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A REASONABLE APPROACH TO THE DOCTRINE OF REASONABLE EXPECTATIONS AS APPLIED TO INSURANCE CONTRACTS

*Perhaps no modern commercial enterprise directly affects so many persons in all walks of life as does the insurance business. Insurance touches the home, the family, and the occupation or the business of almost every person in the United States.*¹

The language in standard-form insurance policies today too often reflects unsuccessful attempts to harmonize the technical, economic, and legal requirements of insurance companies, legislators, and courts.² Draftsmen respond to past judicial interpretations of isolated legal phrases and terms of art in an attempt to draft insurance policies of reasonably certain and predictable meaning. Much insurance litigation, however, concentrates on policyholders' attempts to rebut these "definite" meanings with imaginative arguments based on their particular fact situations. Courts which decide in favor of policyholders often support their opinions with vague references to "established" rules of construction. To increase the confusion, these vague interpretive doctrines are inconsistently applied. As a result, there are no clear guidelines for the interpretation of insurance policy language.

The standard rule of analysis is that because insurance policies are a form of adhesion contract, they require that all ambiguities be resolved against the insurer.³ This rule coexists with

¹ *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1943).

² Young, Lewis & Lee, *Insurance Contract Interpretation: Issues and Trends*, 1975 *INS. L.J.* 71, 72.

³ Judge Learned Hand explained the reason for this doctrine. "[I]nsurers who seek to impose upon words of common speech an esoteric significance intelligible only to their craft, must bear the burden of any resulting confusion." *Gaunt v. John Hancock Mut. Life Ins. Co.*, 160 F.2d 599, 602 (2d Cir.), *cert. denied*, 331 U.S. 849 (1947).

See, e.g., *Heffron v. Jersey Ins. Co.*, 144 F. Supp. 5 (E.D.S.C. 1956), *aff'd*, 242 F.2d 136, 140 (4th Cir. 1957) ("As the insurer prepared the policy, any ambiguity is to be resolved against it and liberally in favor of the insured."); *Hathaway v. Commercial Ins. Co.*, 85

the doctrine of "reasonable expectations," which requires that insurance contracts provide the coverage that the insured could reasonably expect upon reading the policy. Some commentators suggest a broadened interpretation of reasonable expectations to allow the insured to recover even where coverage is excluded by clear and unambiguous policy language.

Part I of this article examines standard insurance contract analysis and the existing confusion within that analysis. Part II examines the doctrine of reasonable expectations. In Part III, Professor Keeton's⁴ expansion of the reasonable expectations doctrine is explained and analyzed. This article concludes in Part IV that Keeton's expanded doctrine has the effect of confusing most courts, which continue to discuss reasonable expectations in relation to conventional rules of contract construction. The article proposes that the reasonable expectations doctrine be limited to contractual language and surrounding circumstances in order to establish clearer guidelines for insurers and consumers.

I. STANDARD INSURANCE CONTRACT ANALYSIS AND THE PROBLEM OF AMBIGUITY

Modern insurance policies are contracts of adhesion.⁵ The insured's unequal bargaining position begins when the insurance company tenders the policy on a "take it or leave it" basis. Thus, the insured may reject but not alter the contract terms,⁶ and often may not see the terms before an agreement is reached.

The adhesiory nature of insurance policies has fostered the rule that "[a]mbiguous policy language in a policy of insurance is to be construed liberally in favor of the insured and strictly against the insurer."⁷ This nearly universal rule of construction,

Misc. 2d 485, 380 N.Y.S.2d 529 (1976).

⁴ Professor Keeton, formerly of Harvard Law School, was confirmed as United States District Judge for the District of Massachusetts in March, 1979.

⁵ See, e.g., 3 A. CORBIN, *CONTRACTS* § 559 n.20 (1960); *Magulas v. Travelers Ins. Co.*, 114 N.H. 704, 327 A.2d 608 (1974); *Allen v. Metropolitan Life Ins. Co.*, 44 N.J. 294, 208 A.2d 638 (1965); and cases cited at note 22 *infra*.

⁶ The lack of choice as to contract terms is a major reason why insurance contracts are singled out as inherently oppressive, because the insurer can legislate the conditions of coverage by contract in a substantially authoritarian form. Kessler, *Contracts of Adhesion — Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 632 (1943).

⁷ 7 WILLISTON ON *CONTRACTS* § 900 (3d ed. 1963). One court, however, disagrees: [I]nsurance contracts are not strictly construed against the insurer. They are construed just as any other contract is construed . . . by its [sic] plain meaning with no application of strictness in favor of either party, *unless* an ambiguity is found. When an ambiguity is found, it will be resolved against the drafter of the

however, gives no specific guidance for interpretation. The rule does not provide parameters for judicial interpretation and courts purporting to apply the rule may thus interpret the whole policy or only the controverted terms.⁹

Since the term "adhesion contract" merely describes the process of contract formation, it offers no guidance for interpretation.⁹ Consequently, the extent to which a court will look beyond express contract language is unpredictable.¹⁰ Predictability rather than a "court's unfettered notion of what is just in a given situation" is necessary to mitigate the unequal bargaining positions of the parties.¹¹

instrument

Union Planters Corp. v. Harwell, 578 S.W.2d 87, 92 (Tenn. 1978) (emphasis in original).

Staunch supporters of standard-form contracts deny the alleged oppressiveness of insurance policies. The standard-form contract is not unique to insurance, yet supporters claim it is the insurer who makes the greatest sacrifice because of insurance's risk-distributing nature. See 9 COUCH ON INSURANCE § 39:2 (2d ed. 1962).

⁹ See, e.g., *Aetna Ins. Co. v. Getchell Steel Treating Co.*, 395 F.2d 12 (8th Cir. 1968) (policy and endorsement were construed to give effect to all provisions, thus the finding that insured's fire policy was intended to cover every loss proximately caused by fire and every loss flowing from such peril); *Great W. Cas. Co. v. Truck Ins. Exch.*, 358 F.2d 883 (10th Cir. 1966) (no policy language supported the insured's claim of coverage for destroyed vehicle which was to have been insured by the lessee); *Union Ins. Soc'y v. William Gluckin & Co.*, 353 F.2d 946 (2d Cir. 1965) (since the critical language in the policy was ambiguous, a triable issue of fact existed as to the intent of the parties); *Fidelity & Cas. Co. v. Seven Provinces Ins. Co.*, 345 F.2d 227 (6th Cir. 1965) (the case was remanded to determine what the ambiguous provision meant in the regular course of business); *Garner v. American Home Assur. Co.*, 62 Tenn. App. 172, 460 S.W.2d 358 (1970) (where the ambiguity is confined to a single provision, only that provision will be interpreted; here no ambiguity existed so the court gave effect to the policy as a whole); 1 COUCH ON INSURANCE § 15:57 (2d ed. 1959).

⁹ It has been suggested that the use of the term "adhesion contract" may be "no more than a symptom that a court is searching more diligently for an ambiguity." Young, Lewis & Lee, *supra* note 2, at 77.

¹⁰ The traditional difference between the admission of extrinsic evidence because of an ambiguity and the admission of extrinsic evidence for lack of integration in fact is not present in insurance contract interpretation. Integrated written contracts usually merge all prior agreements and no evidence of prior negotiations is admitted to vary or contradict the meaning of the integrated document. An insurance contract, on the other hand, is not truly integrated. The applicant may reject the document but may not alter its standard terms. Matters troubling the applicant are inevitably satisfied by oral or written contemporaneous assurances from the local agent but not inserted in the formal instrument. Thus, courts tend to admit evidence of any alleged collateral agreement for the jury's decision-making process. See 4 WILLISTON ON CONTRACTS § 645, at 1141 (3d ed. 1961).

