

2000

# A Realistic Consensus Approach to the Insurance Law Doctrine of Reasonable Expectations

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## Recommended Citation

Peter Nash Swisher, *A Realistic Consensus Approach to the Insurance Law Doctrine of Reasonable Expectations*, 35 *Tort & Ins. L.J.* 729 (2000).

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# A REALISTIC CONSENSUS APPROACH TO THE INSURANCE LAW DOCTRINE OF REASONABLE EXPECTATIONS

*Peter Nash Swisher*

## I. INTRODUCTION

Over the past thirty years, a great number of articles have analyzed, questioned, and debated Professor (now Judge) Robert E. Keeton's doctrine of reasonable expectations as applied to insurance coverage disputes.<sup>1</sup>

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1. The modern insurance law doctrine of reasonable expectations was largely developed by Professor Robert E. Keeton in 1970. See Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions* (Parts I and II), 83 HARV. L. REV. 961 (1970) and 83 HARV. L. REV. 1281 (1970) [hereinafter *Insurance Law Rights*]; see also Robert E. Keeton, *Reasonable Expectations in the Second Decade*, 12 FORUM 275 (1976); ROBERT E. KEETON AND ALAN WIDISS, *INSURANCE LAW* §§ 6.01–6.10 (1988). Since 1970, Professor Keeton's groundbreaking doctrine of reasonable expectations has received widely mixed support and criticism from a number of American courts and commentators. See generally Kenneth S. Abraham, *Judge-Made Law and Judge-Made Insurance: Honoring the Reasonable Expectations of the Insured*, 67 VA. L. REV. 1151 (1981) [hereinafter *Judge-Made Law*]; Kenneth S. Abraham, *The Expectations Principle as a Regulative Ideal*, 5 CONN. INS. L.J. 59 (1998–1999) [hereinafter *A Regulative Ideal*]; Arnold P. Anderson, *Life Insurance Conditional Receipts and Judicial Intervention*, 63 MARQ. L. REV. 593 (1980); Eugene R. Anderson and James J. Fournier, *Why Courts Enforce Insurance Policyholders' Objectively Reasonable Expectations of Insurance Coverage*, 5 CONN. INS. L.J. 335 (1998–1999); Gary L. Birnbaum, *Standardized Agreements and the Parole Evidence Rule: Defining and Applying the Expectations Principle*, 26 ARIZ. L. REV. 793 (1984); H. Walter Croskey, *The Doctrine of Reasonable Expectations in California: A Judge's View*, 5 CONN. INS. L.J. 451 (1998–1999); Amy Cabbage, *The Interaction of the Doctrine of Reasonable Expectations and Ambiguity in Drafting: The Development of the Kentucky Formulation*, 85 KY. L.J. 435 (1997); Douglas Fadel, *Utah Rejects the Reasonable Expectations Doctrine in Insurance Contract Interpretation*, 1993 UTAH L. REV. 275 (1993); Laurie Kindell Fett, *The Reasonable Expectations Doctrine: An Alternative to Bending and Stretching Traditional Rules of Contract Interpretation*, 18 WM. MITCHELL L. REV. 1113 (1992); James M. Fischer, *The Doctrine of Reasonable Expectations Is Indispensable, If Only We Knew What For?*, 5 CONN. INS. L.J. 151 (1998–1999); Frank Gardner, *Reasonable Expectations: Evolution Completed or Revolution Begun?*, 669 INS. L.J. 573 (1978); David Goodhue, *The Doctrine of Reasonable Expectations in Massachusetts and New Hampshire: A Comparative*

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With such a wealth of authority discussing the doctrine, one might question the need for yet another analysis of this elusive and troublesome sub-

*Analysis*, 17 NEW ENG. L. REV. 891 (1991); Roger C. Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L.J. 823 (1990) [hereinafter *Reasonable Expectations After Two Decades*]; Roger C. Henderson, *The Formulation of the Doctrine of Reasonable Expectations and the Influence of Forces Outside Insurance Law*, 5 CONN. INS. L.J. 69 (1998–1999) [hereinafter *Forces Outside Insurance Law*]; Kenneth J. Horner Jr., *Insurance—Contracts—The Ambiguity in the Doctrine of Reasonable Expectations*, 62 NOTRE DAME L. REV. 423 (1986); John Dwight Ingram, *The Insured's Expectations Should Be Honored Only If They Are Reasonable*, 23 WM. MITCHELL L. REV. 813 (1997); Robert H. Jerry II, *Insurance, Contract, and the Doctrine of Reasonable Expectations*, 5 CONN. INS. L.J. 21 (1998–1999) [hereinafter *Insurance, Contract, and Doctrine*]; Martin Kamarck, *Opening the Gate: The Steven Case and the Doctrine of Reasonable Expectations*, 29 HASTINGS L.J. 153 (1977–1978); Start 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. COUNSEL J. 325 (1980); William Mark Lashner, *A Common Law Alternative to the Doctrine of Reasonable Expectations*, 57 N.Y.U. L. REV. 1175 (1982); David Leitner, *Enforcing the Customers' "Reasonable Expectations" in Interpreting Insurance Contracts: A Doctrine in Search of Coherent Definition*, 38 FED'N INS. AND CORP. COUNS. Q. 379 (1988); Diane Lucas, *Decapitation to Cure Dandruff? The Scope of the Reasonable Expectations Doctrine of Darnier Motor Sales Inc. v. Universal Underwriters Ins. Co.*, 20 ARIZ. ST. L.J. 841 (1988); William A. Mayhew, *Reasonable Expectations: Seeking a Principled Application*, 13 PEPPERDINE L. REV. 267 (1986); Jeffrey Pawelski, *Insurers Don't Need the Courts to "Babysit" Them: An Argument for Reasonable Expectations in American Family Mutual Ins. Co. v. Elliot*, 41 SAN DIEGO L. REV. 375 (1996); Harry Perlet III, *The Insurance Contract and the Doctrine of Reasonable Expectations*, 6 FORUM 116 (1970); Susan M. Popik and Carol D. Quackenbos, *Reasonable Expectations After Thirty Years: A Failed Doctrine*, 5 CONN. INS. L.J. 425 (1998–1999); Mark C. Rahdert, *Reasonable Expectations Reconsidered*, 18 CONN. L. REV. 323 (1986); Mark C. Rahdert, *Reasonable Expectations Revisited*, 5 CONN. INS. L.J. 107 (1998–1999); W. Wylie Spicer, *Cb-Cb-Changes: Stumbling Toward the Reasonable Expectations of the Assured in Marine Insurance*, 66 TULANE L. REV. 457 (1991); Conrad Squires, *A Skeptical Look at the Doctrine of Reasonable Expectations*, 6 FORUM 252 (1971); Jeffrey W. Stempel, *Unmet Expectations: Undue Restriction of the Reasonable Expectations Approach and the Misleading Mythology of the Judicial Role*, 5 CONN. INS. L.J. 181 (1998–1999) [hereinafter *Unmet Expectations*]; Scott C. Sterling, *Reasonable Expectations of Insurance Coverage and the Problem of Environmental Liabilities*, 22 ARIZ. ST. L.J. 395 (1990); Jeffrey E. Thomas, *An Interdisciplinary Critique of the Reasonable Expectations Doctrine*, 5 CONN. INS. L.J. 295 (1998–1999); Stephen J. Ware, *A Critique of the Reasonable Expectations Doctrine*, 56 U. CHI. L. REV. 1461 (1989); Note, *Interpreting the Business Pursuits Exclusion in Homeowner's Policies—Toward Honoring "Reasonable Expectations"*, 25 SAN DIEGO L. REV. 132 (1980); Note, *Reasonable Expectations Approach to Insurance Contract Interpretation Modified in Missouri*, 47 MO. L. REV. 577 (1982); Comment, *A Reasonable Approach to the Doctrine of Reasonable Expectations as Applied to Insurance Contracts*, 13 U. MICH. J.L. REFORM 603 (1980); Comment, *Insurer Liability in the Asbestos Disease Context—Application of the Reasonable Expectations Doctrine*, 25 SAN DIEGO L. REV. 239 (1982); Comment, *Reasonable Expectations: The Insurer's Dilemma*, 24 DRAKE L. REV. 853 (1975); Comment, *The Reconstruction of Insurance Contracts Under the Doctrine of Reasonable Expectations*, 18 J. MARSHALL L. REV. 155 (1984).

