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The Reconstruction of Insurance Contracts under the Doctrine of Reasonable Expectations, 18 J. Marshall L. Rev. 155 (1984)

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THE RECONSTRUCTION OF INSURANCE CONTRACTS UNDER THE DOCTRINE OF REASONABLE EXPECTATIONS

The main purpose of contract law is the realization of reasonable expectations induced by promises. A. Corbin.[1]

Insurance is a business built upon contracts.[2] With the increased use of standard form contracts,[3] courts have recognized the need to reconcile traditional contract law with market realities.[4] Today, the private legislation of contracting parties faintly resembles the free market ideal of a bargained for agreement. Courts have observed attempts of the "powerful industrial and commercial overlords . . . to impose a new feudal order of their own making upon a vast host of vassals."[5] In response, courts have adopted the doctrine of reasonable expectations.[6]

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1. A. CORBIN, A TREATISE ON THE LAW OF CONTRACTS § 1 (1960).

2. An insurance contract possesses five characteristics:

> 1) The insured must have an insurable interest—an interest in the insured property or insured life—capable of being valued in money; 2) The insured must be (or both parties must reasonably believe him to be) subject to a possibility of loss through damage to or destruction of his insurable interest by the happening of the casualty or death insured against; 3) The insurer must legally assume such risk of loss in a fixed or determinable amount; 4) As consideration for its assumption of risk the insurer must collect all in advance or at periodic intervals in installments from the insured and all others of his class, a ratable contribution known as a premium; 5) Losses must be distributed by the insurer among a large group of similar insureds by charges to the insurance fund built up through the systematic collection of premiums paid by all members of the insured class or group.

S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 900, at 12 (3d ed. 1963).

3. Leases, mortgages, theatre tickets, credit card purchase receipts and parking lot tickets are standard form contracts. One commentator estimated that 99% of all modern contracts are standardized contracts. Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529 (1971).

4. For a list of contract doctrines traditionally invoked to protect the reasonable expectations of the insured, see *infra* notes 46-52 and accompanying text. As members of a modern economy, we contract so frequently with each other that most agreements are entered into with only a cursory discussion of material contractual terms. The non-drafting party, however, understands that he is assenting to unknown terms, subject to the limitations which the law may impose. RESTATEMENT (SECOND) OF CONTRACTS § 211, comment b (1979).

5. Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 640 (1943).

6. Lambert v. Liberty Mut. Ins. Co., 331 So. 2d 260 (Ala. 1976); National Indem. Co. v. Flesher, 460 P.2d 360 (Alaska 1970); Steven v. Fidelity & Casu-

The essence of this doctrine is that courts will enforce the objective, reasonable expectations of the average insurance policy holder, even though those expectations have been negated in the policy provisions.[7] The reasonable expectations doctrine is an equitable approach to the construction of insurance contracts. This approach guards against the insurer's use of complex and confusing policies to defeat the average insured's reasonable expectations of coverage.[8] For example, an insured's reasonable belief that his insurance policy covers liability arising out of his normal farming operations could subject the insurer to liability for claims arising out of aerial crop spraying, regardless of contrary policy exclusions.[9]

In theory, the expectations doctrine is an interpretive tool courts use to discern the intention of the parties who are bound

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alty Co., 58 Cal. 2d 862, 27 Cal. Rptr. 172, 377 P.2d 284 (1962); Bourchard v. Travelers Indem. Co., 28 Conn. Supp. 122, 253 A.2d 497 (1969); Steigler v. Ins. Co. of N. Am., 384 A.2d 398 (Del. 1978); Commerce Natl. Bank v. Safeco Ins. Co., 252 So. 2d 248, *cert. denied* 284 So. 2d 205 (Fla. App. 1969); Loftin v. United States Fire Ins. Co., 106 Ga. App. 287, 127 S.E. 2d 53 (1962); Corgatelli v. Globe Life & Acc. Ins. Co., 96 Idaho 616, 533 P.2d 737 (1975); C. & J. Fertilizer, Inc. v. Allied Mut. Ins. Co., 227 N.W. 2d 169 (Iowa 1975); Gowing v. Great Plains Mut. Ins. Co., 207 Kan. 78, 483 P.2d 1072 (1971); Zurich Ins. Co. v. Rombough, 384 Mich. 228, 180 N.W.2d 775 (1970); Estrin Construction Co. v. Aetna Casualty & Surety Co., 612 S.W.2d 413 (Mo. App. 1981); McAlear v. St. Paul Ins. Co., 158 Mont. 452, 493 P.2d 331 (1972); Nile Valley Cooperative Grain & Milling Co. v. Farmers Elevator Mut. Ins. Co., 187 Neb. 720, 193 N.W.2d 752 (1972); Prudential Ins. Co. v. Lamme, 83 Nev. 146, 425 P.2d 346 (1967); Magulas v. Travelers Ins. Co., 114 N.H. 704, 327 A.2d 608 (1974); Pribble v. Aetna Life Ins. Co., 84 N.M. 211, 501 P.2d 255 (1972); Lachs v. Fidelity & Casualty Co., 306 N.Y. 357, 118 N.E.2d 555, *reh'g denied*, 306 N.Y. 941, 120 N.E.2d 216 (1954) (In *Lachs*, the New York Court of Appeals did not expressly adopt the doctrine of reasonable expectations, but its judgment rests on the principles of the doctrine); Mills v. Agrichemical Aviation, Inc., 250 N.W.2d 663 (N.D. 1977); Conner v. Transamerica Ins. Co., 496 P.2d 770 (Okla. 1972); Collister v. Nationwide Life Ins. Co., 479 Pa. 579, 388 A.2d 1346 (1978), *cert. denied*, 439 U.S. 1089 (1979); Herwig v. Enerson & Eggen, 98 Wis. 2d 38, 295 N.W.2d 201 (Wis. Ct. App. 1980), *aff'd*, 101 Wis. 2d 170, 303 N.W.2d 669 (1981).

7. *See infra* note 17 and accompanying text.

8. *See* Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961 (1970). The expectations doctrine was the basis of a judgment which required an insurer to defend a workman's compensation action brought by the insured's domestic employee because the exclusion precluding coverage for such actions was hidden in the insured's comprehensive homeowner's policy. Gerhardt v. Continental Ins. Co., 48 N.J. 291, 225 A.2d 328 (1966).

9. Mills v. Agriculture Aviation, Inc., 250 N.W.2d 663 (N.D. 1977). In North Dakota, the doctrine of reasonable expectations has been adopted statutorily as well as judicially. The statute states, in part, "[I]f the terms of a promise in any respect are ambiguous or uncertain, it must be interpreted in the sense in which promisor believed at the time of making it that the promisee understood it." N.D. CENT. CODE § 9-07-14 (1976).

by insurance contracts.[10] The fundamental problem with the doctrine, however, is that rather than aiding interpretation of insurance contracts, the doctrine has evolved into a means of avoiding such contracts.[11] To the extent that this doctrine alters the otherwise legally enforceable agreement between the parties, it is a species of judicial regulation of insurance contracts.[12] In adopting the expectations doctrine, a court must weigh contractual certainty against the social desirability of imposing extracontractual rights and duties upon the parties. Increasingly, the courts are finding the latter desirable to protect the ordinary policy holder untutored in the intricacies of insurance.[13]

This comment analyzes the development of the doctrine of reasonable expectations from a traditional contract perspective. Part I discusses the evolution and applications of the expectations doctrine. Part II examines whether the traditional doctrines of contract law satisfy the insured's reasonable expectations. Part III analyzes the impact of the expectations doctrine on the contracting parties and insurance law. Part IV proposes common law and legislative alternatives which will satisfy the actuarial requirements of the insurer as well as the reasonable expectations of the insured. This comment concludes with a discussion of why the doctrine of reasonable expectations is an unnecessary and unmanageable doctrine in the construction of insurance contracts.