¹¹ Young, Lewis & Lee, *supra* note 2, at 77. For an example of unequal bargaining positions even among professionals, see *Donnelly v. Transportation Ins. Co.*, 589 F.2d 761 (4th Cir. 1978). An exclusion in the plaintiff-attorney's policy denied defense coverage for "any dishonest, fraudulent, . . . act or omission." *Id.* at 763. The insurer refused to defend the attorney because one of the claims for unauthorized sale of a client's securities was not an act covered by the policy. Yet the policy specifically protected the attorney against becoming "obligated to pay as damages because of any act or omission . . .

The greatest hindrance to predictability in standard insurance contract analysis is the use of the term "ambiguity."¹² Courts also refer to ambiguity when discussing the problems of unexpected or unclear policy language and extrinsic circumstances.¹³ Three different problems of ambiguity are presented. First, exclusionary clauses which fail sufficiently to warn the insured of limitations on the primary coverage are a common source of ambiguity. These clauses are usually inconspicuous because they are in fine print, separated from primary provisions, and buried among other clauses.¹⁴ Second, ambiguity may result when a pol-

arising out of performance of professional services for others in the insured's capacity as a lawyer." *Id.* at 765-66. The court held that "[p]olicy language, susceptible of more than one interpretation, is construed, if reasonably possible, to provide coverage." *Id.* at 768. As long as one of the charges against the attorney could arguably fall within this definition of the policy, the insurer owed its insured a defense on all charges.

¹² The general problem of ambiguity has been succinctly stated by the New Jersey Supreme Court:

Even if we were to . . . ask if the event would be commonly spoken of as an accident, we must acknowledge that laymen themselves may speak differently of the same event. Thus, it is compelling for the law to find an answer that will produce consistent results where the essential facts are not in dispute.

Schwartz v. John Hancock Mut. Life Ins. Co., 96 N.J. Super. 520, 526-27, 233 A.2d 416, 420 (1967).

¹³ Another court discusses the definition of ambiguity:

The word has been defined as capable of being understood in more senses than one; obscure in meaning through indefiniteness of expression; having a double meaning; doubtful and uncertain; meaning unascertainable within the four corners of the instrument; open to construction; reasonably susceptible of different constructions; uncertain because susceptible of more than one meaning. Its synonyms have been said to be "doubtful," "equivocal," "indefinite," "indeterminate," "indistinct," "uncertain," and "unsettled."

Simpkins v. Business Men's Assur. Co., 31 Tenn. App. 306, 310, 215 S.W.2d 1, 3 (1948) (quoting 3 C.J.S. p. 1037 [sic]). The analysis necessary to interpret an insurance contract does not establish the presence of ambiguity. Ambiguity arises when more than one interpretation of a policy term may be given. *Traveler's Ins. Co. v. C. J. Gayfer's & Co.*, 366 So. 2d 1199, 1201 (Fla. 1979). One court has gone even further and created an ambiguity whenever an insured did not understand a policy term or provision. *Read v. Western Farm Bureau Mut. Ins. Co.*, 90 N.M. 369, 374, 563 P.2d 1162, 1167 (1977).

¹⁴ See *Paramount Properties Co. v. Transamerica Title Ins. Co.*, 1 Cal. 3d 562, 463 P.2d 746, 83 Cal. Rptr. 394 (1970) (termination provision lay near the bottom of the second page of the policy's fine print, at the end of a paragraph entitled "Payment of Loss," and thus was not "conspicuous" to the insured); *Commercial Union Assur. Co. v. Gollan*, 118 N.H. 744, 394 A.2d 839 (1978) (exclusions were printed in small type and were seventy-eight lines apart, which did not adequately inform the insured that the exclusionary clauses should be read together); *Atwood v. Hartford Accident & Indem. Co.*, 116 N.H. 636, 365 A.2d 744 (1976) (exclusionary clause denying alleged coverage was buried amidst thirteen other clauses); *Gerhardt v. Continental Ins. Cos.*, 48 N.J. 291, 225 A.2d 328 (1966) (coverages and limits were described on the front page of the policy in general terms with the remaining sections in small print with one heading entitled "Coverage E — Comprehensive Personal Liability"; exclusions were on a separate page); *Mills v. Agrichemical Aviation, Inc.*, 250 N.W.2d 663 (N.D. 1977) (ambiguity existed because of dissimilar exclusionary language buried in two policies ostensibly providing coverage).

icy clause uses incorrect,¹⁵ uncertain, or unclear essential terms. Such a term may be unclear because it is undefined and thus of uncertain scope,¹⁶ or because its definition is illogical or unreasonable to the insured¹⁷ in the context in which it appears. Third, information which is extrinsic to the express contractual language, such as written representations by the insurer in brochures and applications¹⁸ or oral representations by an agent, may contradict the written information in the policy.¹⁹

¹⁵ See *Corgatelli v. Globe Life & Accident Ins. Co.*, 96 Idaho 616, 533 P.2d 737 (1975) (policy was ambiguous because it guaranteed payment for dislocation of a collar bone, even though a bone cannot be "dislocated;" compensation awarded for a dislocated shoulder).

¹⁶ See *Insurance Co. of N. Am. v. Sam Harris Constr. Co.*, 22 Cal. 3d 409, 583 P.2d 1335, 149 Cal. Rptr. 292 (1978) (where coverage was limited to "occurrences" or "accidents," which were undefined, the court held that a claim against the insured for negligent maintenance during the policy period causing an injury to occur after the policy's expiration date, was covered); *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 267, 419 P.2d 168, 170, 54 Cal. Rptr. 104, 106 (1966) (since the insured's policy contained a broad promise to defend any bodily injury claim, the insured could reasonably expect to be defended against a charge of assault when his claim was self-defense, even though another clause barred claims for "bodily injury or property damages caused intentionally by or at the direction of the insured"); *Steinbach v. Continental W. Ins. Co.*, 327 N.W.2d 780 (Iowa 1976) (where farm insurance policy did not define the word "theft" and five kinds of losses were explicitly excluded from coverage, the insured's loss was covered, regardless of whether it was technically "larceny by trick" or "false pretenses"); *Elliott Leases Cars, Inc. v. Quigley*, 373 A.2d 810 (R.I. 1977) (where car rental contract stated that the agency would pay for "accident repairs" caused by collision or upset, subject to \$100 deductible and the contract made no mention of negligence, it could be reasonably expected that the agency and its insurer would be liable for repairs).

¹⁷ See *Commercial Union Assur. Cos. v. Aetna Cas. & Surety Co.*, 455 F. Supp. 1190 (D.N.H. 1978) (insured could reasonably expect coverage on a mobile vehicle for which he paid a specific premium, even though policy contained an exclusion for "mobile equipment").

¹⁸ See, e.g., *INA Life Ins. Co. v. Brundin*, 533 P.2d 236 (Alas. 1975) (recovery was awarded because the policy term "accident" was ambiguous due to misleading language in the flyer advertisements); *Klos v. Mobil Oil Co.*, 55 N.J. 117, 259 A.2d 889 (1969) (date of coverage in policy varied from earlier date in application and insured recovered according to earlier date in her favor).