Professor Keeton's doctrine of reasonable expectations also has received attention in a number of practice-oriented insurance law treatises. See, e.g., EUGENE ANDERSON, *INSURANCE COVERAGE LITIGATION* §§ 2.1–2.15 (1997); ROBERT JERRY II, *UNDERSTANDING INSURANCE LAW* § 25D (2d ed. 1996) [hereinafter *UNDERSTANDING INSURANCE LAW*]; BARRY OSTRAGER AND THOMAS NEWMAN, *HANDBOOK ON INSURANCE COVERAGE DISPUTES* § 10.03 (9th ed. 1998); JEFFREY W. STEMPEL, *LAW OF INSURANCE CONTRACT DISPUTES* § 4.09 (2d ed. 1999) [hereinafter *LAW OF INSURANCE CONTRACT DISPUTES*]; ALLAN WINDT, *INSURANCE CLAIMS AND DISPUTES* § 6.03 (3d ed. 1995).

It is surprising, therefore, that two widely respected multivolume insurance law treatises, APPLEMAN ON INSURANCE LAW and COUCH'S CYCLOPEDIA OF INSURANCE LAW, over the past

ject.<sup>2</sup> But if there is a practical way to better understand this interpretive conundrum, such an analysis might assist academic scholars, jurists, and insurance law practitioners alike.<sup>3</sup>

This article's fundamental premise is that, over the past three decades, despite all the debate and confusion surrounding the underlying theory and practice of the insurance law doctrine of reasonable expectations, a modern consensus approach has finally emerged within the academic community and the courts and among insurance law practitioners<sup>4</sup> involving a realistic and viable application of the doctrine to the needs of contemporary

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thirty years have given little recognition to Professor Keeton's doctrine of reasonable expectations. For example, the most recent edition of the Couch treatise still discusses the doctrine of reasonable expectations only as a contractually based concept. See LEE RUSS AND THOMAS SEGALLA, COUCH'S CYCLOPEDIA OF INSURANCE LAW §§ 21:11-15 and 22:11 (3d ed. 1997) [hereinafter COUCH'S CYCLOPEDIA]; see also ERIC HOLMES AND MARK RHODES, HOLMES' APPELMAN ON INSURANCE LAW §§ 5.1-5.8 and 8.1 (2d ed. 1996) [hereinafter HOLMES' APPELMAN ON INSURANCE LAW]. Professor Holmes does refer to Professor Keeton's doctrine of reasonable expectations in his 1996 treatise revision, *id.* at 289, but he concludes that: "... the classical formal judicial process of the interpretation and construction of [insurance] contracts is most familiar. The written contract is presumed to represent the parties' intent and mutual assent on all matters and create the law of their contract. The function of the court is not to rewrite their bargained for language, but rather is to interpret their language according to its plain, common-sense meaning. . . ." *Id.* at 291. Thus, Professor Holmes arguably still applies a more traditional contractually based insurance law doctrine of reasonable expectations to insurance coverage disputes. Nevertheless, as will be discussed below, this traditional contractually based objective reasonable expectations approach is still a practical, viable, and theoretically sound interpretive approach to insurance coverage disputes.

2. See, e.g., *Bensalem Township v. International Surplus Lines Ins. Co.*, 38 F.3d 1303, 1311 (3d Cir. 1994) ("Since Professor Keeton's article, a considerable number of trees have been sacrificed in the name of reasonable expectations as the academic community has debated what reasonable expectations means, which courts have adopted the doctrine, and whether it is desirable for them to have done so.").

3. See, e.g., Richard A. Posner, *The Decline of Law as an Autonomous Discipline: 1962-1987*, 100 HARV. L. REV. 761, 777 (1987) ("Disinterested legal doctrinal analysis of the traditional kind remains the indispensable core of legal thought, and there is no surfeit of such analysis today. I daresay that many legal scholars who today are breathing the heady fumes of deconstruction, structuralism, moral philosophy, and the theory of second best would be better employed . . . synthesizing the law of insurance."). Admittedly, this synthesis of the insurance law doctrine of reasonable expectations represents a pragmatic attempt to find common ground among the various supporters and critics of Professor Keeton's reasonable expectations doctrine. My colleague, Professor Jeffrey Stempel, on the other hand, has analyzed the Keeton reasonable expectations doctrine in terms of the Hegelian progression of thesis, antithesis, and synthesis. Stempel, *Unmet Expectations*, *supra* note 1, at 248-50. The philosopher George Wilhelm Friedrich Hegel appears to be enjoying a modern renaissance of sorts. See, e.g., Chad McCracken, *Hegel and the Autonomy of Contract Law*, 77 TEX. L. REV. 719 (1999).

4. Such a doctrine must have a sound theoretical basis and a practical application in order to meet the needs and concerns of both academic lawyers and practicing lawyers in an insurance law context. For a discussion of the historical conflicts and tensions between practicing lawyers and academic lawyers generally, see W. JOHNSON, *SCHOOLED LAWYERS: A STUDY IN THE CLASH OF PROFESSIONAL CULTURES* (1978). One commentator has observed, for example, that Professor Keeton's doctrine of reasonable expectations "has held particular attraction to academics, while simultaneously prompting resistance from elements of the bench and bar, and particularly from the insurance industry." Jeffrey W. Stempel, *Unreason in Action: A Case*

American society. This consensus approach constitutes a practical “middle ground” synthesis of traditional, objective, and contractually based reasonable expectations principles grafted onto elements of the more modern Keeton formulation of the doctrine. Moreover, this realistic consensus approach to the doctrine of reasonable expectations is both theoretically and practically defensible since, as I have argued in two previous articles,<sup>5</sup> contemporary legal rules of insurance contract interpretation must be both theoretically sound and have practical application.<sup>6</sup>

To quote an oft-cited axiom of early entertainment moguls: “Great idea! But will it play in Peoria?”<sup>7</sup> Arguably, this realistic consensus approach to the insurance law doctrine of reasonable expectations does indeed play equally well in Los Angeles, Peoria, Cleveland, Dallas, Miami, New York, and most other American cities and towns. The remainder of this article

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*Study of the Wrong Approach to Construing the Liability Insurance Pollution Exclusion*, 50 FLA. L. REV. 463, 464–65 (1998). Arguably, a “middle ground” consensus approach to the doctrine of reasonable expectations, as discussed below, would alleviate much of this conflict and tension within the legal community regarding insurance contract interpretation. See also note 6, *infra*, and accompanying text.