I. Evolution and Applications

The exact origin of the expectations doctrine is uncertain.[14] In 1918, Justice Cardozo analyzed an insurance coverage issue by considering the reasonable expectations of the "ordinary

10. *See generally, Insured's "Reasonable Expectations" As to Coverage of Insurance Policy*, 20 Am. Jur. P.O.F. 2d 59 (1979) [hereinafter cited as *Insured's Reasonable Expectation*].

11. As one dissenting state supreme court justice stated: "Thus the problem in deciding an insurance claim seems no longer to be one of ascertaining what the contract as written means, but of somehow divining the 'reasonable expectations' of the insured as to what the contract should mean." Collister v. Nationwide Life Ins. Co., 479 Pa. 579, 590, 388 A.2d 1346, 1357 (1978) (Pomeroy, J., dissenting), *cert. denied*, 439 U.S. 1089 (1979).

12. Professor Keeton of Harvard Law School has acknowledged that the expectations doctrine goes beyond a mere rule of construction and is "a measure of judicial regulation of insurance contracts." Keeton, *Insurance Lawyers View "Wayfaring Fool" Doctrine*, Insurance Advocate, 21 (July 24, 1971).

13. As one court stated: "An insurer who selects standardized contracts and offers them to the insured on a 'take-it-or-leave-it' basis, must assume responsibilities . . . for confusion created in the mind of a non-expert insured." Mills v. Agrichemical Aviation, Inc., 250 N.W.2d 663, 668 (N.D. 1977).

14. *See generally*, Gardner, *Reasonable Expectations: Evolution Completed or Revolution Begun?*, Ins. L.J. 573 (1978).

business man when making an ordinary business contract."[15] Nearly thirty years later, Judge Learned Hand interpreted an insurance contract provision in conformance with the understanding of an ordinary insured.[16] In 1970, Professor Keeton composed a succinct formulation of the expectations doctrine:

> The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though a painstaking study of the policy provisions would have negated those expectations.[17]

The adhesive nature of insurance contracts has induced many courts to support the expectations doctrine.[18] Because policy terms are dictated by underwriting requirements, the insured has little opportunity to bargain over terms or choose a materially different form.[19] Consequently, judicial efforts to protect the insured from complex exclusionary language is founded upon the concept that the insured has been effectively excluded from any understanding of the "agreement" to which he has entered into. Another justification for the doctrine is that the protection of the expectation interest is an established goal of

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15. Bird v. St. Paul Fire & Marine Ins. Co., 224 N.Y. 47, 49, 120 N.E. 86, 88 (1918).

16. Gaunt v. John Hancock Mutual Life Ins. Co., 160 F.2d 599 (2d Cir.), *cert. denied*, 331 U.S. 849 (1947).

17. *Keeton, supra* note 8, at 967. Keeton has also composed a corollary to the expectations doctrine: "If the enforcement of a policy provision would defeat the reasonable expectations of the great majority of policy holders to whose claims it is relevant, it will not be enforced even against those who know of its restrictive terms." *Id.* at 974.

Another commentator has formulated this doctrine: "The objectively reasonable expectations of insureds or of beneficiaries, who actively negotiated the policies' terms, regarding the terms of insurance contracts will be honored if such a reading as an ordinary layman could give the policy would not have negated those expectations." Kelso, *Idaho and the Doctrine of Reasonable Expectations: A Springboard For An Analysis of a New Approach to a Valuable But Often Misunderstood Doctrine*, 47 INS. COUNS. J. 325, 328 (1980).

18. The majority of standard insurance policies are contracts of adhesion, i.e., contracts which are drafted by a party of superior bargaining strength and offered to the weaker party on a take-it-or-leave-it basis. S. WILLISTON, *supra* note 2, § 900 at 19-20. An adhesion contract is an agreement between the parties. A court must determine the extent, if any, to which it will be enforced. Collister v. Nationwide Life Ins. Co., 479 Pa. 579, 593, 388 A.2d 1346, 1360 (1978), *cert. denied*, 439 U.S. 1089 (1979). For a complete discussion on the judicial response to adhesive insurance contracts, see Patterson, *The Interpretation and Construction of Contracts*, 64 COLUM. L. REV. 833 (1964) and Note, *The Adhesion Contract of Insurance*, 5 SANTA CLARA L. REV. 60 (1964).

19. Underwriting is the "process of selecting risks for insurance and determining in what amounts and on what terms the insurance companies will accept the risk." INSURANCE INFORMATION INSTITUTE, INSURANCE FACTS 104 (1983).

contract law.[20] The doctrine has also found judicial support because it promotes the dissemination of information on coverage[21] and provides a variety of coverage options which the insured expects.[22]

Courts adhering to the expectations doctrine have not agreed upon whether the doctrine is applicable in the absence of ambiguous terms.[23] A majority of adherents require ambiguity before the doctrine may be applied.[24] These courts reason that

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20. Contract law has traditionally protected three interests of the contracting parties: 1) the restitution interest which prevents unjust enrichment; 2) the reliance interest which undoes the harm caused by one party's reliance on the other's promise; and 3) the expectations interest which gives the promisee the value of the expectancy created by the promise. *See* Fuller & Purdue, *The Reliance Interest In Contract Damages*: 1, 46 YALE L.J. 52 (1936).

When the law protects a party's expectation interest "[i]t ceases to act defensively or restoratively, and assumes a more active role." *Id.* at 56. Fuller and Perdue believe that the restitution interest presents the strongest case for judicial intervention because it involves a combination of "unjust impoverishment with unjust gain." *Id.*

21. *See* Abraham, *Judge-Made Law And Judge-Made Insurance: Honoring The Reasonable Expectations of the Insured*, 67 VA. L. REV. 1151, 1171 (1981).

In theory, the expectations doctrine penalizes the insurer for the inaccurate information the insured had concerning coverage. To avoid further penalties, the insurer should more fully inform prospective insureds.

An insurer, however, will disseminate coverage information only when the risk of increased liability outweighs the cost of such disclosure. Because it is difficult for the insurer to know whether the dissemination of information is efficient in a particular case, the insurer may be assuming the risk of adverse judgments.

22. *Id.* at 1185. Insurance is a device for distributing the costs of various risks among groups of risk bearers. A court's decision to honor the insured's expectations may further this cost-spreading feature of insurance by expanding the pool of risk bearers. For example, some passengers prefer not to fly on chartered airlines because they are less safe while others are willing to take such risks. Courts can effectively force these two groups together by honoring the insured's expectations of coverage on chartered flights even though he purchased insurance for non-chartered flights. *See* Steven v. Fidelity Casualty Co., 58 Cal. 2d 862, 377 P.2d 27 Cal. Rptr. 172 (1962) (life insurance purchase through vending machine); Lachs v. Fidelity & Casualty Co., 306 N.Y. 357, 118 N.E.2d 555 (1954).

23. *Insured's Reasonable Expectation, supra* note 10, at 80-81. For a list of states that apply the doctrine in the absence of ambiguity, see Goodhue, *The Doctrine of Reasonable Expectations in Massachusetts and New Hampshire: A Comparative Analysis*, 17 NEW ENG. L. REV. 891, 901 n.57 (1982).

24. Note, *Reasonable Expectations Approach To Insurance Contract Interpretation Modified in Missouri*, 47 MO. L. REV. 577, 580 (1982) (discussion of a Missouri decision which repudiates the majority approach).