¹⁹ See *Harr v. Allstate Ins. Co.*, 54 N.J. 287, 255 A.2d 208 (1969). The plaintiff-insured recovered on the basis of agent misrepresentation. The court added that even without the misrepresentation, "where the language of the policy is such that the layman would not understand its full import . . . such provisions will . . . give the maximum protection consistent with its language and the reasonable expectations of the insured . . ." *Id.* at 310, 255 A.2d at 221. The language of the policy contained ambiguous clauses. One exclusionary clause stated that "rupture or bursting of water pipes is not an explosion," thus implying that such damage was not covered, whereas another paragraph, entitled "WATER EXCLUSION CLAUSE," did not list water from bursting pipes as one of the excluded occurrences. *Id.* at 297, 255 A.2d at 213.

A curious case involving "agent misrepresentation" dealt with a life insurance policy solicited by mail. The insured was awarded coverage because he could reasonably expect the offer to be accepted when he deposited the application in the mail. *Fritz v. Old Am. Ins. Co.*, 354 F. Supp. 514 (S.D. Tex. 1973). The court so held even though some language in the policy showed an intention by the insurer that coverage not begin until the

Despite the facts that there is no clear line between ambiguous and unambiguous contract language and that the role of extrinsic circumstances in courts' analyses remains uncertain, decisions favoring the insurer over a sympathetic plaintiff-insured demonstrate that lines *are* being drawn.²⁰ If courts would expand and stipulate the definition of "ambiguity" to include any conflicting elements of a particular transaction capable of more than one interpretation, general guidelines could be established for analyzing standard insurance contracts. These guidelines would achieve more predictable results.

II. THE DOCTRINE OF REASONABLE EXPECTATIONS

The doctrine of reasonable expectations was also developed to neutralize the disparity in the bargaining positions of the insurer and its insured. This doctrine requires that insurance contracts provide that coverage which an insured could reasonably expect after reading the policy.²¹ Moreover, the reasonable expectations

application was accepted. The court reasoned:

[W]hen the potential insurance purchaser cannot consult with an agent to ascertain the parameters of the proposed policy, the concept of an informed meeting of the minds is a myth unless the insurance company clearly and explicitly explains the policy in its literature. To effectuate this goal, the reasonable expectations which such literature raises or does not rebut must govern the interpretations of such policies.

Id. at 518.

²⁰ See *Herzog v. National Am. Ins. Co.*, 2 Cal. 3d 192, 465 P.2d 841, 84 Cal. Rptr. 705 (1970) (discussed in notes 27 & 79 *infra*); *Rodman v. State Farm Mut. Auto. Ins. Co.*, 208 N.W.2d 903 (Iowa 1973) (since nothing gave the plaintiff-insured expectations contrary to language in the contract, judicial interpretation must be limited to expectations arising from policy language; discussed also at note 25 *infra*); *Moorhead Machinery & Boiler Co. v. Employers Commercial Union Ins. Co.*, No. 49086 (Minn. July 20, 1979) (*en banc*) (discussed at note 27 *infra*); *Weedo v. Stone-E-Brick, Inc.*, No. A-11 (N.J. July 18, 1979); *Middle Dep't Inspection Agency v. The Home Ins. Co.*, 154 N.J. Super. 49, 380 A.2d 1165 (1977) (discussed at note 25 *infra*); *Petronzio v. Brayda*, 238 N.J. Super. 70, 350 A.2d 256 (1975) (insured's homeowner's policy covering accidents to "employees" on the premises did not include insured's son-in-law who was injured while voluntarily mowing the lawn because the established definition of "employee" did not cover such gratuitous service).

²¹ See *INA Life Ins. Co. v. Brundin*, 533 P.2d 236 (Alas. 1975). In *Brundin*, a widow-beneficiary recovered under several accidental death policies when her insured husband suffered cardiac arrest during surgery, despite an argument that the deceased's eating, smoking, and drinking habits predisposed him to cardiac problems. The policy covered death through bodily injury caused by an accident, but never defined the term "accident". See note 18 *supra*. Applying the doctrine of reasonable expectations, the court found that the ambiguous policy language included "accidents in the sense of accidental results . . . when unintended injury or death results despite lack of any identifiable accidental causative agent." *Id.* at 242.

See also *Gaunt v. John Hancock Mut. Life Ins. Co.*, 160 F.2d 599 (2d Cir.), *cert. denied*, 331 U.S. 849 (1947), in which Judge Learned Hand described the reasonable person in the place of the insured. The insurance application form "was to go to persons utterly

doctrine followed by most courts operates within the bounds of traditional insurance contract analysis.²²

Reasonable expectations are usually based on what a reasonable person in the place of the insured could expect.²³ The term "reasonable," however, like the term "ambiguity," has no explicit definition.²⁴ Thus, application of the reasonable expectations analysis requires discovering an ambiguity and then testing

unacquainted with the niceties of life insurance, who would read it colloquially. It is the understanding of such persons that counts" *Id.* at 601. See also notes 14-19 *supra*.

²² See, e.g., recent cases in the following jurisdictions: California: *Cobb v. Home & Auto. Ins. Co.*, 86 Cal. App. 3d 673, 150 Cal. Rptr. 370 (1978); *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); *Lowell v. Maryland Cas. Co.*, 65 Cal. 2d 298, 419 P.2d 180, 54 Cal. Rptr. 116 (1966) (*en banc*). Connecticut: *Simms v. North Am. Co. for Life & Health Ins.*, 175 Conn. 77, 394 A.2d 710 (1978); Georgia: *Republic Ins. Co. v. Chapman*, 146 Ga. App. 719, 247 S.E.2d 156 (1978); Iowa: *State Farm Auto. Ins. Co. v. Malcolm*, 259 N.W.2d 833 (Iowa 1977); Maryland: *Harsanyi v. Hartford Accident & Indem. Co.*, 41 Md. App. 685, 398 A.2d 524 (1979); Michigan: *Lebow Assoc., Inc. v. Avemco Ins. Co.*, 439 F. Supp. 1288 (E.D. Mich. 1977) (applying Michigan law); *Zurich Ins. Co. v. Rombough*, 384 Mich. 228, 180 N.W.2d 775 (1970); Minnesota: *Caledonia Community Hosp. v. St. Paul Fire & Marine Ins. Co.*, 307 Minn. 352, 239 N.W.2d 768 (1976) (*en banc*); New Jersey: *Wells v. Wilbur B. Driver Co.*, 121 N.J. Super. 185, 296 A.2d 352 (1972); *Movern v. John Hancock Mut. Life Ins. Co.*, 107 N.J. Super. 570, 259 A.2d 504 (1969); *Rotwein v. General Accident Group*, 103 N.J. Super. 406, 247 A.2d 370 (1968); New Mexico: *Thompson v. Occidental Life Ins. Co.*, 90 N.M. 620, 567 P.2d 62 (1977); New York: *Breed v. Insurance Co. of N. Am.*, 46 N.Y.2d 351, 385 N.E.2d 1280 (1978); Michigan: *Millers Mut. Ins. Co. v. Christopher*, 66 App. Div. 2d 148, 413 N.Y.S.2d 264 (1979); North Carolina: *Woods v. Nationwide Mut. Ins. Co.*, 295 N.C. 500, 246 S.E.2d 773 (1978); North Dakota: *Mills v. Agrichemical Aviation, Inc.*, 250 N.W.2d 663 (N.D. 1977); Pennsylvania: *Daburlos v. Commercial Ins. Co.*, 521 F.2d 18 (3d Cir. 1975) (applying law of Pennsylvania); Texas: *Ranger Ins. Co. v. Bowie*, 574 S.W.2d 540 (Tex. 1978); Washington: *Farmers Home Mut. Ins. Co. v. Insurance Co. of N. Am.*, 20 Wash. App. 540, 583 P.2d 644 (1978); *Muench v. Oxley*, 90 Wash. 2d 637, 584 P.2d 939 (1978) (*en banc*); Wisconsin: *Chemtec Midwest-Services, Inc. v. Insurance Co. of N. Am.*, 288 F. Supp. 763 (W.D. Wis. 1968) (applying New Jersey law).