5. See Peter Nash Swisher, *Judicial Rationales in Insurance Law: Dusting Off the Formal for the Function*, 52 OHIO ST. L.J. 1037 (1991) [hereinafter *Judicial Rationales in Insurance Law*]; Peter Nash Swisher, *Judicial Interpretations of Insurance Contract Disputes: Toward a Realistic Middle Ground Approach*, 57 OHIO ST. L.J. 543 (1996) [hereinafter *A Middle Ground Approach to Insurance Contract Disputes*].

6. Judge Harry T. Edwards is a strong proponent of such “practical” legal scholarship:

The growing disjunction between legal education and legal practice is most salient with respect to scholarship. There has been a clear decline in the volume of “practical” scholarship published by law professors. “Practical” legal scholarship, in the broadest sense, has several defining features. It is *prescriptive*: it analyzes the law and the legal system with an aim to instruct attorneys in their consideration of legal problems, to guide judges and other decision makers in their resolution of legal disputes, and to advise legislators and other policymakers on law reform. It is also *doctrinal*: it attends to the various sources of law (precedents, statutes, constitutions) that constrain or otherwise guide the practitioner, decision maker, and policymaker. . . . There are too few books, treatises, and law review articles now that usefully “chart the line of development and progress” for judges and other governmental decision makers. . . .

Harry T. Edwards, *The Growing Disjunction Between Legal Education and the Legal Profession*, 91 MICH. L. REV. 34, 42–43 (1992). For a reply to Judge Edwards’s criticism of current legal scholarship, see Barbara Bennett Woodhouse, *Mad Midwifery: Bringing Theory, Doctrine, and Practice to Life*, 91 MICH. L. REV. 1977, 1997 (1993):

[T]he disease of disjunction between legal education and the profession is not caused by too much theory or too little doctrine and practice, but by too little attention to their essential interplay in a complex and interconnected world. The cure I prescribe is not further polarization but a more thoughtful integration not only of theory, doctrine, and practice in the classroom, but of the complementary roles of scholar, teacher, and lawyer in ourselves and in our understanding of each other.

*Id.*

7. Significantly, the Keeton insurance law doctrine of reasonable expectations has not played well in Peoria. See, e.g., Edward Collins, *Insurance Contract Interpretation: The Doctrine of Reasonable Expectations Has No Place in Illinois*, 1985 S. ILL. U. L.J. 687 (1985).

will analyze, discuss, and demonstrate the viability and practicality of this realistic consensus approach to the insurance law doctrine of reasonable expectations.

## II. WHAT EXACTLY IS THE INSURANCE LAW DOCTRINE OF REASONABLE EXPECTATIONS?

A majority of commentators and courts that have addressed and debated the insurance law doctrine of reasonable expectations over the past three decades have focused on the seminal writings of Professor Keeton in 1970.<sup>8</sup> The impact of his influential article on the body of American insurance law in general, and on insurance contract interpretation in particular, has been profound.<sup>9</sup> As propounded by Professor Keeton, this “modern” doctrine of reasonable expectations is based upon a two-pronged rationale: (1) that an insurer should be denied any unconscionable advantage in an insurance contract; and (2) that the reasonable expectations of the insurance applicants and intended beneficiaries regarding the terms of insurance contracts should be honored, even though a painstaking study of the policy provisions contractually would have negated those expectations.<sup>10</sup> Although few courts or commentators today question the merits of Professor Keeton’s first doctrinal principle,<sup>11</sup> there has been a firestorm of criticism over his second principle.<sup>12</sup> Under this “modern” reasonable expectation formula, the insurance policy need not be interpreted according to its clear and unambiguous contract language—which is anathema to a classical formalistic theory of insurance contract interpretation:

The Keeton formula suggests that an insured can have reasonable expectations of coverage that arise from some source other than the policy language itself, and that such an extrinsic expectation can be powerful enough to override any policy provisions no matter how clear. So interpreted, the Keeton formula pushes insurance law in a dramatic new direction, one that discards the traditional contract premise that a written agreement is the controlling code for determining the parties’ rights and duties.<sup>13</sup>

8. See Keeton, *Insurance Law Rights*, *supra* note 1.

9. See, e.g., Jerry, *Insurance, Contract, and Doctrine*, *supra* note 1, at 22 (“Legal rules, somewhat like laws of science, await discovery by explorers whose prescience enables them to understand something others observed but could not comprehend. . . . In the field of insurance law, Judge Robert Keeton is one of the grander explorers of them all.”); Henderson, *supra* note 1, at 70 (describing Professor Keeton as a “gifted legal astrologer in the galaxy of insurance law”).

10. Keeton, *Insurance Law Rights*, *supra* note 1, at 963–64.

11. See generally *infra* notes 55–70 and accompanying text.

12. See, e.g., Fadel, *supra* note 1; Ingram, *supra* note 1; Lashner, *supra* note 1; Popik and Quackenbos, *supra* note 1; Squires, *supra* note 1; Ware, *supra* note 1.

13. Rahdert, *Reasonable Expectations Reconsidered*, *supra* note 1; see also Swisher, *Judicial Rationales in Insurance Law*, *supra* note 5, at 1039–58.

What many supporters and critics of Professor Keeton's doctrine of reasonable expectations do not sufficiently appreciate, however, is how significantly this "modern" doctrine of reasonable expectations has evolved from, and has been grafted onto, the depth and breadth of a more traditional contractually based doctrine of reasonable expectations that a majority of courts and commentators can readily embrace, irrespective of their formalistic<sup>14</sup> or functionalistic<sup>15</sup> jurisprudential roots. For example, Justice Benjamin Cardozo stated in his celebrated 1918 decision of *Bird v. St. Paul Fire and Marine Insurance*<sup>16</sup> that "our guide is the *reasonable expectation* and purpose of the ordinary businessman when making an ordinary business contract. It is his intention, expressed or *fairly to be inferred*, that counts. . . ."<sup>17</sup>

Other insurance law cases that predate Professor Keeton's 1970 reasonable expectations article employed this contractually based and objective reasonable expectations doctrine in order to identify the terms of an insurance contract, to determine the scope of the parties' contractual duties

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14. Legal formalism, also known as legal positivism, is the traditional view that correct legal decisions are largely determined by preexisting judicial and legislative precedent, and the law should be viewed as an autonomous system of logical, socially neutral principles and rules. Judging under this formalistic theory is thus a matter of logical necessity rather than a matter of choice. See, e.g., MARIO JORI, *LEGAL POSITIVISM* (1992); Frederick Schauer, *Formalism*, 97 *YALE L.J.* 509 (1988) (discussing how legal formalism still serves a useful function in limiting judicial discretion and judicial activism); Ernest J. Weinrib, *Legal Formalism: On the Imminent Rationality of Law*, 97 *YALE L.J.* 949 (1988) (questioning whether the law is essentially rational as the formalists believe, or whether law is essentially political as the functionalists believe); see also Swisher, *Judicial Rationales in Insurance Law*, *supra* note 5, at 1039-42, 1048-50; Symposium, *Formalism Revisited*, 66 *U. CHI. L. REV.* 527-942 (1999).

