more complex than businesses, yet the knowledge about how to manage them is amazingly sparse.”¹⁴⁵ Problems result from archaic or underfunded administrative systems: “[I]nadequate management information systems and antiquated hiring procedures . . . discourage or lose good applicants in a sea of paperwork.”¹⁴⁶

Negligence on the part of school districts frequently does arise from financial constraints, however. For example, a school district held liable for failure to accommodate a student with disabilities may have been unwilling to make “the heightened investment in resources and personnel attention required for students with disabilities under the [Individuals with Disabilities Education Act (IDEA)].”¹⁴⁷ However, the fact that these financial pressures arise from a

¹⁴¹ Linda Darling-Hammond & Laura Post, *Inequality in Teaching and Schooling: Supporting High-Quality Teaching and Leadership in Low-Income Schools*, in A NOTION AT RISK: PRESERVING PUBLIC EDUCATION AS AN ENGINE FOR SOCIAL MOBILITY 127, 136 (Richard D. Kahlenberg ed., 2000).

¹⁴² *Id.* at 136.

¹⁴³ *Id.*

¹⁴⁴ *Id.* at 146 (observing that one study “found that many districts emphasize teachers’ ability to ‘fit in’ . . . rather than their professional expertise”).

¹⁴⁵ Stacey Childress, Richard Elmore & Allen Grossman, *How to Manage Urban School Districts*, HARV. BUS. REV., Nov. 2006, at 55, 56 (noting that “[t]here is no management model” for school districts and that while “[m]any corporate executives have exhorted superintendents and school boards to run their districts more like businesses—apply the same management, leadership, and organizational approaches . . . [t]he differences between the two are greater than their similarities”).

¹⁴⁶ Darling-Hammond & Post, *supra* note 141, at 147.

¹⁴⁷ Ralph D. Mawdsley, *Standard of Care for Students with Disabilities: The Intersection of Liability Under the IDEA and Tort Theories*, 2010 BYU EDUC. & L.J. 359, 360.

genuine lack of resources rather than a desire to maximize profits demonstrates that the difference between a reformed policy price and a full denial of coverage may have a reduced effect on school district decision makers as compared to corporate officers and directors.¹⁴⁸

While commercial companies have strong incentives to remain focused on the best interests of customers and shareholders built into their business model, school districts may slip into negligence because “the voice of the customer (the student) often gets lost in the din” of “parents and elected officials[] who are often at odds over what success looks like and how to achieve it.”¹⁴⁹ The ease with which students’ needs slip through the cracks gives rise to liability when school districts prioritize other concerns over students’ best interests. However, unlike the case of corporate insureds, the vulnerability of student plaintiffs and the importance of preventing uncompensated injuries make insurance coverage essential for school districts.

D. Policy Concerns Necessitating Coverage of Claims Against School Districts

States have recognized that certain fields of liability insurance, such as no-fault auto insurance, entail special policy concerns that may make rescission undesirable as a remedy.¹⁵⁰ Under New York law, “rescission of auto liability insurance policies after an accident stands in high disfavor, and is generally prohibited”¹⁵¹ because “[a]utomobile accident reparation is something special, born of a distinct and enlarging social need. It depends

¹⁴⁸ See *supra* note 134 (discussing the incentive effect of risk-based pricing on public company behavior).

¹⁴⁹ Childress et al., *supra* note 145, at 56.

¹⁵⁰ See, e.g., *State Farm Mut. Auto. Ins. Co. v. Wall*, 222 A.2d 282, 289–90 (N.J. Super. Ct. App. Div. 1966) (holding that state-mandated auto insurance could not be rescinded in the face of fraudulent misrepresentations because “the benefit bestowed on innocent third parties emanates from the statute”).