²³ See *Bandura v. Fidelity & Guar. Life Ins. Co.*, 443 F. Supp. 829, 832 (W.D. Pa. 1978) (policy interpreted according to the parties' intent when the contract was made); *INA Life Ins. Co. v. Brundin*, 533 P.2d 236, 242 (Alas. 1975) (policyholder's reasonable expectations control interpretation); *Insurance Co. of N. Am. v. Sam Harris Constr. Co.*, 22 Cal. 3d 409, 583 P.2d 1335, 149 Cal. Rptr. 292 (1978) (meaning ascertained by reference to insured's reasonable expectations of coverage); *Allstate Ins. Co. v. Anderson*, 87 Mich. App. 539, 542, 274 N.W.2d 66, 68 (1978) (*per curiam*) (court's duty is to ascertain the meaning the insured would reasonably expect); *Nile Valley Coop. Grain & Milling Co. v. Farmers Elevator Mut. Ins. Co.*, 187 Neb. 720, 722, 193 N.W. 2d 752, 754 (1972) (*per curiam*) (objectively reasonable expectations of the insured will be honored); *Jones v. Continental Cas. Co.*, 123 N.J. Super. 353, 359, 303 A.2d 91, 94 (1973) (insured receives protection necessary to fulfill his reasonable expectations).

²⁴ "[A]n attempt to give a specific meaning to the word 'reasonable' is trying to count what is not number, and measure what is not space." *Althuler v. Coburn*, 38 Neb. 881, 890, 57 N.W. 836, 838 (1894). See also *In re Nice & Schreiber*, 123 F. 987 (E.D. Pa. 1903) ("reasonable" is a relative term); *Waschak v. Moffat*, 173 Pa. Super. Ct. 209, 96 A.2d 163 (1953) ("reasonable" depends on the set of facts involved); *Houston & T.C.R. Co. v. Everett*, 11 Tex. 862, 86 S.W. 17 (1905) ("reasonable" encompasses what is sensible, rational, fitting, and proper).

it to determine whether a construction favoring the insured is reasonable. If "ambiguity" were broadly defined to include any conflicting elements of a particular transaction capable of various interpretations, an insured's reasonable expectations would be easier to determine. Since existence of an ambiguity results in a presumption for the insured, the insured's actual expectations would be reasonable if they coincided with what an average insured would expect under the circumstances.

Under present law, if no factor exists to create expectations contrary to the contract language, courts limit the application of the reasonable expectations doctrine to expectations arising from the policy's terms.²⁵ This application of the doctrine assumes that the insured has made an attempt to read the policy and also considers a variety of extrinsic evidence, including the reasonableness of an insured's understanding of the insurer's purpose in providing the policy.²⁶ An insured's reasonable expectations will depend on whether the language of the policy is so ambiguous that an average insured could reasonably expect coverage other than what is given by the policy.²⁷

²⁵ See *Maples v. Aetna Cas. & Sur. Co.*, 83 Cal. App. 3d 641, 148 Cal. Rptr. 80 (1978) ("[A]ccidents which occur during the policy period" unambiguously referred not to the time the wrongful act was committed, but the time when the insured was actually damaged; thus, decision favored insurer because insured's damage claim originated after policy expired.). See also *Middle Dep't Inspection Agency v. The Home Ins. Co.*, 154 N.J. Super. 49, 55, 380 A.2d 1165, 1168 (1977) ("The mere fact that one clause limits coverage to such errors and omissions occurring during the policy period while another simply extends coverage to pre-policy errors and omissions under particularized conditions does not lead to a latent ambiguity."); *National Ins. Underwriters v. Carter*, 17 Cal. 3d 380, 551 P.2d 362, 131 Cal. Rptr. 42 (1976) (reasonable expectations of the insured were upheld in a decision favoring carrier when insured could understand clearly set forth pilot exclusion clause in aircraft liability policy, limiting coverage to certain qualified pilots); *Rodman v. State Farm Mut. Auto. Ins. Co.*, 208 N.W.2d 903 (Iowa 1973) (plaintiff-insured argued that even though he agreed he was not covered, in retrospect he would have misunderstood the policy if he had read it).

²⁶ See *Bracy v. American Family Mut. Ins. Co.*, 189 Neb. 631, 204 N.W.2d 174 (1973). The court stated:

In provisions for liability for medical expense or medical payments some difficulty has been experienced in the use of the phrases "owned automobile" and "non-owned automobile." It has been said: "The purpose of the insurer is readily apparent. It is willing to make medical payments when an insured is injured while occupying a vehicle which is insured under the policy It is unwilling, however, to make medical payments to an insured who is injured in another vehicle owned by . . . [the] insured but not insured under the policy."

Id. at 633, 204 N.W.2d at 175 (citations omitted).

²⁷ Disregard of the normal meanings of words in unambiguous circumstances does not represent the reasonable expectations of either party to the contract. See *Herzog v. National Am. Ins. Co.*, 2 Cal. 3d 192, 465 P.2d 841, 84 Cal. Rptr. 705 (1970). When an insured carried both an auto policy and a "Comprehensive Personal Liability Policy" (CPLP), he could not reasonably expect coverage for his auto under the CPLP. The phrase "ways immediately adjoining" was technically possible of more than one con-

III. THE ROLE OF THE KEETON DOCTRINE IN RECENT DECISIONS

A. *Explication of the Doctrine*

While guidelines for application of the reasonable expectations doctrine were still being developed, Professor Keeton described as the unarticulated rationale of numerous court decisions that "[t]he objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored *even though painstaking study of the policy provisions would have negated those expectations.*"²⁸ This principle had been adopted by some courts,²⁹ and by 1976 Professor Keeton viewed its acceptance as "explicit

struction, but in this context the court held that the argument that the personal liability provisions of the CPLP should provide coverage for auto accidents occurring three to four miles from the vicinity of the home was an unreasonable construction of the phrase "ways immediately adjoining."

Similarly, in *Moorhead Mach. & Boiler Co. v. Employers Commercial Union Ins. Co.*, No. 49086 (Minn. July 30, 1979) (*en banc*), the court found the exclusionary language clear and not hidden in complex legal terminology. As a result, "though more careful drafting of the insurance contract may have avoided this lawsuit, [it cannot be said] the contract is ambiguous as a matter of law."

²⁸ Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 967 (1970) (emphasis added) [hereinafter cited as Keeton I]. In a recent article, Professor Keeton noted that "[w]hen members of the public purchase policies of insurance they are entitled to the broad measure of protection necessary to fulfill their reasonable expectations." Keeton, *Reasonable Expectations in the Second Decade*, 12 FORUM 275, 275 (1976) (quoting *Kievet v. Loyal Protective Life Ins. Co.*, 34 N.J. 475, 482, 170 A.2d 22, 26 (1961)) [hereinafter cited as Keeton II]. He went on to describe three concepts as vital to his analysis:

[1] The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though the painstaking study of the policy provisions would have negated those expectation.