The courts in Iowa and New Jersey have experimented with both positions and ultimately adopted the majority approach. Chipokas v. Travelers Indem. Co., 267 N.W.2d 393 (Iowa 1978); DiOrio v. New Jersey Mfrs. Ins. Co., 79 N.J. 257, 398 A.2d 1274 (1979). In *Chipokas* and *DiOrio*, the courts perceived the unfairness to the insurance companies of allowing the insured to expand coverage beyond the coverage clearly delineated in their respective policies.

the insured does not need protection from unambiguous exclusions in the policy.[25] Ambiguity is not a great hurdle for any court, however, because ambiguity can be discovered in unexpected or unclear policy language and extrinsic circumstances.[26]

The doctrine of reasonable expectations has been utilized to create precontractual liability on the part of the insurer. Several courts have determined that regardless of clear language to the contrary, insurance applicants are entitled to temporary insurance during the period between the date an application is submitted and the date of completion or termination of the underwriting process.[27] Advocates of the temporary insurance

25. Illinois courts have adopted a similar approach to the construction of insurance contracts. As a matter of public policy in Illinois, a clearly written provision, not the insured's reasonable expectations, will govern coverage. Menke v. Country Mut. Ins. Co., 78 Ill. 2d 420, 401 N.E.2d 539 (1980). In construing ambiguous provisions, the Illinois Supreme Court has considered the insured's expectations; however, the basis of the court's rulings has not been the expectations doctrine but rather the construction of ambiguous provisions in favor of the policy holder. *Compare Menke* (no stacking of insurance policies where clearly precluded by policy language) *with* Kaufmann v. Economy Fire & Cas. Co., 76 Ill. 2d 11, 389 N.E.2d 1150 (1979) (insured allowed to stack insurance policies where anti-stacking clause was ambiguous); Squire v. Economy Fire & Cas. Co., 69 Ill. 2d 167, 370 N.E.2d 1044 (1977) (ambiguous anti-stacking clause construed liberally in favor of the insured). *See also* First Nat'l Bank of Chicago v. Fidelity & Cas. Co. N.Y., 428 F.2d 499, 501, (7th Cir.) (insured's reasonable expectations do not control the policy's express terms) *cert. denied*, 401 U.S. 912 (1970); Ins. Co. of North America v. Adkisson, 121 Ill. App. 3d 224, 459 N.E.2d 310 (1984) (expectations doctrine not used to circumvent unambiguous provision of insurance policy); Bain v. Ben Trust Life Ins. Co., 123 Ill. App. 3d 1025, 463 N.E.2d 1082 (1984) (expectations doctrine not adopted in Illinois).

26. When a policy term is susceptible to more than one interpretation, it is ambiguous. Traveler's Ins. Co. v. C.J. Gayfer's & Co., 366 So. 2d 1199, 1201 (Fla. App. 1979). Ambiguities can appear in three different ways. First, inconspicuous clauses which fail to warn the insured of limitations of coverage are commonly labeled ambiguous. Read v. Western Farm Bureau Mut. Ins. Co., 90 N.M. 369, 374, 563 P.2d 1162, 1167 (1977) (ambiguity found where insured did not understand poorly defined terms). Second, inaccurately defined terms are also considered ambiguous. *See* Corgatelli v. Globe Life & Accident Ins. Co., 96 Idaho 616, 533 P.2d 737 (1975) (ambiguity found in a policy which guaranteed payment for dislocation of collar bone even though a bone cannot be dislocated). Third, extrinsic information such as the agent's statements or statements in a borchure may cause in ambiguity. *See* Dobosz v. State Farm Fire & Cas. Co., 120 Ill. App. 3d 674, 458 N.E.2d 611 (1983) (ambiguity found where insurer's advertising brochure contradicted the exclusionary provisions of the policy). Professor Keeton has observed that courts sometimes invent ambiguity where none exists. *Keeton. supra* note 8, at 972.

27. *See, e.g.*, Turner v. Worth Ins. Co., 106 Ariz. 132, 472 P.2d 1 (1970); Smith v. Westland Life Ins. Co., 15 Cal. 3d 111, 539 P.2d 433, 123 Cal. Rptr. 649 (1975) (policy not terminated until insurance company actually rejects policy application and paid premium); Toevs v. Western Fam Bureau Life Ins. Co., 94 Idaho 151, 483 P.2d 682 (1971); Simpson v. Prudential Ins. Co., 227 Md. 393, 177 A.2d 417 (1962); Allen v. Metropolitan Life Ins. Co., 44 N.J. 294, 208 A.2d 638 (1965) (prepayment consituted acceptance to coverage where insured died 24 hours after issuance); Damm v. National Ins. Co. of America,

rule reason that applicants reasonably expect immediate coverage when they submit an application and pay the first month's premium to the insurer.[28]

Where insurance policies have been issued, some courts have used the expectations doctrine to mandate extracontractual coverage where a policy contained coverage restrictions which either rendered the policy of little value to the insured,[29] failed to afford the insured clear warning of noncoverage[30] or denied coverage.[31] Thus, where a policy bestows coverage on one

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200 N.W.2d 616 (N.D. 1972) (prepayment of premium constitutes acceptance of interim insurance).

28. *See generally* Warner, *Pre-Contractual Liability*, 12 FORUM 281 (1976). There are legitimate reasons for requiring payment of the first month's premium in advance of coverage being effective. As Professor Williston has noted:

> During the period when the applicant's offer [application] is outstanding and unaccepted by the company, the offeror [applicant] has the power to revoke his offer. Should he do so, the company not only loses its expected underwriting profit but is also out the cost of the medical examination and related expenses of securing and processing the application. Such costs are particularly burdensome where a considerable volume of the company's business consists of applications for policies in small dollar amounts.

S. WILLISTON, *supra* note 2, § 902, at 197-201.

The temporary insurance rule also allows one who is an uninsurable risk to secure coverage for as long as it takes the insurer to discover that the applicant is not an insurable risk. Even without the expectations doctrine, courts can find interim coverage for insurable applicants by ruling that the insurer's acceptance of an application and payment creats a contract subject to a condition subsequent, that the applicant is insurable at the time of the application. Unless the insurer can establish the applicant was uninsurable at that time, the applicant would have temporary insurance under the contract. *See* APPLEMAN, 12A INSURANCE LAW AND PRACTICE §§ 7237-43 (1943).

29. *See* Kievet v. Loyal Protective Life Ins. Co., 34 N.J. 475, 170 A.2d 22 (1961) (provisions would defeat the insured's purpose for obtaining coverage if read literally and applied mechanically).

30. Courts have found that the reasonable expectations of the insured were violated where a policy has contained: 1) a provision confusing to the average consumer, Gerhardt v. Continental Ins. Co., 48 N.J. 291, 225 A.2d 328 (1966); 2) a general coverage provision followed by restrictive definitions, C. & J. Fertilizer, Inc. v. Allied Mut. Ins. Co., 227 N.W.2d 169 (Iowa 1975) (general coverage for burglary followed by restrictive definition of burglary); or 3) a restrictive provision preceded and followed by language emphasizing benefits. Atwood v. Hartford Accident & Indem. Co., 110 N.H. 636, 365 A.2d 744 (1976).