15. Legal functionalism, also known as legal realism or legal pragmatism, is based on the belief that the formalistic theory of a logical and socially neutral legal uniformity and predictability is rarely attainable and may be undesirable in a changing society, and the paramount concern of the law should not be logical consistency, but socially desirable consequences. Thus, where legal formalism is logically based and precedent-oriented, legal functionalism is sociologically based and result-oriented. See, e.g., ROSCOE POUND, *JURISPRUDENCE* (1959); WILFRED RUMBLE, *AMERICAN LEGAL REALISM* (1968); G. AICHELE, *LEGAL REALISM AND TWENTIETH CENTURY AMERICAN JURISPRUDENCE* (1990); see also Swisher, *Judicial Rationales in Insurance Law*, *supra* note 5, at 1043-45, 1050-58. A third emerging school of American legal theory, the critical legal studies movement, which calls for the dismantling of existing political and legal institutions in favor of newly empowered forms of social democracy, has not yet made any appreciable impact in the field of American insurance law. See, e.g., MARK KELMAN, *A GUIDE TO CRITICAL LEGAL STUDIES* (1987); ROBERTO UNGER, *THE CRITICAL LEGAL STUDIES MOVEMENT* (1986); Mark Tushnet, *Critical Legal Studies: A Political History*, 100 *YALE L.J.* 1515 (1991).

16. 120 *N.E.* 86 (N.Y. 1918).

17. *Bird*, 120 *N.E.* at 87 (emphasis added). In a subsequent decision, *Smith v. Northwestern Fire & Marine Ins. Co.*, 159 *N.E.* 87, 93 (N.Y. 1927), then-Judge Cardozo recognized that insurers as well as insureds could invoke this contractually based "reasonable expectations" doctrine. See also Jerry, *Insurance, Contract, and Doctrine*, *supra* note 1, at 32 ("Cardozo viewed reasonable expectations as a two-way street; each party was entitled to assert them as the other. Thus, in an insurance setting, Cardozo thought it as important to consider the reasonable expectations of insurers as it was to examine the expectations held by the insureds.").

and obligations, and to determine the meaning of disputed terms in the insurance contract, primarily by utilizing a number of interpretive rules involving: (1) contract ambiguity; (2) contract unconscionability and public policy issues; (3) the application of equitable remedies such as waiver, equitable estoppel, promissory estoppel, election, and reformation of contract to insurance coverage disputes; and (4) additional interpretive rules applied to standardized insurance contracts as contracts of adhesion.<sup>18</sup> A significant number of post-1970 judicial decisions continue to utilize this traditional contractually based reasonable expectations doctrine to resolve insurance contract coverage disputes.<sup>19</sup>

Thus, there are currently *two* competing and overlapping doctrines of reasonable expectations, both well established in theory and practice, that co-exist in American insurance law today.

### III. THE TRADITIONAL CONTRACTUALLY BASED INSURANCE LAW DOCTRINE OF REASONABLE EXPECTATIONS GENERAL PRINCIPLES

#### A. *Doctrine of Ambiguities*

The first general principle of an objective, contractually based insurance law doctrine of reasonable expectations involves the doctrine of ambiguities. Under this widely recognized rule of insurance contract interpretation, whenever an insurance policy is susceptible to two or more reasonable interpretations<sup>20</sup> so that an ambiguity exists, under the doctrine of *contra proferentem*, such ambiguous policy language will be strictly construed against the insurer who drafted the contract, and the language will be lib-

18. See, e.g., *Coast Mutual Bldg. & Loan Ass'n v. Security Title Ins. & Guar. Co.*, 57 P.2d 1392, 1393 (Cal. Ct. App. 1936) (holding that an insurance policy provision "must be construed so as to give the insured the protection which he reasonably had a right to expect, and to that end, doubts, ambiguities, and uncertainties arising out of the language used in the policy must be resolved in his favor"); see also *Ertlinger v. Importers & Exporters Ins. Co.*, 247 N.Y.S. 260 (N.Y. Sup. Ct. 1931); *Mohan v. Union Fidelity Life Ins. Co.*, 216 A.2d 342 (Pa. Super. 1966); *N.W. Elec. Power Cooperative v. American Motorists Ins. Co.*, 451 S.W. 2d 356 (Mo. Ct. App. 1969); *Harr v. Allstate Ins. Co.*, 255 A.2d 208 (N.J. 1969). Indeed, Professor Arthur Corbin, over a half century ago, listed his first "black letter" statement of the law of contracts as the "Main Purpose of Contract Law Is the Realization of Reasonable Expectations Induced by Promises." ARTHUR L. CORBIN, *THE LAW OF CONTRACTS*, § 1 at 1 (1952).

19. See, e.g., *Cody v. Remington Electric Shavers*, 427 A.2d 810 (Conn. 1980); *Strickland v. Gulf Life Ins. Co.*, 272 S.E.2d 148 (Ga. 1978); *Simkins Indus. Inc. v. Lexington Ins. Co.*, 401 A.2d 181 (Md. Ct. App. 1979); *Slater v. United States Fidelity & Guaranty Co.*, 400 N.E.2d 1256 (Mass. 1980). See generally COUCH'S CYCLOPEDIA, *supra* note 1, §§ 22:10-22:11; HOLMES' APPLEMAN ON INSURANCE LAW, *supra* note 1, § 8.6.

20. See *New Castle County v. Hartford Accident & Indem. Co.*, 933 F.2d 1162, 1182 (3d Cir. 1991) (insurance policy language considered ambiguous only if it "permits two or more reasonable interpretations"); *Norfolk & Western Ry. v. Accident & Casualty Ins. Co.*, 796 F. Supp. 929, 936 (W.D. Va. 1992) (similar holding).



erally construed in favor of the insured who was the nondrafting party.<sup>21</sup> Accordingly, most state and federal courts today have widely recognized the doctrine of ambiguities in its most generalized conceptual form.<sup>22</sup>

Yet, a closer analysis of the doctrine of ambiguities in an insurance law context demonstrates that a wide interpretive disparity still exists in how the courts actually apply this interpretive rule to specific insurance contract disputes. Some courts, for example, will apply the doctrine of ambiguities strictly against the insurer, irrespective of whether the insured was a “sophisticated policyholder,” and without resorting to any extrinsic evidence to resolve such uncertainty.<sup>23</sup> This rather severe and formalistic application of the doctrine of ambiguities in an insurance law context has been criti-