[2] An insurer will not be permitted an unconscionable advantage in an insurance transaction even though the policyholder or other person whose interests are affected has manifested fully informed consent.

[3] A policyholder or other person intended to receive benefits under an insurance policy is entitled to redress against the insurer to the extent of detriment he suffers because he or another person justifiably relied upon an agent's representation incidental to his employment by the insurer.

Id. at 278 (citations omitted).

²⁹ See *Smith v. Westland Life Ins. Co.*, 15 Cal. 3d 111, 539 P.2d 433, 123 Cal. Rptr. 649 (1975), discussed in notes 43-49 and accompanying text *infra*; *Corgatelli v. Globe Life & Accident Co.*, 96 Idaho 616, 533 P.2d 737 (1975), discussed in note 15 and accompanying text *supra*; *C & J Fertilizer, Inc. v. Allied Mut. Ins. Co.*, 227 N.W.2d 169 (Iowa 1975), discussed in notes 39-42 and accompanying text *infra*; *Rodman v. State Farm Mut. Auto Ins. Co.*, 208 N.W.2d 903 (Iowa 1973), discussed in notes 20 & 25 and accompanying text *supra*; *Nile Valley Coop. Grain & Milling Co. v. Farmers Elevator Mut. Ins. Co.*, 187 Neb. 720, 193 N.W.2d 752 (1972), discussed in note 23 *supra*; *Magulas v. Travelers Ins. Co.*, 114 N.H. 704, 327 A.2d 608 (1974).

judicial endorsement of a new ground of decision — a development connoted by the term ‘doctrine.’”³⁰ Within this doctrine Keeton includes decisions explicitly honoring the doctrine of reasonable expectations and also an “explanatory theory of decision that goes beyond resolving ambiguities against the party responsible for them.”³¹ Keeton argues that the principle of resolving ambiguities against the insurer inadequately explains the results reached in many cases because courts often create ambiguities where none exist.³² Thus, his expansion of the doctrine hinges on an insured’s reasonable expectations, regardless of unambiguous policy language to the contrary.

Keeton notes that the protection of an insured’s reasonable expectation becomes essential when the realities of the insurance sales transaction are examined. The insurer knows an insured will probably not read the policy; most insureds could not read their policies and obtain a detailed understanding; finally, the marketing processes usually reveal the terms of the contract to the insured only after the contract negotiations have been completed.³³ Consequently, Keeton maintains that an insurer wishing to include qualifying clauses in its policies must explicitly call them to the applicant’s attention.³⁴

Keeton argues further that a “surprising” provision should be construed against the insurer even when a policyholder knew of the restrictive terms. He reasons that as a result of judicially imposed controls on policy language, especially in coverage clauses, there are certain policy terms that cannot be effectively brought to the attention of insureds.³⁵

³⁰ Keeton II, *supra* note 28, at 276.

³¹ *Id.* at 279.

³² Keeton refers to three cases where courts have “created ambiguities.” See Keeton I, *supra* note 28, at 972 n.19; Keeton II, *supra* note 28, at 280 n.24. Keeton remarks: “[This] not only causes confusion and uncertainty about the effective scope of judicial regulation of contract terms but also creates an impression of unprincipled judicial prejudice against insurers. If results in such cases are supportable at all, generally it is because the principle of honoring policyholder’s reasonable expectations applies.” Keeton I, *supra* note 28, at 972.

³³ *Id.* at 968. See also *Rempel v. Nationwide Life Ins. Co., Inc.*, 471 Pa. 404, 370 A.2d 366 (1977), where due to agent misrepresentations the court allowed reformation of the contract in favor of the insured.

³⁴ Keeton I, *supra* note 28, at 968.

³⁵ [N]o amount of care in drafting and in marketing will avoid the creation of reasonable expectations contrary to the literal terms of the policy provisions To apply a different rule among various policyholders would produce the result that those who remained ignorant of the terms would receive substantially more protection for their premium dollars than those aware of them.

Id. at 974.

B. Judicial Application of the Doctrine

The earliest example of a court utilizing Keeton's expanded doctrine is *Kievit v. Loyal Protective Life Insurance Co.*³⁶ Despite the unambiguous exclusionary clause clearly denying coverage,³⁷ the *Kievit* court stressed the coverage which an insured could reasonably expect from an accident policy: indemnification for an accidental injury resulting in a later disability.³⁸ The unambiguous language to the contrary went unheeded.

In *C & J Fertilizer, Inc. v. Allied Mutual Insurance Co.*³⁹ the court held that an average insured in the plaintiff's position could reasonably expect coverage for goods stolen from his premises⁴⁰ even though the plaintiff had previous knowledge that the policy excluded coverage if there were no visible marks of forced entry on the exterior of the insured premises.⁴¹ Retreating to the standard analysis for decisions favoring the insured, the factors "weighed" included insureds' common failure to read their policies, the parties' unequal bargaining positions, and the exclusionary clause's fine print.⁴²

In *Smith v. Westland Life Insurance Co.*⁴³ the court, following the Keeton doctrine, refused to adopt the rule that a temporary contract of insurance is terminated by rejection of the application and notice thereof to the insured.⁴⁴ Again the court

³⁶ 34 N.J. 475, 170 A.2d 22 (1961). See also Keeton II, *supra* note 28, at 275.

³⁷ "[I]nsurance under the policy shall not cover disability or other loss resulting from or contributed to by any disease or ailment." 34 N.J. at 477, 170 A.2d at 24.

³⁸ "When members of the public purchase policies of insurance they are entitled to the broad measure of protection necessary to fulfill their reasonable expectations." *Id.* at 482, 170 A.2d at 26.

³⁹ 227 N.W.2d 169 (Iowa 1975). This decision has created much controversy. See Gardner, *Reasonable Expectations: Evolution Completed or Revolution Begun?*, 1978 INS. L.J. 537, at 580; Note, *Reasonable Expectations: The Insurer's Dilemma*, 24 DRAKE L. REV. 853 (1975); 64 GEO. L.J. 987 (1976); 53 N.D. L. REV. 613, 617 (1977).

⁴⁰ *C & J Fertilizer, Inc. v. Allied Mut. Ins. Co.*, 227 N.W.2d 169, 177 (Iowa 1975).

⁴¹ *Id.*

⁴² *Id.* at 179-80. But see the dissent's statement that the entire policy, excepting face sheet and print designating divisions and subheadings, was of the same size and style of print and created no ambiguity. *Id.* at 182 (Le Grand, J., dissenting). *C & J Fertilizer* has been criticized elsewhere. See, e.g., Gardner, *supra* note 39, at 580:

C & J Fertilizer clearly illustrates the urgent need for judicial endorsement of a well-defined test in this area lest we find more cases where the court "ignores virtually every rule by which we have heretofore adjudicated such cases and affords plaintiff ex post facto insurance coverage which it not only did not buy but which it *knew* it did not buy."

⁴³ 15 Cal. 3d 111, 539 P.2d 433, 123 Cal. Rptr. 649 (1975).