31. *See* Gyler v. Mission Ins. Co., 10 Cal. 3d 216, 514 P.2d 1219, 110 Cal. Rptr. 139 (1973). In *Gyler*, the insured purchased malpractice insurance wherein the insurer assumed liability for the insured's professional negligence as long as the claim was made within the policy period. The insurer refused to defend Gyler when a former client filed suit after the policy period had expired. The court held that Gyler could reasonably have expected coverage for the claim in question because without it, attorneys would have no coverage for claims brought against them after their retirement. In other words, the court found that imposing coverage desirable

page and imperceptibly takes it away on another page, courts are likely to honor the insured's reasonable expectations in light of the deceptive policy. To the extent the expected coverage is not independently available, some courts have tacked such coverage onto existing policies.[32] Courts commonly use the expectations doctrine to construe an ambiguous term in accordance with the insured's reasonable expectations.[33] For example, an insurer was held liable under its policy, which excluded coverage for rental of the insured machines, because the insured would not reasonably expect the rental exclusion to apply when the insured allowed prospective buyers to test the machines.[34]

Several courts have gone further by mandating retroactive insurance coverage where the insureds not only did not buy, but knew they did not buy such coverage.[35] In *C. & J. Fertilizer, Inc. v. Allied Mutual Insurance Company*,[36] the insured purchased a "Merchandise Burglary and Robbery Policy" which excluded coverage if there were no visible marks of forced entry on the exterior of the premises.[37] The insured warehouse was robbed but there were no visible marks on the exterior door.[38] Although the insured knew of the express exclusion, the Iowa Supreme Court held the insurer liable for the loss based, in part, upon the expectations doctrine.[39] The burglary insurance policy was judicially reconstructed to provide coverage which the insured knew he did not purchase but which the average insured would reasonably expect.

Another example in which retroactive insurance coverage was imposed is *Karol v. New Hampshire Insurance Company*.[40] In *Karol*, the insured sought recovery under an all-risk policy for damage to his documentary film during developing.[41] The policy excluded "loss or damage . . . due to any process or [damage sustained] while being actually worked upon and re-

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rather than actually expected. *See generally* Comment, *The "Claims-Made" Dilemma in Professional Liability Insurance*, 22 U.C.L.A. L. REV. 925 (1975).

32. Abraham, *supra* note 21, at 1163.

33. *See, e.g.*, Chalmers v. Metropolitan Life Ins. Co., 86 Mich. App. 25, 272 N.W.2d 188 (1978) (court construed the term "totally disabled" according to the insured's reasonable expectations).

34. Herwig v. Enerson & Eggen, 98 Wis. 2d 38, 295 N.W.2d 201 (1980), *aff'd*, 101 Wis. 2d 170, 303 N.W.2d 669 (1981).

35. Goodhue, *supra* note 23, at 900.

36. 227 N.W.2d 169 (Iowa 1975).

37. *Id.* at 171.

38. *Id.*

39. *Id.* at 177.

40. 120 N.H. 287, 414 A.2d 939 (1980).

41. *Id.* at 289, 414 A.2d at 940.

sulting therefrom."[42] In imposing coverage, the New Hampshire Supreme Court stated that the insured's reasonable expectations are not defeated by inconspicuous exclusions even where the insured read and fully understood the policy exclusion.[43]

These applications of the expectations doctrine illustrate a clear departure of American insurance law from English insurance law.[44] The courts of Canada and Great Britain have adopted the attitude that as long as the insurance business is carried on without any risk of pervasive losses through insolvency, insurance coverage should be left to the control of competitive forces in the insurance market.[45] In contrast, almost one-half of American state courts have adopted the doctrine of reasonable expectations to control insurance coverage. Before analyzing this departure, it is necessary to understand how the common law traditionally protects the insured's reasonable expectations.

II. TRADITIONAL REMEDIES

To protect the expectations of insureds against undiscovered exclusions and limitations in their policies, courts have traditionally invoked the following doctrines: unconscionability,[46] estoppel,[47] waiver,[48] implied warranty of fitness,[49] reformation,[50] construction of ambiguities against the insurer who drafted the policy,[51] and public policy.[52] These doctrines will be analyzed to

42. *Id.*

43. *Id.* at 290-91, 414 A.2d at 941.

44. Keeton, *Reasonable Expectations in the Second Decade*, 12 FORUM 275, 280 (1976).

45. Pickering, *The Control of Insurance Business In Great Britain*, 1969 WIS. L. REV. 1141, 1166; *Gardner, supra* note 14, at 579.

46. *See, e.g.*, C. & J. Fertilizer, Inc. v. Allied Mutual Ins. Co., 227 N.W.2d 169 (Iowa 1975). *But see* Royal Indemnity Co. v. Westinghouse Elec. Corp., 385 F. Supp. 520 (S.D.N.Y. 1974) (no unconscionability where adverse term was product of negotiations between two industrial giants). *See generally* Kornhauser, *Unconscionability in Standard Forms*, 64 CALIF. L. REV. 1151 (1976).

47. *See, e.g.*, Armstrong v. United Ins. Co. of America, 98 Ill. App. 3d 1132, 424 N.E.2d 1216 (1981); Bowler v. Fidelity & Casualty Co., 53 N.J. 313, 250 A.2d 580 (1969).

48. *See generally*, Morris, *Waiver and Estoppel in Insurance Policy Litigation*, 105 U. PA. L. REV. 925 (1957); *Corbin, supra* note 1, § 1376 at 21.

49. *See, e.g.*, C. & J. Fertilizer, Inc. v. Allied Mutual Ins. Co. 227 N.W.2d 169 (Iowa 1975); Mills v. Agrichemical Aviation, Inc., 250 N.W.2d 663 (N.D. 1977).

50. *See generally* 76 C.J.S. *Reformation of Instruments* § 18 (1952); A. APPLEMAN, 13 INSURANCE LAW AND PRACTICE § 7608 (1976).

51. For the general rule of liberal construction of ambiguities in favor of the insured, see 43 AM. JUR. 2d *Insurance* § 271 (1979).

52. *See, e.g.*, Strickland v. Gulf Life Ins. Co., 240 Ga. 723, 242 S.E.2d 148 (1978).

determine whether the traditional doctrines of contract law satisfy the reasonable expectations of the average insured.

Under the doctrine of unconscionability, a court may refuse to enforce any contract provision which is patently oppressive to the insured.[53] In general, this doctrine is used when a contract has been created through procedurally unfair means and incorporates terms which unreasonably favor one party.[54] Although the doctrine of unconscionability has not had a great impact on insurance law, it can protect the insured from oppression and unfair surprise.[55] Indeed, some courts have recognized that unconscionability is an alternative to the expectations doctrine where the insured's expectations were at variance with the unconscionable policy provisions.[56]

Another doctrine used by courts to remedy problems arising from insureds' unfamiliarity with contract provisions is estoppel.[57] When the insurer represents a present or past fact to the insured who detrimentally relies on that representation, the insurer is estopped from denying the truth of that representation. Because insurance agents and consumers usually discuss the consumer's broad insurance needs, the doctrine of estoppel can create insurance coverage for risks which are not included in the policy but which were the focus of the parties' discussion.[58] Moreover, estoppel is available where the misrepresentation was innocently made before the policy was issued.[59] Thus, the doctrine of estoppel provides relief to the insured who elicits coverage terms from his agent's promises and detrimentally relies on the promises thereby created.

For almost a century courts have held that where an insurer or his authorized agent intentionally relinquishes a known and

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53. *See* RESTATEMENT (SECOND) OF CONTRACTS § 208 (1979).

54. *Id.*

55. Gardner, *supra* note 14, at 577.

56. Smith v. Western Life Ins. Co., 15 Col. 3d 111, 539 P.2d 433 (1975) (holding that keeping premiums without providing coverage was unconscionable); C. & J. Fertilizer Inc. v. Allied Mutual Ins. Co., 227 N.W.2d 169 (Iowa 1975) (finding the policy's definition of liability unconscionable).

57. As one court observed:

> Estoppel refers to an abatement raised by law, of rights and privileges of the insurer where it would be inequitable to permit their assertion; such relinquishment need not be voluntary, intended or desired by the insurer, but it necessarily requires some prejudicial reliance of the insured upon some act, conduct or non-action of the insurer.

National Discount Shoes v. Royal Globe Ins., 99 Ill. App. 3d 54, 57, 424 N.E.2d 1166, 1170 (1981).