21. See generally RESTATEMENT OF CONTRACTS § 236(d) (1932); RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981); COUCH'S CYCLOPEDIA, *supra* note 1, §§ 21:11–21:15; HOLMES' APPLEMAN ON INSURANCE LAW, *supra* note 1, § 6.1; JERRY, UNDERSTANDING INSURANCE LAW, *supra* note 1, § 25A; WINDT, *supra* note 1, § 6.02. Thus, the doctrine of ambiguities is a widely recognized rule of contract interpretation in general, and insurance contract interpretation in particular, even though this rule has been subject to some criticism. See, e.g., Rahdert, *Reasonable Expectations Reconsidered*, *supra* note 1, at 330, 369–70. But see Jeffrey Stempel, *Reassessing the “Sophisticated” Policyholder Defense in Insurance Coverage Litigation*, 42 *DRAKE L. REV.* 807, 810–11 (1993):

*Contra proferentem* continues to have force when applied to many coverage questions because most policyholders are nondrafters who have nothing to say about the language of the [insurance] contract. Consequently, if someone has to lose a contract dispute, one can make a good case [that] it should not be the nondrafting policyholder. . . .

The complex nature of insurance, the information disparity between insurer and policyholder, the virtual necessity for insurance, and the industry's ability to collaborate on contract terms without legal liability (because of the McCarran-Ferguson Act's anti-trust exception for insurers) all make modern consumer insurance a stronger case for calling close questions in favor of the nondrafter than were presented in the customized land lease, sale of goods, and shipping contracts from which the ambiguity doctrine sprang. Thus, the implicit rationale of *contra proferentem* continues with some vigor. *Id.*; see also Swisher, *A Middle Ground Approach to Insurance Contract Disputes*, *supra* note 5, at 583–89.

22. See, e.g., *Agfa-Gevaert A.G. v. A.B. Dick Co.*, 879 F.2d 1518, 1521 (7th Cir. 1989) (applying N.Y. law) (“[T]he four-corners rule has now pretty much yielded to a rule that “extrinsic” evidence may be introduced not only if the written contract is ambiguous on its face, but also to show that it is ambiguous.”); see also *Harnett v. Southern Ins. Co.*, 181 So. 2d 524, 528 (Fla. 1965) (“So long as [insurance] contracts are drawn in such a manner that it requires the proverbial Philadelphia lawyer to comprehend the terms embodied in it, the courts should and will construe them liberally in favor of the insured and strictly against the insurer to protect the buying public who rely upon [the insurers and their agents] in such transactions.”); STEMPER, *LAW OF INSURANCE CONTRACT DISPUTES*, *supra* note 1, § 4.08.

23. See, e.g., *Adrian Associates v. National Surety Co.*, 638 S.W.2d 138, 140 (Tex. Ct. App. 1982) (language construction urged by the insured “must be adopted as long as the construction itself is not unreasonable, and even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the intent of the parties”); *Niagra County v. Utica Mut. Ins. Co.*, 427 N.Y.S.2d 171, 176 (Sup. Ct. 1980) (similar holding). A number of other courts also have refused to admit extrinsic evidence in insurance contract disputes involving the doctrine of ambiguities. See, e.g., *Eli Lilly & Co. v. Home Ins. Co.*, 794 F.2d 710, 714–16 (D.C. Cir. 1986) (applying Indiana law); *ACANDS, Inc. v. Aetna Cas. & Sur. Co.*, 764 F.2d 968, 973 (3d Cir. 1985) (applying Pennsylvania law).

cized by some recent commentators.<sup>24</sup> A large and growing number of other courts, however, have held that if the insurance policy terms are ambiguous, then extrinsic evidence should be permitted to ascertain the parties' true intent, and the *contra proferentem* rule interpreting ambiguous policy language in favor of the insured should be relied upon only as a "last resort" interpretive tiebreaker.<sup>25</sup>

Another important element involving the *contra proferentem* doctrine of ambiguities involves the so-called sophisticated policyholder defense. Normally, the terms of an insurance contract will be construed and interpreted in their ordinary sense, rather than in a purely technical or legal sense, from the viewpoint of the untrained mind or of the "common man or woman in the marketplace."<sup>26</sup> However, should a sophisticated policyholder, such as an insurance company involved in a reinsurance or excess insurance coverage dispute, or a large commercial policyholder with ready access to legal and technical assistance in procuring and understanding its insurance coverage, be entitled to this same interpretive rule as the untrained policyholder or the "common man or woman in the marketplace"? Again, the courts and commentators are split on this important issue.

Some courts have applied a strict contractual *contra proferentem* interpretation to every policyholder, irrespective of whether the insured policyholder was "sophisticated" or "unsophisticated" in procuring insurance

24. See, e.g., WINDT, *supra* note 1, at 368-69:

[Under this strict rule] once an ambiguity is discovered, courts may not look first to extrinsic evidence in order to eliminate the ambiguity; they may, instead, automatically resolve the ambiguity against the insurer. This can, of course, result in the creation of policy coverage when neither party intended or expected such coverage. This should not, therefore, be the law. . . .

The rule interpreting ambiguous policy language in favor of the insured should be relied on only as a last resort. It should not be permitted to frustrate the intention of the parties, if that intent can somehow be ascertained. As a result, courts should resort to the rule only if an evaluation of the pertinent extrinsic evidence does not indicate the parties' true intent.

*Id.*; see also OSTRAGER AND NEWMAN, *supra* note 1, at 5-7 (agreeing that the doctrine of ambiguities should only be applied "as a last resort," and the doctrine should not arise "unless it is first demonstrated that: (a) the policy is ambiguous; and (b) the ambiguity may not be resolved by resort to extrinsic evidence of intent").

25. See, e.g., Rainer Credit Co. v. Western Alliance Corp., 217 Cal. Rptr. 291, 295 (Cal. Ct. App. 1985); Inland Constr. Co. v. Home Indem. Co., 447 N.E.2d 1023, 1024 (Ill. Ct. App. 1983); General Am. Life Ins. Co. v. Barrett, 847 S.W.2d 125, 132 (Mo. Ct. App. 1993); see also Stempel, *supra* note 21, at 821 ("This notion of invoking the *contra proferentem* principle as a tie-breaker only after consideration of extrinsic evidence specific to the case is the better reasoned modern view of contract law.")

26. See, e.g., United States Fire Ins. Co. v. Colver, 600 P.2d 1, 3 (Alaska 1979); Barber v. Old Republic Life Ins. Co., 647 P.2d 1200, 1202 (Ariz. Ct. App. 1982); Pacific Indem. Ins. Co. v. Interstate Fire & Cas. Co., 488 A.2d 486, 488 (Md. 1985); Dixon v. Gunter, 636 S.W.2d 437, 441 (Tenn. Ct. App. 1982). See generally Swisher, *A Middle Ground Approach to Insurance Contract Disputes*, *supra* note 5, at 579-83.

coverage or in understanding the technical language within the insurance policy.<sup>27</sup> Other courts, however, have recognized that in the real world many insurance companies and large commercial corporations often are sophisticated policyholders, and therefore they should not be entitled to the doctrine of ambiguities as an interpretive rule, since this *contra proferentem* doctrine should be applied only to an unsophisticated policyholder or “common man or woman in the marketplace.”<sup>28</sup> But even under this latter approach, an underlying interpretive problem remains to determine who is a “sophisticated” policyholder and who is not.