⁴⁴ *Id.* at 123, 539 P.2d at 442, 123 Cal. Rptr. at 658. For authorities supporting the general rule, see, e.g., *Hurd v. Maine Mut. Fire Ins. Co.*, 139 Me. 103, 27 A.2d 918 (1942); *Colorado Life Co. v. Teague*, 117 S.W.2d 849 (Texas Civ. App. 1938); 9 COUCH ON INSURANCE § 39:207 (2d ed. 1962).

relied on common assumptions: insurance policies are contracts of adhesion,⁴⁵ clear language by the insurer is required in order to express its intention, expectations of insured about acquiring immediate coverage are reasonable, and the advantage gained by the insurance companies from receiving early payment must not be abused.⁴⁶ The court also adopted a new rule: temporary coverage is not terminated until the applicant receives from the insurer both a notice of the rejection of the application and a refund of the premium.⁴⁷

Even if this last rule is clear, it fails to conform realistically to an insured's reasonable expectations. In *Smith*, although the return premium had not been received, the insured had been personally notified of his rejection and the one month period clearly covered by the advance premium had expired.⁴⁸ It therefore seemed reasonable for the insured to expect that coverage would terminate when he knew of his application's rejection.⁴⁹

The open-endedness of the Keeton doctrine allowed the court in *Collister v. Nationwide Life Insurance Co.*⁵⁰ to go beyond the rule formulated in *Smith*. *Collister* applied the reasonable expectations doctrine to create a presumption that an insured can reasonably expect coverage immediately upon payment of an advance premium.⁵¹ The deceased's widow recovered because the insurer was unable to show that it had verbally notified the insured *before accepting* advance payment that no coverage would be forthcoming until after successful completion of a physical

⁴⁵ The court equated conditional receipts with adhesion contracts, noting the general rule that after issuance of a conditional receipt for a premium paid the insured has immediate protection, unless his insurer brings a limitation to his attention. *Smith v. Westland Life Ins. Co.*, 15 Col. 3d 111, 122, n.2, 539 P.2d 433, 439 n.2, 123 Cal. Rptr. 649, 655 n.2.

⁴⁶ *Id.* at 119-20, 539 P.2d at 439, 123 Cal. Rptr. at 655.

⁴⁷ *Id.* at 124, 539 P.2d at 442, 123 Cal. Rptr. at 658. This test was designed to eliminate uncertainty and controversy. *Id.*

⁴⁸ *Id.* at 128, 539 P.2d at 446, 123 Cal. Rptr. at 662 (Clark, J., dissenting).

⁴⁹ *See, e.g.*, *John Hancock Mut. Life Ins. Co. v. McNeill*, 556 P.2d 803, 807 (Ariz. App. 1976), in which the court questioned the *Smith* result: "Aside from the unsupported premise that the 'reasonable expectation of the ordinary applicant' is that upon payment of a premium the applicant immediately thinks he is insured The literal application of that doctrine in our opinion has led to questionable results. *See*, for example, *Smith v. Westland* . . ." *McNeill*, which concerned conditional receipt, instead applied an objectivity doctrine — what the contracting parties can objectively determine from the face of the document will be conditions precedent to effective coverage. *Id.* *See also* *Megee v. United States Fidelity & Guar. Co.*, 391 A.2d 189 (Del. 1978). The court found unreasonable an applicant's asserted expectations that his policy became effective when a credit check and physical examination were complete and approved in the face of clear policy language to the contrary.

⁵⁰ 479 Pa. 579, 388 A.2d 1346 (1978).

⁵¹ *Id.* at 588, 388 A.2d at 1350.

exam.⁵² Under the *Collister* standard, the insurer must verbally notify the applicant before accepting payment that he receives nothing in return for his money because the insurance coverage does not take effect until approval.⁵³

Other courts, however, have held that only if the conditional receipt given the applicant upon payment is ambiguous may the court rewrite the terms of the receipt in favor of the applicant.⁵⁴ These decisions focus on complicated and ambiguous language, and assume that clear *written* notice can be given to the applicant that payment does not provide immediate coverage. Instead of interpreting the provisions of this conditional receipt, *Collister* resolved the situation by creating a contract when the premium payment was accepted. The majority completely disregarded both clear contract language in a simple, brief document and notice by the agent as to the contract's meaning.⁵⁵

⁵² *Id.* at 596, 388 A.2d at 1354-55.

⁵³ If . . . the insurer wishes to enjoy the substantial benefits it receives by securing the customer's cash at the time of the taking of the application, it must return what the customer can reasonably expect that the insurer is selling: i.e., immediate coverage. Alternatively, the insurer could inform the prospective applicant, *before any money changes hands*, that it does not intend to give the customer anything in return for advance payment, and that the customer is actually paying money now for nothing because no insurance will take effect until approval As such, the notice could not be printed on a receipt.

Id. at 598, 388 A.2d at 1355 (emphasis in original).

⁵⁴ See, e.g., *Machinery Center, Inc. v. Anchor Nat'l Life Ins. Co.*, 434 F.2d 1 (10th Cir. 1970) (court held for insurer because no ambiguity existed in the application or conditional premium receipt); *Scheinman v. Phoenix Mut. Life Ins. Co.*, 409 F.2d 999 (7th Cir. 1969) (no ambiguity existed so court held there was no temporary insurance contract); cases cited in *Collister v. Nationwide Life Ins. Co.*, 479 Pa. 579, 602 n.3, 388 A.2d 1346, 1358 n.3 (1978) (Pomeroy, J., dissenting).

⁵⁵ The front of the receipt in *Collister* declared on the top line in capital 12-point letters that "NO INSURANCE WILL BECOME EFFECTIVE PRIOR TO POLICY DELIVERY UNLESS THE ACTS REQUIRED BY THIS RECEIPT ARE COMPLETED." On the reverse side, headed "IMPORTANT," is a final admonition in 14-point type:

The Company reserves the right to require a medical examination. Until you can provide proof that you are insurable, the Company provides no insurance. If you are requested to have an examination, don't delay. Make arrangements promptly. There is no insurance until a satisfactory medical examination has been made and all the conditions of this receipt are completed.

Collister v. Nationwide Life Ins. Co., 479 Pa. 579, 596, 388 A.2d 1346, 1356 (1978).

The dissent criticized the majority for supporting its new rule with cases involving contracts with ambiguous language, while ignoring the specific terms in this contract.

Thus, regardless of the ambiguity, or lack thereof, inherent in a given set of insurance documents (whether they be applications, conditional receipts, riders, policies, or whatever), the public has a right to expect that they will receive something of comparable value in return for the premium paid [T]he expectations of the insured are in large measure created by the insurance industry itself.

Id. at 594, 388 A.2d at 1353 (1978).

It is understandable that *Collister* was deeply concerned with the inequities of the general insurance-buying transaction. But this concern led to a result unjustified by the circumstances which seems to go beyond even Keeton's doctrine of reasonable expectations.⁵⁶ No explication of the doctrine should allow a claimant to be "entitled to every benefit imaginable within a contractual framework."⁵⁷ The underlying rationale is rather to "guard against the use of complex and confusing qualifications and exceptions by insurers to defeat the reasonable expectations of the average layman entering into an insurance transaction."⁵⁸

Most cases, unlike *Collister*, create a temporary insurance contract in favor of the applicant only when complicated and ambiguous contract language exists or when other representations have been made that interim insurance will be provided.⁵⁹ Written representations by the insurer to the applicant are considered in determining the applicant's "reasonable expectations."⁶⁰

⁵⁶ As of this writing, *Collister* has been cited only twice, both times in dicta. *Puritan Life Ins. Co. v. Guess*, No. 3807 (Alas. July 20, 1979), involved an ambiguity in the contract; however, the court cited other factors which would have caused the same result, regardless of the ambiguity. More importantly, in *Central Dauphin School Dist. v. American Cas. Co.*, No. 229 (Pa. Super. Ct., Oct. 19, 1979), the Superior Court of Pennsylvania did not apply the *Collister* approach, mentioning the Pennsylvania's Supreme Court's analysis only in a footnote.