58. *See* Armstrong v. United Ins. Co., 98 Ill. App. 3d 1132, 424 N.E.2d 1216 (1981) (holding the insurer accountable by agent's expectation to the insured of his rights).

59. *See* Harr v. Allstate Ins. Co., 54 N.J. 287, 255 A.2d 208 (1969).

existing right, the insurer has waived that right.[60] The insured does not have to suffer a detriment to claim that an insurance provision has been waived.[61] For example, older fire and automobile insurance policies required the insured to warrant that he had sole ownership of the insured property.[62] Courts readily found these requirements waived when the agent failed to inquire about the insured's title when the policy was issued.[63] In a more recent case, the insurer waived a requirement that the insured possess an insurable interest in the property because the insured had knowledge to the contrary.[64] These examples illustrate that courts will not permit an insurer to sit on its rights, collect premiums, and then assert those rights to defeat the insured's reasonable expectations.[65]

An alternative approach taken by courts where an insurance policy fails to fulfill its essential purpose is to impose coverage through the doctrine of implied warranty of fitness.[66] Since the insurance applicant depends on the insurance agent's judgment to sell the applicant a policy which suits his needs, the agent may implicitly warrant that the provisions in the policy satisfy the applicant's expressed needs.[67] Although implied warranties are rarely applied to insurance contracts, the doctrine is consistent with traditional contract law that infers contractual terms from the conduct of the parties.

Disappointed policy holders have also argued that the insurance policy does not express the real intentions of the con-

60. *See, e.g.*, Early v. Mutual Fire Ins. Co., 178 Pa. 631, 36 A. 195 (1897) (insurer found to have waived defense when it negotiated with plaintiff without telling him they intended to assert a defense); Mutual Savings Life Ins. Co. v. Noah, 291 Ala. 444, 282 So.2d 271 (1974) (insurer obligated to pay proceeds of policy, even when the insured died during a defaulting period, when it retained the late payment).

61. Salloum Foods & Liquor, Inc. v. Parliament Ins. Co., 69 Ill. App. 3d 442, 388 N.E.2d 23 (1979) (insurer waived one year statute of limitation for refusing to return insured's copy of the policy despite fact insured was informed of limitations period).

62. Morris, *supra* note 48, at 926.

63. *Id.* at 39.

64. Republic Ins. Co. v. Silverton Elevators, Inc., 493 S.W.2d 748 (Tex. 1973) (knowledge of agent that the insured did not own the household goods was imputed to insurer).

65. Most states require by statute that after a predetermined number of years, the validity of a policy is uncontestable, i.e., the insurer is barred from asserting that the applicant's statements were fraudulent as the basis for invalidating the policy. R. KEETON, BASIC TEXT ON INSURANCE LAW, § 6.5(d) (1971).

66. *See generally* Note, *Burglary Insurance Policies-Reasonable Expectations-Unconscionability-Application of Implied Warranty of Fitness*, 9 AKRON L. REV. 584 (1976).

67. *See supra* note 50.

tracting parties, and therefore should be reformed.[68] Reformation is a remedy available only when there is either mutual mistake or fraud on the part of one and mistake on the part of the other.[69] Whether a mistake is one of law or one of fact, courts will reform the contract to reflect the true intent of the parties.[70] The insured who negligently fails to familiarize himself with the policy terms, however, cannot seek reformation.[71]

These doctrines are part of the framework of traditional contract law. Each doctrine assumes that freedom of contract requires the court to interpret contracts, but not to make them. By merely labeling a document "contract", however, courts are not committed "to an indiscriminate extension of the ordinary contract rules to all contracts."[72] Thus, courts have relied on their prerogative of interpretation to add unique doctrines to the traditional rules of contract interpretation and construction when dealing with insurance policies.[73]

These specialized doctrines include the doctrine of *contra proferentum*,[74] adhesion,[75] and the principle of the wayfaring fool.[76] The doctrine of *contra proferentum* requires that ambiguities in a contract be interpreted against the contract maker regardless of the relative bargaining strength of the parties.[77] In applying this doctrine, courts will interpret ambiguous lan-

68. *See, e.g.*, Mutual of Omaha Ins., Co. v. Russel, 402 F.2d 339 (5th Cir. 1968), *cert. den.*, 394 U.S. 973; Hammel v. United States Fidelity & Guaranty Co., 246 Mich. 80, 224 N.W. 337 (1929) (granting reformation upon mutual mistake of law).

69. *See supra* note 51.

70. *See, e.g.*, Providence Washington Ins. Co. v. Rabinovitz, 227 F.2d 300 (5th Cir. 1955) (mistake of fact); Hammel v. United States Fidelity & Guaranty Co., 246 Mich. 80, 224 N.W. 337 (1929) (mistake of law).

71. Gardner, *supra* note 14, at 578.

72. Kessler, *supra* note 5, at 633.

73. The use of unique doctrines has been criticized by one commentator:

> Given the proper combination of contract language and factual situation, the causes of "fairness" and "equity" can be equally served by either approach-application of an independent doctrine which largely ignores policy language or strained construction of existing policy language. The difficulty lies in the fact that the prevailing judicial rationales are often so camouflaged by reference to "established rules" that it is impossible to pair a given situation with the appropriate doctrine so as to achieve a high degree of predictability. The law is left in an untidy state where neither party to the insurance contract knows precisely what the contract does or does not provide until after the fact of litigation.

Young, Lewis, & Lee, *Insurance Contract Interpretation: Issues and Trends*, 625 INS. L.J. 73 (Feb. 1975).

74. *See infra* notes 77-79 and accompanying text.

75. *See infra* note 80 and accompanying text.

76. *See infra* note 81 and accompanying text.

77. *Insured's Reasonable Expectation, supra* note 10, at 75.

guage, where semantically possible, to provide the insured with coverage for the losses to which his insurance policy relates.[78] In construing the plain and ordinary meaning of ambiguities, a court will not consider the drafter's intent.[79]

The doctrine of adhesion requires that all contract ambiguities be interpreted against the insurer because of the disparity of bargaining strength between the parties.[80] In contrast, the wayfaring fool principle requires that an insurer use language that is sufficiently clear so that a wayfaring man, however foolish, would not be deceived.[81] Although this principle is utilized occasionally, *contra proferentum* is repeated "with almost monotonous regularity."[82]

It is evident that the insured has an extensive list of general and specialized doctrines to protect him from latent defects in his insurance contract. If the insured's reasonable expectations are induced by the insurer's promises or conduct, the insured can assert the doctrine of waiver or estoppel when his expectations differ from the policy provisions. If the insured's relies on his agent to select an appropriate policy, a court will not allow the insurer to defeat those expectations by selecting a policy containing unconscionable, inappropriate or ambiguous provisions. In short, the traditional contract law doctrines honor the insured's reasonable expectations when the insured can establish a rational basis for those expectations.

III. IMPLICATIONS OF THE REASONABLE EXPECTATIONS DOCTRINE

The doctrine of reasonable expectations is a judicial rationale which balances justice and freedom of contract. Unfortunately, this rationale has evolved from an equitable approach to contract construction into the unbridled reconstruction of insurance contracts.[83] It is essential, therefore, to consider the impli-

78. *See, e.g.*, Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); Glidden v. Farmers Automobile Ins. Ass'n, 57 Ill. 2d 330, 312 N.E.2d 247 (1974) (where insured had purchased three policies from the same insurer, he was not limited to what he would recover under one policy).

79. Young, Lewis, & Lee, *supra* note 7, at 74.

80. *See generally* 43 AM. JUR. 2d *Insurance* § 271 (1979); R. ANDERSON, 1 COUCH ON INSURANCE 2d § 15:73 (1959).

81. *Insured's Reasonable Expectations, supra* note 10, at 75.