“Sophisticated policyholder” has been defined in one insurance law treatise as commercial policyholders whose “business insurance policies . . . are typically negotiated (and often drafted) on behalf of the insured by sophisticated brokers, risk managers, and/or counsel. . . .”<sup>29</sup> However, this overly broad definition of “sophisticated policyholder” has come under attack by other commentators:

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27. See, e.g., *St. Paul Mercury Ins. Co. v. Grand Chapter of Phi Sigma Kappa*, 651 F. Supp. 1042 (E.D. Pa. 1987) (applying doctrine of ambiguities to commercial policyholders as well as to ordinary consumers unless parties possessed equal bargaining power); *Minier v. Travelers Indem. Co.*, 159 F. Supp. 230 (N.D. Ill. 1958) (doctrine of ambiguities is based, not upon the sophistication or bargaining power of the policyholder, but on concept that the insurer drafted the policy); *Outboard Marine Corp. v. Liberty Mut. Ins. Co.*, 607 N.E.2d 1204 (Ill. 1992) (sophistication of the insured is irrelevant); see also *Boeing Co. v. Aetna Cas. & Sur. Co.*, 784 P.2d 507 (Wash. 1990).

28. See, e.g., *Eastern Associated Coal Corp. v. Aetna Cas. & Sur. Co.*, 632 F.2d 1068, 1080 (3d Cir. 1980) (applying Pennsylvania law) (“If an ambiguity does exist and if the insurer wrote the policy or is in a stronger bargaining position than the insured, the ambiguity is generally resolved in favor of the insured and against the insurer. However, the principle that ambiguities in policies should be strictly construed against the insurer does not control the situation where large corporations, advised by counsel and having equal bargaining power, are the parties to a negotiated policy.”); *Eagle Leasing Corp. v. Hartford Fire Ins. Co.*, 540 F.2d 1257, 1261 (5th Cir. 1976) (applying Missouri law) (“We do not feel compelled to apply, or indeed, justified in applying the general rule that an insurance policy is construed against the insurer in the commercial insurance field when the insured is not an innocent, but a corporation of immense size, carrying insurance with annual premiums of six figures, managed by sophisticated business men, and represented by counsel on the same professional level as the counsel for the insurers.”); see also *Halpern v. Lexington Ins. Co.*, 715 F.2d 191 (5th Cir. 1983).

29. See BARRY OSTRAGER AND THOMAS NEWMAN, *HANDBOOK ON INSURANCE CONTRACT DISPUTES* § 1.03[c], at 26 (7th ed. 1994). In a later edition to their treatise, Ostrager and Newman state that:

The courts that have declined to apply the *contra-insurer* rule [to sophisticated policyholders] have relied on evidence establishing the equivalence of bargaining power between the insurer and the insured, including: (1) the large size of the business insured, (2) the involvement of counsel on behalf of the insured in the negotiation of the policy, (3) the representation of the insured by an independent broker in the negotiation of the policy, (4) the use of a “manuscript” policy [an individually negotiated and drafted policy, rather than a standard form policy], (5) the “insurance” sophistication of the insured, (6) whether the dispute is between two insurance companies, and (7) whether the parties possess equal bargaining power.

OSTRAGER AND NEWMAN, *supra* note 1, at 26–36 (9th ed. 1998).

The first obvious problem with the sophisticated policyholder argument is that standard form insurance policies contain no "sophisticated" policyholder exclusion, although nothing prevents the insurance industry from drafting one.<sup>30</sup> That a "sophisticated" policyholder exclusion does not exist is strong evidence that insurance companies never intended to treat commercial and individual policyholders differently. In fact, insurance companies apparently have no specific criteria to determine what constitutes a "sophisticated" policyholder. One insurance company argued (unsuccessfully) that a policyholder who had graduated from business school was a sophisticated policyholder.<sup>31</sup> The slippery slope character of the "sophisticated" policyholder argument is self-evident.

Holding commercial policyholders to a higher standard based on nebulous factors such as size and wealth "suggests that big companies ought to receive less insurance coverage than small companies, notwithstanding that big companies pay big premiums for their coverage."<sup>32</sup> The size or wealth of a commercial policyholder has nothing to do with its understanding of the language in its insurance policy.

The truth is that America's largest corporations purchase standard form policy language just like everybody else.<sup>33</sup> In fact, most large commercial policyholders do not purchase "manuscript" policies, and policies that insurance companies purport to be manuscript policies are often no more than a typewritten version of the standard form language.<sup>34</sup>

Thus, since not all commercial policyholders will be sophisticated policyholders, those courts that do recognize the sophisticated policyholder defense should be very hesitant to apply this troublesome exception to the doctrine of ambiguities unless the policyholder clearly meets a number of necessary requirements to determine whether or not the policyholder is "sophisticated." Professor Jeffrey Stempel recommends that courts employ the following factors:

First, courts should consider the actual identity of the drafter. At the outset, commentators and courts should distinguish more carefully between situations in which the policyholder is merely a sophisticated party adhering to a standardized contract of adhesion, and those cases in which the policyholder is more than the consumer of a prefabricated insurance product. . . . Second,

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30. See generally Carl A. Salisbury, *Pollution Liability Insurance Coverage, the Standard-Form Pollution Exclusion, and the Insurance Industry: A Case Study in Collective Amnesia*, 21 ENVTL. L. 357, 362-363 (1991).

31. See generally *Brotherhood Mut. Ins. Co. v. Roseth*, 532 N.E.2d 354 (Ill. Ct. App. 1988).

32. See generally Salisbury, *supra* note 30, at 362.

33. Citing to David B. Goodwin, *Disputing Insurance Coverage Disputes*, 43 STANFORD L. REV. 779, 796-97 (1991) (listing examples of cases involving large policyholders with insurance policies containing unvaried standard form language).