Concerned with the inferior bargaining position of the insured, the Pennsylvania Supreme Court recently has criticized the traditional contractual approach to the interpretation of insurance contracts and has adopted an analysis by which the court reviews the totality of the transaction to determine the reasonable expectations of the insured as to the coverage provided by the policy.

Id. at n.3.

Central Dauphin's interpretation of *Collister* did not indicate the latter's radical approach but rather applied conventional doctrines and found that unambiguous policy language clearly granted coverage.

⁵⁷ *Collister v. Nationwide Life Ins. Co.*, 479 Pa. 579, 608, 388 A.2d 1346, 1361 (1978).

⁵⁸ *Id.* A similar argument was made in *Thompson v. Occidental Life Ins. Co.*, 90 N.M. 620, 567 P.2d 62 (1977):

The doctrine of "reasonable expectations" is an equitable approach to a solution of this controversy. By this doctrine we mean that the insured is the "Rock of Gibraltar"; that the *insurance policy* will yield the maximum protection to, and the reasonable expectations of, the insured; that the insurer will not be permitted to take an unconscionable advantage.

Id. at 626, 567 P.2d 62 at 68 (Sutin, J., concurring in part and dissenting in part) (emphasis added).

⁵⁹ See note 54 *supra*. It is also unusual for a court to perform the legislative task of formulating a rule for when insurers must give notice to applicants concerning payment of the premium deposit. The rule formulated seems to draw a clear line, but is unrealistic and imposes a heavy burden on the insurance company to prove that it gave this notice before the applicant paid any advance premium.

⁶⁰ See cases cited at notes 12-18 *supra*. For another recent example, see *Stordahl v. Government Employees Ins. Co.*, 564 P.2d 63 (Alas. 1977). To ascertain the insured's

C. Criticism of the Doctrine

The doctrine of reasonable expectations combined with traditional contractual principles enhances the predictability of insurance contract construction. More precise guidelines are necessary, however, to aid the judiciary in its application of the reasonable expectations doctrine.

The Keeton doctrine theoretically eliminates any unconscionable advantage for the insurer and honors the insured's reasonable expectations. It attempts to impose a positive duty upon the stronger party to this adhesion contract to protect the weaker party's reasonable expectations. By adhering to the reasonable expectations of the insured, the "essence" of the bargain may be protected,⁶¹ but the bargain courts protect under the Keeton analysis may be neither in the contract nor indicated by the surrounding circumstances.⁶² His analysis thus fails to consider the well-established rule of adhering to express contract language, and it allows expectations to be reasonable despite the clarity of all the surrounding circumstances.⁶³

The enforcement of such "phantom" bargains will only be alleviated by explicit judicial recognition of the standard tests generally applied. Acknowledgement of these standards will establish workable guidelines for the judiciary and insurance policy draftsmen. In contrast, Keeton's doctrine provides no limits for judicial interpretations. He purports to have formulated an objective standard,⁶⁴ but the only factor he offers to determine a

reasonable expectations the court examined the "language of the disputed policy provisions, the language of other provisions of the insurance policy, . . . the relevant extrinsic evidence . . . [and] the case law interpreting similar provisions." *Id.* at 66. The disputed provision was held to be unambiguous and no recovery was allowed, on the ground that when the uninsured motorist policy was purchased, the insured reasonably expected coverage "only if there were no other applicable insurances to compensate him for injuries caused by an automobile." *Id.* at 67.

⁶¹ Note, *Opening the Gate: The Steven Case and the Doctrine of Reasonable Expectations*, 29 HASTINGS L.J. 153, 165 (1977). The author of this note claims that the reasonable expectations doctrine can be accommodated by traditional contract law analysis and that this protection of the "essence" of the bargain between parties may be extended to any similar adhesion contract. *Id.*

⁶² Thus, according to traditional insurance contract analysis, the protected "bargain" may never have been made. Keeton offers no guidance for defining the terms "ambiguous" or "reasonable," so these problems remain in the application of his doctrine. Yet he describes the strict adherence to an insured's "reasonable expectations" as an "objective standard produc[ing] an essential degree of certainty and predictability about legal rights, as well as a method of achieving equity . . ." Keeton I, *supra* note 28, at 967-68.

⁶³ "[M]ost courts have been hesitant to verbalize a doctrine which admits the judicial imposition of a coverage that has clearly been excluded by policy language." Young, Lewis & Lee, *supra* note 2, at 79. See also notes 25-27 and accompanying text *supra*.

⁶⁴ See note 62 *supra*.

party's "objectively reasonable expectations" is an examination of the policy by an average insured. This single factor seems irrelevant because his doctrine is based in part on the assumption that policyholders may not even read their policies.⁶⁵

Keeton rejects traditional insurance law doctrine and its assumptions, arguing that it creates judicial confusion and the "impression of unprincipled prejudice against insurers."⁶⁶ Yet by offering no guidelines for determining reasonable expectations, Keeton's solution provides courts with an even greater opportunity to exercise their will against the insurer, regardless of the circumstances, as long as they deem the insured's expectations reasonable.

Furthermore, Keeton claims that courts create ambiguities where none exist. He argues that such cases are justifiable, if at all, only by the application of his broader principle of honoring an insured's reasonable expectations.⁶⁷ The correctness of his assumption depends on the definition of the term "ambiguity".⁶⁸ Keeton offers no definition, apparently assuming that ambiguity means policy language possible of more than one interpretation.⁶⁹ Yet ambiguity is often used as an explanation for a court's consideration of the surrounding circumstances as well as the reason for the conclusion.⁷⁰ Thus, if ambiguity is defined to include any element of the transaction capable of more than one interpretation of coverage, courts themselves do not create ambiguities.⁷¹

An insurer cannot contemplate every surprise to the insured.

⁶⁵ Keeton states as a corollary of the reasonable expectations doctrine that insurers ought not to be allowed to use qualifications and exceptions from coverage inconsistent with the reasonable expectations of one having an ordinary degree of familiarity with the coverage involved. This is true even if the insurer's form is explicit and unambiguous because of the assumption that insureds will most likely not read their policies. See Keeton I, *supra* note 28, at 968.

⁶⁶ *Id.* at 972.

⁶⁷ *Id.*

⁶⁸ For a discussion of the definition of ambiguity, see notes 12-13 *supra*.

⁶⁹ See Keeton I, *supra* note 28, at 969: "[T]here has always been an implicit understanding that ambiguities, which in most cases might be resolved in more than just one or the other of two ways, would be resolved favorably to the insured's claim only if a reasonable person in his position would have expected coverage." Many courts do not share Keeton's assumption. See notes 14-19 and accompanying text *supra*.

⁷⁰ See, e.g., *Farmers Home Mut. Ins. Co. v. Insurance Co. of N. Am.*, 20 Wash. App. 815, 583 P.2d 644 (1978) (to determine its meaning, the disputed clause must be viewed in light of the entire contract and then be construed in a manner consistent with the apparent object and intent of the parties); *Harr v. Allstate Ins. Co.*, 54 N.J. 287, 255 A.2d 208 (1969) (misrepresentation by agent and policy language combined to estop the insurers from denying coverage).

⁷¹ See note 32 *supra*.