82. S. WILLISTON, *supra* note 2, § 900 at 17.

83. In rejecting the doctrine of reasonable expectations, the Idaho Supreme Court concluded:

> Reliance on this traditional approach avoids the danger that the court might create liability by construction of the contract terms or creation of a new contract for the parties. In the event that there is an ambiguity

cations of this doctrine which could ultimately entitle an insured or applicant to every benefit imaginable within a contractual framework.

The first implication of the expectations doctrine is that existing doctrines of contract construction fail to protect the insured's reasonable expectations. Proponents of the expectations doctrine argue that despite traditional contract remedies, the insured is vulnerable to an insurer who unilaterally places unambiguous coverage restrictions in its standard form policy which the insured is unlikely to read.[84] This argument fails to take into account that traditional notions of contract formation require the insured's assent, express or implied, to policy terms.[85] Traditional contract law does not bind insureds to unknown terms in their standard form contracts which eviscerate the terms agreed upon.[86] Thus, the expectations doctrine is unnecessary because the insured has traditionally been

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in the terms of the policy, special rules of construction apply to insurance contracts to protect the insured.

Since these rules protect the insured under a more traditional approach, it becomes unnecessary to adopt a new theory of recovery where, conceivably, the periphery of what losses would be covered could be extended by an insured's affidavit of what he "reasonably expected" to be covered.

Casey v. Highland Ins. Co., 100 Idaho 505, 600 P.2d 1387 (1979).

84. *Compare* Collister v. Nationwide Life Ins. Co., 479 Pa. 579, 388 A.2d 1346 (1978) (insured under no duty to read policy), *cert. denied*, 439 U.S. 1089 (1979), *with* Dobosz v. State Farm Fire & Cas. Co., 120 Ill. App. 3d 458 N.E.2d 611 (1983) (insured charged with notice of the contents if the insurance policy made available). For an interesting discussion on the duty to read, see Macaulay, *Private Legislation and The Duty To Read—Business Run by IBM Machine, The Law of Contracts and Credit Cards*, 19 VAND. L. REV. 1051 (1966).

85. A. CORBIN, *supra* note 1, § 3; Kessler, *supra* note 5, at 630. An insured's signature on the contract is usually a suitable manifestation of assent, however, the parameters of that assent are debatable. The Restatement (Second) of Contracts adopts the view that the signer has assented to "terms not read or understood, subject to such limitations as the law may impose." RESTATEMENT (SECOND) OF CONTRACTS § 211 comment b (1979). This view has been criticized because the signer is ignorant of the contract's terms or their existence until the transaction is consumated, therefore, this blind assent is no assent. Slawson, *supra* note 3, at 541.

One commentator has concluded that a bifurcated assent theory is required to explain consumer assent to insurance contracts. Lashner, *A Common Law Alternative To The Doctrine of Reasonable Expectations in The Construction of Insurance Contracts*, 57 N.Y.U. L. REV. 1175, 1192 (1982). Under this theory, the consumer gives his general assent to procedural provisions, which give the contract its full effect, though unknown. *Id.* at 1197. The consumer must give his specific assent, however, to provisions delineating the bargained for coverage, including exclusions of or limitations on that coverage. *Id.* The insurer cannot enforce any exclusion or limitation unless it can establish these provisions were adequately explained to the insured. *Id.* For an application of Lashner's theory, see Hionis v. Northern Mutual Ins. Co., 230 Pa. Super. 511, 327 A.2d 363 (1974).

86. The Restatement (Second) of Contracts states:

protected from unknown and contradictory terms in his standardized agreement.

The second implication of the expectations doctrine is that it leads courts toward two bodies of contract law. Courts differ on whether the contours of traditional contract law apply to insurance contracts.[87] Many courts tend to treat insurance contracts as *sui generis*.[88] As the reasonable expectations of the insured become a paramount consideration over the contractual language, traditional contract principles become inapplicable to insurance law because the rationales underlying each form of contract law are unique and polar. Underlying the traditional approach is the rationale that courts should not interfere with

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> Similarly, a party who adheres to the other party's standard terms does not assent to a term if the other party has reason to believe that the adhering party would not have accepted the agreement if he had known that the agreement contained the particular term. Such a belief or assumption may be shown . . . from the fact that [the term] eviscerates the non-standard terms explicitly agreed to . . . .

RESTATEMENT (SECOND) OF CONTRACTS § 211 comment f (1979). *See also* K. LLEWELLYN, THE COMMON LAW TRADITION-DECIDING APPEALS 370 (1960) (fine print which has not been read cannot undercut the dickered terms).

87. The courts have been criticized for their tendency to "pay merely lip service to the dogma that the common law of contracts governs insurance contracts." Kessler, *supra* note 5, at 635. *Compare* Penn-Air Inc. v. Indemnity Ins. Co., 439 Pa. 511, 517, 269 A.2d 19, 22 (1970) (law of contracts not changed because contract pertains to insurance) *with* Satz v. Massachusetts Bonding & Ins. Co., 243 N.Y. 385, 153 N.E. 844, 846 (1926) ("what do they know of the law of the insurance contract who only the law of contract know?").

88. There are several characteristics of an insurance contract which theoretically set it apart from other commercial contracts. The first differentiating characteristic is that insurance contracts are contracts of adhesion. Because the terms of insurance contracts are substantially dictated by actuarial tables and statutes, the applicant has little opportunity to negotiate changes in the proposed contract. This differentiation, however, is suspect because the standardized commercial contract is so common and so complicated that the parties rarely haggle over its standard terms. Thus, the contrast between the negotiated commercial contract and the adhered to insurance contract is anything but conspicuous.

Another distinguishing characteristic is that the public views the insurance policy as chattel rather than as contract. "The prevalence of airplane and other trip or voyage accident insurance coin-operated coupon-dispensed machines probably adds measurably to this prevailing tendency to look upon 'protection' as a purchasable commodity rather than as a result of a personal contract between the insurer and insured." S. WILLISTON, *supra* note 2, § 900, at 34. The courts have adopted this "chattel approach" with negotiable instruments and collective labor agreements. *Id.* at 35-37.

The third differentiating characteristic is that the insurance consumer receives only a conditional promise for his premium; therefore, such contracts have inherent potential of being oppressive. Young, Lewis, & Lee, *supra* note 73, at 75. Even though no present tangible benefit passes to the insurance applicant, this does not establish that the insurer will perform in bad faith. Nor does it leave the insured in any different position than a party to a standard contract incorporating conditions precedent and/or conditions subsequent.

freedom of contract where the intent of the parties is expressed by clear and unambiguous language.[89] In contrast, the expectations doctrine is built upon the rationale that an insurance policy is not a negotiated agreement, and therefore the rights and duties of the parties are governed not by a document, but by the "dynamics of the transaction viewed in its entirety."[90] These disparate rationales not only generate a dual system of contract law, but each rationale challenges the other's applicability to the construction of standardized contracts.

Insurance contracts, like the vast majority of modern contracts, are standardized to keep the cost of writing, performing and enforcing them within reasonable limits.[91] The insurance purchaser usually agrees on the premium, the duration, the amount of coverage and the subject matter to be covered. The remaining provisions are written by the insurer only. Under

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89. A. CORBIN, *supra* note 1, § 559, at 268. In other words, the court's function is not to rewrite express and unambiguous terms in a contract to comport with what it deems a fair result under the circumstances. *See, e.g.*, R. ANDERSON, 1 COUCH ON INSURANCE 2d § 14136, at 616 (1959) (court not authorized to rewrite the terms of clear binder).