34. Anderson and Fournier, *supra* note 1, at 369-71. *But see* Stempel, *supra* note 21, at 855-57.

courts should consider broker presence and activity. . . . Third, courts must consider attorney presence and activity. . . . Fourth, courts should consider the degree of negotiation surrounding the policy and whether it is fairly characterized as "customized" rather than standardized. . . . Fifth, courts must consider whether, regardless of the drafter's identity, the term in dispute is really ambiguous if examined in light of the parties and the facts. . . . Sixth, courts should consider the understanding conveyed by the oral and written conduct of the parties surrounding the negotiation, finalization, and implementation of the policy. . . . Seventh, courts should consider the presence of an objectively reasonable expectation of or reasonable reliance upon coverage due to no fault of the policyholder. . . . Eighth, courts should consider the presence of a genuine contractual relationship between the disputants. . . . Ninth, courts must consider the presence of extrinsic evidence. . . . Tenth, courts should consider whether, in the absence of more probative evidence of contract meaning, it is fundamentally fair to invoke *contra proferentem* against the insurer. . . . Finally, courts must consider the impact of policyholder sophistication on contract doctrines other than ambiguity. . . .<sup>35</sup>

In resolving any insurance contract ambiguity, therefore, a court must assess the two or more reasonable competing interpretations offered by the parties in order to decide which interpretation is to be preferred. Over the years the courts have established certain interpretive rules, found in a wealth of judicial precedent and commentary,<sup>36</sup> and largely codified in the *Restatement (Second) of Contracts*.<sup>37</sup> These important interpretive rules include the following:

(1) In choosing among reasonable alternative meanings in an agreement or terms within that agreement, the meaning that operates against the drafting party is generally preferred;<sup>38</sup>

(2) Words and other conduct are interpreted in the light of all the circumstances, and if the principal purpose of the parties is ascertainable, it is given great weight;<sup>39</sup>

(3) A writing is interpreted as a whole, and all writings that are part of the same transaction are interpreted together;<sup>40</sup>

35. Stempel, *supra* note 21, at 849–57. See also OSTAGER AND NEWMAN, *supra* note 29; STEMPER, LAW OF INSURANCE CONTRACT DISPUTES, *supra* note 1, § 4.11.

36. See generally 3 CORBIN ON CONTRACTS §§ 532–560 (1960); WINDT, *supra* note 1, § 6.02.

37. RESTATEMENT (SECOND) OF CONTRACTS §§ 201, 202, 203, 206, and 207 (1981).

38. See RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981) (citing with approval 3 CORBIN ON CONTRACTS § 559 (1960 and Cum. Supp. 1980) and SAMUEL WILLISTON, 4 A TREATISE ON THE LAW OF CONTRACTS § 621 (Walter H.E. Jaeger ed., 3d ed. 1961)). Once again, this rule does not apply if the nondrafting party's interpretation is unreasonable. See, e.g., *Intertherm Inc. v. Coronet Corp.*, 558 S.W.2d 344 (Mo. Ct. App. 1977). This is the "basic bedrock insurance rule of *contra proferentem*." HOLMES' APPLEMAN ON INSURANCE LAW, *supra* note 1, § 5.8 at 99 (2d ed. 1996).

39. See RESTATEMENT (SECOND) OF CONTRACTS § 202(1) (1981).

40. *Id.* § 202(2).

(4) Where language has a generally prevailing meaning, it is interpreted in accordance with that meaning;<sup>41</sup>

(5) Technical terms and words of art are given their technical meaning when used in a transaction within their technical field;<sup>42</sup>

(6) Where an agreement involves repeated performances, any course of performance accepted or acquiesced by the other party is given great weight in the interpretation of the agreement;<sup>43</sup>

(7) Whenever reasonable, the terms of the agreement are to be interpreted as consistent with each other, and with any relevant course of performance, course of dealing, or trade usage;<sup>44</sup>

(8) An interpretation that gives a reasonable, lawful, and effective meaning to all the terms is preferred to an interpretation that leaves a part unreasonable, unlawful, or of no effect;<sup>45</sup>

(9) Express terms are given greater weight than terms implied from a course of performance, course of dealing, and usage of trade; course of performance is given greater weight than course of dealing or usage of trade; and course of dealing is given greater weight than usage of trade;<sup>46</sup>

(10) Specific terms and exact terms are given greater weight than general language;<sup>47</sup>

(11) Separately negotiated or added terms are given greater weight than standardized terms or other terms not separately negotiated<sup>48</sup> so if provisions of a policy endorsement are in conflict with the body of the policy, the endorsement will control,<sup>49</sup> and typewritten provisions will supersede printed provisions when the two conflict;<sup>50</sup>

(12) In choosing among the reasonable meanings of a promise or agreement, or a term thereof, a meaning that serves the public interest is generally preferred.<sup>51</sup>

These interpretive rules in resolving insurance contract ambiguities, however, were not established in a vacuum, and various interpretive co-

41. *Id.* § 202(3)(a).

42. *Id.* § 202(3)(b).

43. *Id.* § 202(4).

44. *Id.* § 202(5).

45. *Id.* § 203(a).

46. *Id.* § 203(b).

47. *Id.* § 203(c).

48. *Id.* § 203(d).

49. *See, e.g.,* *Certain Underwriters at Lloyd's v. Eng's Motor Truck Co.*, 185 Cal. Rptr. 613, 614 (Cal. Ct. App. 1982); *Central Ill. Pub. Serv. Co. v. Allianz Underwriters Ins. Co.*, 608 N.E.2d 155, 159 (Ill. Ct. App. 1992); *County of Columbia v. Continental Ins. Co.*, 634 N.E.2d 946, 950 (N.Y. 1994).

50. *See, e.g.,* *Eureka Investment Corp. v. Chicago Title Ins. Co.*, 530 F. Supp. 1110, 1118 (D.D.C. 1982); *Maryland Cas. Co. v. Carolina Cas. Ins. Co.*, 445 A.2d 535, 536 (Pa. Super. Ct. 1982).

51. *See* RESTATEMENT (SECOND) OF CONTRACTS § 207 (1981).

nundrums continue to exist in many contemporary American insurance coverage disputes, as will be discussed more fully below.<sup>52</sup>

### B. Contract Unconscionability and Public Policy Issues

Although some courts and commentators believe that a traditional, contractually based doctrine of reasonable expectations is limited only to the judicial application of the doctrine of ambiguities,<sup>53</sup> there is a second, and equally powerful, basis for ascertaining the reasonable expectations of the parties: whether or not a particular insurance contract, or any term or provision within that insurance contract, is unconscionable. Moreover, where *Restatement (Second) of Contracts* section 206 (1981) has been described as the “basic bedrock rule” supporting the contra proferentem doctrine of ambiguities,<sup>54</sup> the “basic bedrock rule” for interpreting contract unconscionability is *Restatement (Second) of Contracts* section 208 (1981). Section 208 provides the following:

If a contract or term thereof is unconscionable at the time the contract is made a court may refuse to enforce the contract, or may enforce the remainder of the contract without the unconscionable term, or may so limit the application of an unconscionable term as to avoid any unconscionable result.<sup>55</sup>

Since the concept of contract unconscionability is rather vague,<sup>56</sup> the scope of section 208 is arguably very broad, and may be liberally construed by the courts:

Like the obligation of good faith and fair dealing (section 205),<sup>57</sup> the policy against unconscionable contracts or terms applies to a wide variety of types of

52. See *infra* notes 86–127 and accompanying text.

53. See *supra* notes 20–51 and accompanying text. A number of courts still insist upon the existence of an ambiguity as a prerequisite for a court to apply the doctrine of reasonable expectations. See, e.g., *Wellcome v. Home Ins. Co.*, 849 P.2d 190 (Mont. 1993) (holding that the insured’s reasonable expectation to coverage contrary to the clear and unambiguous policy language is not “objectively reasonable”); see also *Sturla v. Fireman’s Fund Ins. Co.*, 684 P.2d 960 (Haw. 1984); *Silk v. Flat Top Constr. Co.*, 453 S.E.2d 356 (W. Va. 1994). See generally *Jerry, Insurance, Contract, and Doctrine*, *supra* note 1, at 139–40.