¹⁵¹ *Allstate Ins. Co. v. Sullam*, 349 N.Y.S.2d 550, 552 (Sup. Ct. 1973). The court goes on to explain that auto insurance policies thus carry in a lower standard for waiver of the misrepresentation defense:

Certainly, where the rights of innocent auto accident victims are concerned, insurers who undertake to investigate their insureds upon issuance of auto liability policies are charged with the knowledge to which they are reasonably alerted. They cannot simply disregard danger signs. . . . In auto accident cases, insurers who, in face of investigative results which signal caution, accept premiums and let their policies continue to run, enabling their insureds to remain on the roads, must reckon with the doctrine of estoppel when they seek post-loss disclaimer of coverage.

Id.

upon a specific public interest in policing roads and streets, and in making provision for injuries sustained in automobile accidents.”¹⁵²

Similarly, educators professional liability insurance—like all policies held by school districts—responds to a critical and growing social need that arises out of the central role of public education in our society.¹⁵³ School districts’ statutory duties often extend far beyond mere provision of educational services. For example, school systems may be required “[t]o protect the morals and health of the pupils”¹⁵⁴ or “to equip a child for his role as a citizen.”¹⁵⁵ The fundamental importance of public schools to the public interest, and the extent to which the fundamental goals of education are jeopardized by negligence that puts student safety at risk, necessitate special rules for the treatment of school district liability insurance policies.

Rescission of school district insurance policies undermines the unique concerns of public education. School districts require a greater guarantee of coverage because of the sensitive nature of the claims at issue.¹⁵⁶ It is well established that for third-party insurance policies, such as commercial general liability coverage for school districts, “public policy favors compensating innocent victims.”¹⁵⁷ Where victims would be unable to recover without a liability insurance policy, public interest in favor of their compensation weighs against the moral hazard of insulating the insured from the cost of its wrongdoing.¹⁵⁸

¹⁵² *Id.* at 558.

¹⁵³ See Areto A. Imoukhuede, *Education Rights and the New Due Process*, 47 IND. L. REV. 467, 467 (2014) (arguing that public education “is essential to any meaningful concept of personal liberty and to democracy”).

¹⁵⁴ IDAHO CODE ANN. § 33-512 (West Supp. 2015).

¹⁵⁵ *Robinson v. Cahill*, 303 A.2d 273, 295 (N.J. 1973).

¹⁵⁶ Plaintiffs include disabled students denied access to equal educational opportunities, victims of discrimination and other constitutional violations, and children sexually abused while under a school’s supervision. See, e.g., *Sch. Union No. 37 v. United Nat’l Ins. Co.*, 617 F.3d 554 (1st Cir. 2010) (reversing dismissal of a claim for coverage arising from student’s IDEA claim); *New Madrid Cnty. Reorganized Sch. Dist. No. 1, Enlarged v. Cont’l Cas. Co.*, 904 F.2d 1236, 1238 (8th Cir. 1990) (coverage for successful § 1983 suit by teachers “denied renewal of teaching contracts, made involuntary reassignments, and denied certain contractual benefits in retaliation for the teachers’ exercise of their First Amendment rights in joining a particular educational association”); *Doe v. Durtschi*, 716 P.2d 1238, 1245 (Idaho 1986) (stating that the school district “ignore[d] their statutory duty and retain[ed] known child molesters in the classroom with total impunity”); *Doe v. Tex. Ass’n of Sch. Bds.*, 283 S.W.3d 451 (Tex. App. 2009) (denying coverage under the terms of the policy for a claim by a nine-year-old student sexually assaulted by a bus driver).

¹⁵⁷ Christopher C. French, *Debunking the Myth that Insurance Coverage Is Not Available or Allowed for Intentional Torts or Damages*, 8 HASTINGS BUS. L.J. 65, 94 (2012).

¹⁵⁸ *Id.* at 94–95.