90. Collister v. Nationwide Life Ins. Co., 478 Pa. 579, 588, 388 A.2d 1346, 1354 (1978), *cert. denied*, 439 U.S. 1089 (1979). In *Collister*, the applicant was informed that a physical examination and home office approval were prerequisites to coverage. *Id.* at 588, 388 A.2d at 1361. The *Collister* court held that a contract of insurance came into being between the applicant and the insurer at the time the insurer accepted the application and first premium payment. *Id.* at 586, 388 A.2d at 1354. The court reasoned that the public had a right to expect immediate coverage for the premium paid, and therefore, the applicant who died had temporary coverage prior to his medical examination and insurer's home office approval. *Id.*

In *Collister*, the court stated that "the reasonable expectations of the insured clearly become important once the courts had decided that normal contract principles were no longer applicable in insurance transactions." *Id.* at 586, 388 A.2d at 1351. Thus, the doctrine of reasonable expectations is not a supplement, but rather a replacement of traditional contract law in construing insurance contracts. The *Collister* decision bases the consumer's reasonable expectations on the insurance transaction rather than the insurance contract. Such an adjustment is likely to expand coverage because a transactional basis is inherently broader than a contractual basis.

91. The standardized form contract is not only a pervasive fixture in the insurance industry, but is also an economic necessity. Standard form insurance contracts spare both parties the time and cost of legal counsel ordinarily necessary for the bargaining and drafting of a negotiated agreement. Moreover, the form insurance contract informs the parties how to conduct themselves under anticipated contingencies. Finally, the form insurance contract enforces such conduct by conditioning the insurance coverage on the performance of that conduct. The cost of producing these contracts are minimized by spreading the mechanical and legal costs of production over a large number of users. For the insured, the hidden cost in standardized contracts is the expense of enforcing his reasonable expectations which are at variance with the standardized contract. *See also* RESTATEMENT (SECOND) OF CONTRACTS § 211 comment a (1979) (utility of standardization); Kessler, *supra* note 5, at 632 (stating standardized contracts "belong in the same category as codifications and restatements.").

traditional contract law, such a transaction is viewed as the formation of a negotiated agreement which is enforceable only to the extent the writing expresses the intent of the parties. Under the expectations doctrine, the same transaction is viewed as the formation of a non-negotiated agreement which is enforceable only to the extent the writing expresses the reasonable expectations of the insured.

A third implication of the expectations doctrine is that the insurance consumer will receive every possible benefit of the transaction. First, the expectations doctrine does not require a court to consider the insurer's contractual expectations. Thus, the fact that the insurer has a sound reason for including a restrictive provision in the contract is immaterial to a court's determination of the coverage intended and afforded.[92] Moreover, the insured's expectations can be based on noncontractual sources.[93] Finally, a sophisticated insured who understands the coverage restrictions in his policy may receive a windfall of coverage which the average insured reasonably expects. The informed insured has an advantage because courts are reluctant to reward the uninformed insured with more protection than the informed insured would expect.[94] Thus, the expectations doctrine improperly affords coverage which some insureds did not reasonably expect.

The final implication of the expectations doctrine is that the insured will ultimately pay the premiums which cover the risk of unenforceable coverage restrictions.[95] Policy language is

92. In a burglary insurance policy, an insurer frequently conditions coverage on a showing of forced marks of entry on the outside of the insured premises. This condition protects the insurer against an "inside job," however the expectations doctrine ignores such underwriting rationales to the benefit of the insured. *See, e.g.*, C. & J. Fertilizer, Inc. v. Allied Mut. Ins. Co., 227 N.W.2d 169 (Iowa 1975). For a discussion of the rationale behind conditional health insurance, see *supra* note 28.

93. The common belief that one can expect to get something in return for their money has translated into temporary insurance. *See supra* note 27 and accompanying text; *see also* Glidden v. Farmers Automobile Ins. Ass'n., 57 Ill. 2d 330, 312 N.E.2d 247 (1974) (stacking insurance policies).

94. *See Insured's Reasonable Expectations, supra* note 10, at 83. Professor Keeton stated:

> It is a sound rule to strike down a surprising policy provision uniformly, sustaining even the claim of the occasional policyholder who can be shown to have known of its restrictive terms. 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.

95. Coverage restrictions reflect the insurer's underwriting decisions, i.e., what risks, in what amounts, and on what terms. *See supra* note 19. When a restriction is voided, the underwriting operation is undermined, if not completely abandoned. At this point, the insurer will either increase its premiums or decrease its coverage in order to avoid further underwriting

drafted to meet the economic and legal requirements of insurance companies.[96] Because it is difficult for the insurer to know which insured's expectations are contrary to the policy provisions, the insurer is likely to raise premiums to account for the actuarial uncertainty. Moreover, the public is prejudiced when an insurer's liabilities are stretched over risks that could not be profitably underwritten for a fair premium. As a result, many insurance companies will cease writing policies for the unprofitable insurance risks and those insurance companies which continue to write those policies will force many potential insureds out of the market.

These implications of the doctrine of reasonable expectations illustrate the unmanageability of the doctrine. Many courts are utilizing the doctrine to bypass traditional contract principles and to impose their sense of justice on the market place. This contrivance affords some insureds with coverage they neither expected nor paid for. Even Professor Keeton, who

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losses. *See* Crawford v. Equitable Life Assurance Society, 56 Ill. 2d 41, 305 N.E.2d 144 (1973) (defense based on lack of eligibility, not barred by an unconscionability clause).

To the extent courts determine the scope of an insurer's coverage, the insurer will take steps to protect its fund from risks that cannot be underwritten. One of these steps is to allocate a greater fraction of each premium dollar to its reserves. In life insurance, the "reserve is an amount that, together with future premiums, all accumulated at an assumed rate of interest, will suffice to satisfy the company's future obligations as predicted by specified mortality tables. So long as the company has assets to match this reserve liability, it is solvent." Kimball, *The Purpose of Insurance Regulation: A Preliminary Inquiry in the Theory of Insurance Law*, 45 MINN. L. REV. 471, 483 (1961).

Of each dollar of income received by U.S. insurance companies, $.715 comes from premiums and $.285 comes from net investment earnings. AMERICAN COUNCIL OF LIFE INSURANCE, FACT BOOK (1982). The following shows how each premium dollar received from insurance purchasers is spent:

Benefit payments to policy holders	$ .466
Addition to policy reserve funds	$ .324
Addition to special reserves	$ .019
Commission to agents	$ .001
Home and Field Office expenses	$ .096
Taxes	$ .023
Dividends to shareholders	$ .011

The underwriting operations of insurance companies do not always generate profits. In fact, property and casualty insurance companies have shown profits on underwriting operations in only nine of the last 25 years. INSURANCE INFORMATION INSTITUTE, INSURANCE FACTS 19 (1983). In 1981 alone, the insurance industry was subject to 235 million dollar verdicts. *Id.* at 52. Fortunately, property and casualty insurers recorded $14,906,655,340 in investment income for the year 1982. *Id.* at 20.

96. Insurance companies execute thousands of standard policies using a printed form prepared and approved by its actuaries, officers and attorneys. A. CORBIN, *supra* note 1, at § 559. For a discussion of insurance regulators, see *infra* notes 110-13 and accompanying text.

strongly advocates the doctrine, concedes that it is "too general to serve as a guide from which particularized decisions can be derived through an exercise of logic, and too broad to be universally true. . . ."[97] To avoid these implications of the expectations doctrine, an alternative must be implemented.

IV. PROPOSALS

A viable alternative to the doctrine of reasonable expectations must protect the insurance consumer from latent pitfalls in his standardized policy without creating the impression of judicial prejudice against insurers. A list of potential alternatives can be gleaned from judicial, legislative and administrative remedies presently available to the disappointed insured. Each alternative attempts to satisfy the insured's reasonable expectations.