If insurance companies are forced to pay all claims for which an insured convinces a court he reasonably expected coverage, companies will be less able to offer the gamble of insurance protection at moderately affordable prices.⁷² Other than eventual price increases for insureds, courts face the problem that the insurance contract is tested when a claim occurs and not at the time of marketing. What the parties originally intended is easier to adapt to this situation than to the initial bargain. More troublesome is that the only available evidence of an insured's expectations may be his self-serving testimony.⁷³ As a result, the court's function must be to analyze the evidence presented in relation to policy language and other pertinent elements of the transaction.

The courts' continued application and development of the reasonable expectations doctrine shows an unwillingness to abandon as many of the traditional rules of construction as Keeton's expansion would require.⁷⁴ The original reasonable expectations doctrine does not allow coverage for insureds who fail to read or to understand their policies despite clear policy language. Confusion caused by Keeton's expansion will only be alleviated by a return to and acknowledgement of the standard rules which should serve as guidelines for the judiciary and insurance policy draftsmen.

IV. CONCLUSION: A PROPOSAL FOR APPLYING THE ORIGINAL DOCTRINE OF REASONABLE EXPECTATIONS

Problems of construction continue to plague insurance law be-

⁷² See Note, *supra* note 39.

⁷³ See Connor & Olerich, *The Creation of Insurance Coverage by Estoppel*, 20 DEF. L.J. 461, 471 (1971).

⁷⁴ Despite the use of Keeton's expanded doctrine in *Kievit v. Loyal Protective Life Ins. Co.*, 34 N.J. 475, 170 A.2d 22 (1961), see notes 36-38 *supra*, various courts have continued to apply the reasonable expectations doctrine with regard to policy language. See, e.g., *First Nat'l Bank v. Fidelity & Cas. Co.*, 428 F.2d 499 (7th Cir.), *cert. denied*, 401 U.S. 912 (1970); *Brown v. First Ins. Co.*, 424 F.2d 680 (9th Cir. 1970); *Lebow Assoc., Inc. v. Avemco Ins. Co.*, 439 F. Supp. 1288 (E.D. Mich. 1977); *Chemtec Midwest Servs., Inc. v. Insurance Co. of N. Am.*, 288 F. Supp. 763 (W.D. Wis. 1968); *Insurance Co. of N. Am. v. Sam Harris Constr. Co.*, 22 Cal. 3d 409, 583 P.2d 1335, 149 Cal. Rptr. 292 (1978); *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); *Steven v. Fidelity & Cas. Co.*, 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 172 (1963); *Allstate Ins. Co. v. Anderson*, 87 Mich. App. 539, 274 N.W.2d 66 (1978) (*per curiam*); *Connor v. Transamerica Ins. Co.*, 496 P.2d 779 (Okla. 1972). *But see* *Linden Motor Freight Co. v. Travelers Ins. Co.*, 40 N.J. 511, 525, 193 A.2d 217, 225 (1963) (New Jersey Supreme Court applied the *Kievit* doctrine, but added a limiting proviso that the clear basic terms and particular provisions of an insurance contract may not be disregarded).

cause uniform statutory and judicial guidelines are lacking.⁷⁶ In developing proper guidelines, the doctrine of reasonable expectations should be retained, but without Professor Keeton's limitless reasonable expectations analysis. The desired goal of insurance policy construction, neutralization of the disparate bargaining position between carrier and applicant, is inherent in the original doctrine of reasonable expectations. Most courts wisely apply various forms of the original doctrine.⁷⁶ Keeton's expansion of the doctrine invites unbridled judicial regulation that may cause more uncertainty and confusion.

The proper rationale of the reasonable expectations doctrine was suggested in *Herzog v. National American Insurance Co.*,⁷⁷ where the California Supreme Court held that an ambiguity will be construed in favor of coverage, provided that the resulting coverage is within the reasonable expectations of the policyholder.⁷⁸ In *Herzog* the term "ambiguity" encompassed the reasonable construction of policy language in the entire context of a particular case. This explication of the reasonable expectations doctrine focuses a court's attention on the insured's reasonable expectations during contract formation, when the most accurate assessment of the parties' original intentions may be obtained.

The search for an insured's reasonable expectations should include an examination of policy language and adherence to traditional contract analysis. No coverage or primary liability should be created where none was contemplated by the insured. If, for example, policy language is unclear and the court finds that an insured could reasonably expect coverage not technically within

⁷⁶ The sparse legislation in this area was noted in Gardner, *supra* note 39, at 582-83: "Massachusetts H.B. 6599 in fact covers the entire area of reasonable expectations, including the organization and content of policies." It is hoped this Act will be an indication of things to come: plain language statutes recognizing that insureds' reasonable expectations arise from the function of the readability of the policy as well as the substance and extent of the expected protection.

⁷⁶ See notes 5, 14-19, 20, 22-23, 25-27, 29, 49-50, 55-56, 60, 70, 74 and accompanying text *supra*. See also *Jim Hawk Chevrolet-Buick, Inc. v. Insurance Co. of N. Am.*, 270 N.W.2d 466 (Iowa 1978) (the same court which embraced the Keeton doctrine in *C & J Fertilizer, Inc. v. Allied Mutual Ins. Co.*, 227 N.W.2d 169 (Iowa 1975), refused to apply it here, concentrating on language of accidental flight policy and the surrounding circumstances to determine the insured's reasonable expectations and held for insurer); *DiOrto v. New Jersey Manufacturers Ins. Co.*, 79 N.J. 257, 398 A.2d 1274 (1979) (the majority cited Keeton's doctrine but did not apply it, noting instead the clear policy language, the surrounding circumstances, and implied a duty to read on behalf of the insured; the court held in favor of the insured).

⁷⁷ 2 Cal. 3d 192, 465 P.2d 841, 84 Cal. Rptr. 705 (1970). See also Squires, *A Skeptical Look at the Doctrine of Reasonable Expectations*, 6 FORUM 252, 252 (1971).

⁷⁸ *Herzog v. National Am. Ins. Co.*, 2 Cal. 3d 192, 198-99, 465 P.2d 841, 844, 84 Cal. Rptr. 705, 708 (1970).

the contract terms, the ambiguity should be construed in his favor. On the other hand, if policy language is clear and the court finds an insured could not otherwise have reasonably expected additional coverage, compensation should be denied.

Several other factors, depending on the particular situation, could aid in the definition of reasonable expectations: (1) whether the insurer could have avoided an ambiguity in the contract with clearer language; (2) whether the term at issue is defined in the policy; (3) the meaning of the policy as a whole; (4) what representations the agent made to the insured; (5) the insured's knowledge and understanding of his policy coverage; (6) whether case law assists in discerning an unusual meaning of the provision at issue.

Courts would be forced under this analysis of the reasonable expectations doctrine to discover some ambiguity or some fact relied on by the insured which led him to reasonably expect coverage. If the policy language is clear and an insured could reasonably have understood the coverage for which he contracted, the original contract should be enforced.

This proposed analysis places a stronger duty on the insurer to give special notice of exclusions and to draft a more clearly understood policy. This burden is appropriate given the parties' unequal bargaining positions. It does not eliminate, however, the insured's duty to read his policy. Understanding of the policy inevitably benefits both parties. If insureds understand their policies from the start, insurance companies have a valuable defense in actions by their policyholders for additional coverage. Another advantage will be a decline in the number of disputes. Finally, the primary benefit will be the increased predictability of judicial decisions. Guidelines consisting of policy language and other elements of the transaction will be acknowledged and possible of consistent application.

—Karen K. Shinevar