The public interest in ensuring coverage for innocent victims is particularly salient in the context of educators professional liability insurance, where injured third parties are particularly vulnerable.¹⁵⁹ Concern over whether third parties would be compensated at all in the absence of liability insurance is increasingly urgent in light of decreasing education funding and increasing threats of municipal and school district insolvency.¹⁶⁰ Moreover, school districts may not only be unable to fully pay claims, but may also be entirely immune from them as a result of governmental immunity in the absence of insurance coverage.¹⁶¹

Insurance coverage of school districts is unique in its intimate relationship to governmental immunity. The possibility of immunity amplifies the danger that rescission will leave particularly vulnerable victims without compensation. In many jurisdictions, the existence of insurance coverage is legally operative in itself to waive governmental immunity on the part of the school district.¹⁶² The Supreme Court of Oklahoma, for example, has recognized that “consent to be sued or waiver of governmental immunity may be implied” by the school district’s decision to obtain coverage, and the waiver extends “to the extent of the insurance coverage.”¹⁶³ Thus, the applicable policy may determine not only whether governmental immunity applies at all but exactly those claims from which the school district is immune.¹⁶⁴

Thus, the scope of insurance coverage is of particularly paramount importance to plaintiffs’ ability to recover for their injuries in the educational context. For example, the Supreme Court of Montana found that a school district had waived governmental immunity for the claims of a student injured after being instructed to perform an unsupervised, unspotted “straddle-cut dismount” from gymnastic rings during her gym class.¹⁶⁵ The court concluded that the policy coverage evidenced the school district’s intent to compensate

¹⁵⁹ See *supra* note 156.

¹⁶⁰ See Kristi L. Bowman, *Before School Districts Go Broke: A Proposal for Federal Reform*, 79 U. CIN. L. REV. 895 (2011) (describing imminent school district insolvency). Insolvency has ramifications beyond failure to compensate plaintiffs: “[F]iscal stability is one necessary component among many in determining whether educational adequacy exists.” *Id.* at 902.

¹⁶¹ Markesinis & Stewart, *supra* note 19, at 436–37.

¹⁶² See, e.g., *Crowell v. Sch. Dist. No. 7*, 805 P.2d 522, 534 (Mont. 1991) (holding that “the purchase by the School District of liability insurance waives its immunity to the extent of the coverage granted by the pertinent insurance policy” and noting that at least sixteen other states had a similar waiver rule).

¹⁶³ *Lamont Ind. Sch. Dist. No. 1-95 v. Swanson*, 548 P.2d 215, 216–17 (Okla. 1976).

¹⁶⁴ *Id.*

¹⁶⁵ *Crowell*, 805 P.2d at 523.

plaintiffs for such claims because “[t]he policy demonstrate[d] an intention on the part of the School District to provide insurance extending coverage for the type of personal injuries involved in the present case, and to provide by such insurance for the settlement and payment of claims found to be properly due.”¹⁶⁶ The court relied on the school district’s sophistication and bargaining position in finding that the waiver should be closely tailored to each claim of the insurance coverage, noting that “the District readily could have excluded coverage under the policy.”¹⁶⁷

III. REFORMATION OF EDUCATORS PROFESSIONAL LIABILITY INSURANCE POLICIES

States should adopt a reformation remedy that would apply to all misrepresentations by school districts. This remedy, like the quasi-reformation remedy outlined in the Principles for innocent misrepresentations by small commercial policyholders, would require the insurer to cover the claim while allowing it to charge a reasonable increased premium for the coverage.¹⁶⁸ Unlike the Principles’ quasi-reformation remedy, and in sharp contrast to the strict liability rescission scheme envisioned by the Restatement, it would ensure coverage for claims against school districts by applying even in the case of intentional misrepresentations¹⁶⁹ and by not permitting prospective cancellation.¹⁷⁰ This remedy would provide more flexibility to courts than the binary remedies available to litigants under the current system, in which a court may either rescind the policy entirely or order payment of the claim with no change to the existing terms of the policy.¹⁷¹

In providing for mandatory reformation even after intentional misrepresentations, this remedy would extend further than the framework originally designed for small commercial policy holders under the Principles.¹⁷² This reformation remedy would also extend further than the Principles’ quasi-reformation remedy in that it would not provide for prospective cancellation of the policy within a reasonable period of time.¹⁷³

¹⁶⁶ *Id.* at 533–34.

¹⁶⁷ *Id.*

¹⁶⁸ PRINCIPLES, *supra* note 22, § 11 cmt. a.

¹⁶⁹ *Id.* § 7 (allowing rescission for intentional misrepresentations).