Use of the doctrine of unconscionability is a promising remedy for the insured because it allows a court to pass on the substantive fairness of a contract provision.[98] Regardless of the parties' promises and conduct, a court can strike a term which patently favors the drafter of a standard form contract.[99] Unconscionability allows a court to get beyond freedom of contract where it can protect the weaker party's interests. Moreover, a court's determination that a contract or term is unconscionable is based not just on the facts which favor one party, but on all the material facts.[100]

The presence of unconscionable terms, however, is not necessarily due to imperfections in the bargaining process.[101]

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97. Keeton, *supra* note 8, at 967.

98. *See supra* notes 53-56 and accompanying text; *see also* RESTATEMENT (SECOND) OF CONTRACTS § 208 comment a (1979) ("Particularly in the case of standardized agreements, the rule in this Section permits the court to pass directly on the unconscionability of the contract or clause rather than to avoid unconscionable results by interpretation.").

99. "Standardized contracts such as insurance policies, drafted by powerful commercial units and put before individuals on the 'accept this or get nothing' basis, are carefully scrutinized by the purpose of avoiding enforcement of 'unconscionable' clauses." A. CORBIN, *supra* note 1, § 1376, at 21.

100. RESTATEMENT (SECOND) OF CONTRACTS § 211 comment f (1979). This approach would allow the insurer to present the underwriting rationale behind the coverage restriction at variance with the insured's reasonable expectations, thereby avoiding the appearance of unprincipled judicial prejudice against the insurer. *See supra* note 97.

101. Even the best negotiator may adhere to an oppressive insurance contract if he or she is not sufficiently informed to act rationally. "Complex fine-print standard forms might be viewed as goods whose quality people cannot determine." Korhauser, *Unconscionability in Standard Forms*, 64 CALIF. L. REV. 1151, 1177 (1976). Thus, the existence of oppressive terms in form contracts may not reflect the imperfection of the bargaining process, but the imperfection of coverage dissemination.

When a consumer cannot sort through the complex, finely printed standard form, it becomes difficult for him to even discern the value of that policy. Standard policy statutes are an efficient means of providing the public with plain,[102] easy to understand[103] insurance policies. Although the typical American insurance code has been labeled "a rubbish heap without parallel in the law-making of modern man," legislation is more likely to promote understandable policies than judicial action.[104] There are essentially two benefits to plainly written policies.

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102. For an example of "Plain Talk Car Policy" see Gardner, *supra* note 14, 584-86. The following is an excerpt from Sentry Insurance Company's "Plain Talk Car Policy":

> Our Promises To You
>
> We Promise to pay *damages* for bodily injury or property damage for which the law holds *you* responsible because of a *car accident* involving a *car* we insure. We also promise to pay additional benefits.
>
> Additional Benefits
>
> These benefits are in addition to our limit of liability for *damages.*
>
> We'll pay for the cost of investigating the *car accident* and arranging for the settlement of any claim against *you.* We'll also defend *you,* hire and pay a lawyer, and pay all defense costs if *you're* sued by someone for *damages* because of a *car accident*—even if the accusations aren't true. However, we won't be obligated to pay for the cost of any further investigation or arrangement for settlement or to defend *you* further after we've paid our entire limit of liability for *damages.*

Id. at 584-85.

103. For a list of successfully marketed "Easy-To-Understand" policies see Young, Lewis & Lee, *supra* note 73, at 72.

104. Kimball, *Unfinished Business In Insurance Regulation,* 1969 WIS. L. REV. 1019. In 1980, several states passed legislation requiring title insurance policies to be written in clear and understandable language. R. KRATOVIL & WERNER, REAL ESTATE LAW § 11.06(b) (8th ed. 1983). Compare the readibility of the following Residential Title Insurance Policies, one written before plain language legislation, the other after such legislation.

Before: 2. Continuation of Insurance after Conveyance of Title

> The coverage of this policy shall continue in force as of the Date of Policy in favor of an insured so long as such insured retains an estate or interest in the land, or holds an indebtedness secured by a purchase money mortgage given by a purchaser from such insured, or so long as such insured shall have liability by reason of convenants of warranty made by such insured in any transfer or conveyance of such estate or interest; provided, however, this policy shall not continue in force in favor of any purchaser from such insured of either said estate or interest or the indebtedness secured by a money mortgage give to such insured.

American Land Title Insurance (Amended 10-17-70).

After: 2. Continuation of Coverage

> This policy protects you as long as you:
> * own your title, or
> * own a mortgage from anyone who buys your land, or
> * are liable for any title warranties you make.
>
> This policy protects anyone who receives your title because of your death.

American Land Title Association, Residential Title Insurance Policy Form 2098.

First, the consumer can take a more active role in the contract formation process when he is able to understand the agreement. A clearly written policy will not only generate consumer awareness but also consumerism. Clearly written insurance policies also benefit the insurer because it can delineate the coverage and control the consumer's reasonable expectations. In the interest of contractual certainty, it is best to have the consumer pay a larger premium for a simpler policy which does not qualify the coverage with detailed exclusions and limitations.[105]

Most states have enacted legislation which allows an administrative agency to regulate the content of insurance policies.[106] Unfortunately, at the helm of those agencies are insurance commissioners which are understaffed and whose employees are over worked.[107] Historically, the regulation of insurance policy forms has not been a high priority with these administrative agencies.[108] Perhaps the most effective way of motivating the agencies to bring their discretionary powers to press for more clearly written policies would be to develop consumer interest groups.[109] Until insurance consumers make incomprehensible insurance policies a political or a controversial issue, the insurance industry will continue to control the regulations.

CONCLUSION

Insurance is a business built upon the standard form contract. These contracts are increasingly being viewed as a consumer product rather than a negotiated agreement. Still the courts must interpret these complex legal forms to which the consumer has agreed. Consequently, courts will no longer give

105. When Sentry Insurance Company issued its "Plain Talk Car Policy" it realized it would be granting a broader range of coverage by simplifying the policy; however, the company concluded that it would be better to charge the insured for the extra coverage rather than try to exclude it. Gardner, *supra* note 14, at 581.

106. Goodhue, *supra* note 23, at 921.

107. One commentator noted: "The reluctance of states to properly provide resources to insurance [regulation] departments is matched only by the willingness of legislators to increase the regulatory burdens on departments." Carter, *The Limits of Regulatory Powers of Insurance Commissioners—An Industry Viewpoint*, 13 FORUM 403, 406 (1978).

108. In order of their priority, the primary functions of insurance regulators are (1) to ensure the solvency of the insurance company, (2) to maintain fair and reasonable prices, and (3) to avoid the over-reaching of insurers. *Id.* at 405.

109. Professor Keeton has observed that "[m]ost insurance consumers are unorganized, and their complaints about rates are seldom urged upon an insurance commission unless insurance rates become a political issue. . . ." R. KEETON, BASIC TEXT ON INSURANCE LAW 565 (1971).

literal effect to a provision that will defeat the insured's reasonable expectations.

Insurance law has gone beyond traditional contract law in order to protect the unwary insurance consumer. The courts can only protect one consumer at a time, on a case by case basis. The price of that protection is contractual uncertainty and the fragmentation of contract law. Therefore, a solution to the problem of standard form contracts is needed.

Legislative remedies provide a wholistic alternative to the doctrine of reasonable expectations. The enactment of statutes mandating comprehensible standard insurance contracts will help the consumer understand his contract and enable him to tailor his expectations accordingly. The rewording of standard form insurance contracts into clearly written, understandable language is a policy that should be pursued by the courts, consumers, and legislators. Such a policy will ensure that the standard form contract expresses the reasonable expectations of the parties and allow courts to get back to the business of contract interpretation rather than contract reconstruction. Clearly written promises will promote the realization of reasonable profits, precedent, and expectations.

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