¹⁷⁰ *Id.* § 11 (allowing cancellation “within a reasonable time of discovery”).

¹⁷¹ *See supra* notes 87–88.

¹⁷² PRINCIPLES, *supra* note 22, § 7 (allowing rescission in the face of misrepresentation).

¹⁷³ *Id.* § 11.

The Principles envisioned a scheme under which courts would never order policy reformation as a remedy for a material, fraudulent misrepresentation.¹⁷⁴ The weight of state law supports this approach.¹⁷⁵ Such material, fraudulent misrepresentations do occur in the educators professional liability insurance context, however. For example, the school district's assertion in *Stratford* that it was aware of no potential claims against it, despite the fact that it had just recommended for employment a known perpetrator of sexual assault, could readily be found to be a knowing and material misrepresentation.¹⁷⁶

The policy concerns demanding coverage for claims arising from school districts' innocent misrepresentations are equally present and urgent when a district has made a fraudulent misrepresentation. The egregiousness of leaving public school students uncompensated for sexual abuse that occurred at school is unaffected by the school district's fraud. Because misconduct at schools does not arise from profit-seeking motives,¹⁷⁷ the financial incentive inherent in the threat of rescission would not necessarily be effective in influencing the school's future behavior.

Proponents of limiting liability for claims against school districts deny the primacy of the public interest in covering claims arising from the districts' misconduct.¹⁷⁸ They contend that large recoveries often occur in civil rights and employment claims, which are purportedly unrelated to students' interests, force taxpayers to bear their cost, and "distract the administration and staff from their primary purpose of educating students."¹⁷⁹ However, this argument's insistence that school district liability is inappropriate in light of the need to avoid "inconvenience and punishment of the citizenry through monetary judgments and costly litigation"¹⁸⁰ ignores both the regulating and smoothing effect that insurance coverage provides, and the cost to the public of the harms sustained by innocent students.¹⁸¹

¹⁷⁴ *Id.* § 7.

¹⁷⁵ See *supra* notes 35–38 (allowing rescission for intentional and innocent misrepresentations); *supra* notes 49–53 (allowing rescission for intentional misrepresentations).

¹⁷⁶ See *supra* notes 79–85.

¹⁷⁷ See *supra* notes 140–49 and accompanying text.

¹⁷⁸ See, e.g., Amy P. Maloney & Matt J. O'Laughlin, *The People Can Do No Wrong: An Examination of State and Eleventh Amendment Governmental Immunity for Missouri's Public School Districts*, 74 UMKC L. REV. 883 (2006).

¹⁷⁹ *Id.* at 885.

¹⁸⁰ *Id.*

¹⁸¹ See, e.g., *Thomas v. Broadlands Cmty. Consol. Sch. Dist. No. 201*, 109 N.E.2d 636, 640–41 (Ill. App. Ct. 1952) ("The only justifiable reason for the immunity of quasi-municipal corporations from suit for tort is

While public companies and school districts face different regulatory environments,¹⁸² both school districts and public companies may benefit from insurance market regulation in addition to state regulation.¹⁸³ Such regulation is optimally accomplished through reformation remedies because the problem of post-claim underwriting¹⁸⁴ is particularly salient in situations of rare, high-stakes risks,¹⁸⁵ a condition exacerbated by the availability of rescission. Furthermore, rescission undercuts the system's ability to spread risk by increasing access to the insurance pool for as many insureds as possible.¹⁸⁶

The need for effective pricing and cost spreading is much more critical for school districts than for public companies. In the corporate context, effective cost spreading promotes economic efficiency of the insurance market, while accurate pricing tailored to the real risks incurred by certain companies ensures some fairness for more careful insureds.¹⁸⁷ While these effects are salutary for corporate insureds, they are matters of urgent public concern for school districts, which operate with wide disparities in resources, resulting from forces beyond the district's control.¹⁸⁸

Moreover, the fact remains that many plaintiffs are students who have been harmed by the very educational activities the proponents seek to protect, a reality ignored by a relentless emphasis on reducing public school liability at all costs. The danger that administrators and staff will be "distracted" from their job duties¹⁸⁹ loses its relevance when those teachers are using their positions as platforms to intentionally abuse students. Even to the extent that policy concerns grounded in expense may undercut an absolute, generalized

the sound and unobjectionable one that it is the public policy . . . to prevent the diversion of tax moneys, in this case school funds, to the payment of damage claims. . . . If the public funds are protected by liability insurance, the justification and reason for the rule of immunity are removed.").

¹⁸² See *supra* notes 132–40.

¹⁸³ Ben-Shahar & Logue, *supra* note 16, at 200–01 (arguing that insurers are able "to assess the distribution of harm and determine the desirability of safety measures" and that "private insurance markets can and sometimes do outperform the government in regulating conduct because of both superior information and competition").

¹⁸⁴ See Thomas C. Cady & Georgia Lee Gates, *Post Claim Underwriting*, 102 W. VA. L. REV. 809 (2000).

¹⁸⁵ Barnes, *supra* note 28, at 340; see Susan Koehler Sullivan & David A. Ring, *Recurring Issues in Rescission Cases*, 42 TORT TRIAL & INS. PRAC. L.J. 51 (2006).

¹⁸⁶ BAKER & GRIFFITH, *supra* note 14, at 202; Barnes, *supra* note 28, at 351.

¹⁸⁷ Avraham, *supra* note 39, at 34–35 (describing the "efficient insurance contract paradigm" in which insurance law protects "insureds and insurers from contracting inefficiently due to transaction costs primarily in the form of each other's strategic behavior and hidden characteristics").

¹⁸⁸ Darling-Hammond & Post, *supra* note 141, at 136.

¹⁸⁹ Maloney & O'Laughlin, *supra* note 178, at 885.

policy interest in compensating all plaintiffs, school districts have long been on notice that their purchase of liability insurance policies is construed as an intent to compensate plaintiffs for particular claims.¹⁹⁰ Therefore, their continued decision to do so is a specific public policy choice that the availability of rescission and cancellation under the Restatement approach would contravene.

In contrast, a reformation remedy applied to misrepresentations by school districts would recognize school districts' policy choice without unfairness to insurers. Under a reformation remedy, insurers would maintain the benefit of the contract bargain by charging an increased premium based on the factors it would have assessed had it known the true characteristics of the insured.¹⁹¹ These increased premiums would both adequately compensate insurers for their actual losses and allow insurers to continue to engage in strategic pricing to ensure optimal efficiency and behavioral incentives.

CONCLUSION

Student victims of intentional torts and negligence perpetrated by public school teachers and administrators are among the most vulnerable tort victims. Nevertheless, under current insurance doctrine as reflected and embodied by the Restatement, student victims may fail to recover on judgments in their favor because their school district's insurance policy has been rescinded. Under the Restatement scheme, school districts are subject to policy rescission for both innocent and intentional misrepresentations. Not only does this outcome deprive innocent victims of compensation, it ignores the economic and policy realities of school district insurance coverage.

School districts do not resemble other commercial policyholders, either in the reasons for their misconduct or the policies undergirding the need for liability insurance coverage. The extreme financial punishment delivered by rescission is unlikely to incentivize care on the part of school districts because school district negligence is not the result of a desire to maximize profits. Courts have recognized these key differences by treating school district insurance application misrepresentations with lenience; however, the binary nature of the remedies traditionally available to courts rendered this lenience

¹⁹⁰ See *supra* notes 162–64.

¹⁹¹ PRINCIPLES, *supra* note 22, § 11 cmt. a.

inequitable to insurers, preventing them from recovering any of the loss caused by the insured's misrepresentation.

The application of a reformation remedy to misrepresentations by school districts would allow courts to answer the policy concerns inherent in school district liability by providing coverage for claims while allowing insurers to charge increased premiums for the risks posed by a particular school district's behavior. The tailored, risk-based pricing that will result from policy reformation and increased premiums will provide optimal efficiency in the insurance market for school districts, a market characterized by wide disparities in resources and risks.

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