54. See *supra* notes 21 and 38 and accompanying text.

55. RESTATEMENT (SECOND) OF CONTRACTS § 208 (1981).

56. See, e.g., SAMUEL WILLISTON, 8 A TREATISE ON THE LAW OF CONTRACTS § 18.8 at 46–47 (Richard A. Lord ed., 4th ed. 1998):

Unconscionability is a vague concept that the courts, practicing attorneys, and contract drafters have struggled with since well before the widespread adoption of the [Uniform Commercial Code, § 2–302–1]. The Uniform Commercial Code does not provide a definition for the term “unconscionable,” but gives the courts broad latitude in determining, either on their own initiative or based on an assertion by a party, that a particular contract or clause was unconscionable *as a matter of law* at the time the agreement was made.

*Id.*

57. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981). See generally DENNIS J. WALLS, LITIGATION AND PREVENTION OF INSURER BAD FAITH (2d ed. 1994); WILLIAM SHERNOFF ET AL., INSURANCE BAD FAITH LITIGATION (1984); *Symposium on the Law of Bad Faith in Contract and Insurance*, 72 TEX. L. REV. 1203 (1994).

conduct. The determination that a contract or term is or is not unconscionable is made in the light of its settling, purpose, and effect. Relevant factors include weaknesses in the contracting process like those involved in more specific rules as contractual capacity, fraud, and other invalidating causes; the policy also overlaps with rules that render particular bargains or terms unenforceable on grounds of public policy. Policing against unconscionable contracts or terms has sometimes been accomplished "by adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract."<sup>58</sup> Particularly in the case of standardized agreements, the rule of this section permits the court to pass directly on the unconscionability of the contract or clause rather than to avoid unconscionable results by interpretation.<sup>59</sup>

The genesis of this unconscionability rule in an insurance law context is the recognition that most insurance contracts, rather than being the result of anything resembling equal bargaining between the parties, are often contracts of adhesion<sup>60</sup> in which many insureds face two options: (1) accept the standard insurance policy offered by the insurer; or (2) go without insurance. The unconscionability rule therefore essentially states that: (1) an insured's reasonable expectation to coverage on reading the policy should guide policy construction; and (2) policy provisions should not be construed to reach a result that is unconscionable.<sup>61</sup> This unconscionability rule is the outgrowth of ordinary contract law, which has long recognized that some terms in a contract of adhesion are so one-sided that they should not be enforced, even if the parties were both aware of the intended effect of such contractual provisions at the time of contracting.<sup>62</sup>

Thus, according to *Williston on Contracts*, although freedom of contract has been regarded as an important part of our common law heritage, so that absent mistake, fraud, or duress, parties who have made a contract are generally bound by their contract (even though it may be an unwise or foolish contract), a court of equity may refuse to enforce contractual agreements when, in its discretion, the contractual terms have been deemed to be unconscionable.<sup>63</sup> This applies with equal force to insurance contracts as well.<sup>64</sup>

Contract unconscionability may be procedural or substantive:

58. Uniform Commercial Code § 2-302 cmt. 1.

59. RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. a (1981).

60. See PART V *infra* notes 128-44 and accompanying text.

61. See COUCH'S CYCLOPEDIA, *supra* note 1, § 22:11, at 22-23.

62. *Id.* at 22-27; see also HOLMES' APPLEMAN ON INSURANCE LAW, *supra* note 1, § 8.6.

63. See WILLISTON ON CONTRACTS, *supra* note 56, § 18.1 at 2-9 (4th ed.).

64. *Id.* § 18.5; see also *Allstate Ins. Co. v. Royal Globe Ins. Co.*, 481 A.2d 298 (N.J. Super. Ct. App. Div. 1984); *State Farm Mut. Auto. Ins. Co. v. Atlantic Indem. Co.*, 468 S.E.2d 570 (N.C. Ct. App. 1996); *Bishop v. Washington*, 480 A.2d 1088 (Pa. Super. Ct. 1984).



The concept of unconscionability was meant to counteract two generic forms of abuses: the first of which relates to procedural deficiencies in the contract formation process, such as deception or refusal to bargain over contract terms, today often analyzed in terms of whether the imposed-upon party had meaningful choice about whether and how to enter into the transaction; and the second of which related to the substantive contract terms themselves and whether those terms are unreasonably favorable to the more powerful party, such as terms that impair the integrity of the bargaining process or otherwise contravene the public interest or public policy. . . .<sup>65</sup>

Moreover, since the insurance business is influenced by a strong public interest,<sup>66</sup> and is regulated through state legislative statutes, judicial decisions,<sup>67</sup> and administrative regulations,<sup>68</sup> it is appropriate that public policy should influence the determination of insurance coverage disputes.<sup>69</sup> Thus, a determination of whether an insurance policy provision is in violation of state public policy is another important component found in the rule prohibiting unconscionable insurance contracts.<sup>70</sup>

### C. *Judicial Application of Equitable Remedies, Including Waiver, Estoppel, Election, and Contract Reformation*

A third, and increasingly powerful, judicial validation of the contractually based reasonable expectations doctrine is found in the application of certain equitable remedies, including waiver, estoppel, election, and reformation

65. See WILLISTON ON CONTRACTS, *supra* note 56, § 18.10 at 57 (4th ed.).

66. Insurance is affected with a strong public interest, and thus an insurer's alleged constitutional right to contract with its insureds free from state regulation will be rejected by the courts unless the objectives of state statutory, judicial, and administrative regulation go well beyond the reasonable and legitimate interest of the state. See *California State Auto. Ass'n Inter-Ins. Bureau v. Maloney*, 341 U.S. 105 (1951). See generally Spencer Kimball, *The Purpose of Insurance Regulation*, 45 MINN. L. REV. 471, 490-91 (1961) (defining insurance law as hybrid of contractual law and state statutes that seek to enable the insured to enter into a fair and equitable contract).

67. See generally Spencer Kimball and Werner Pfennigstorf, *Legislative and Judicial Control of the Terms of Insurance Contracts*, 39 IND. L.J. 675 (1964).

68. See generally Spencer Kimball and Werner Pfennigstorf, *Administrative Control of the Terms of Insurance Contracts*, 40 IND. L.J. 143 (1965).

69. The test of whether or not an insurance contract is void as against public policy is whether it is injurious to the public or contravenes some important established social interest, or when its purpose is to promote, effect, or encourage a violation of law. See *L'Orange v. Medical Protective Co.*, 394 F.2d 57 (6th Cir. 1968) (applying Ohio law); see also *Kirk v. Financial & Life Ins. Co.*, 389 N.E.2d 144, 147-48 (Ill. 1978) (insurance department approval of policies of insurance is entitled to great weight against contention that such a provision is against public policy); *Scarborough v. Travelers Ins. Co.*, 718 F.2d 702, 709 (5th Cir. 1983) (holding that an insurance policy is the "law between the parties" and must be enforced as written unless the insurance policy provisions are contrary to state public policy or statutory law). See generally *supra* notes 45 and 51 and accompanying text.

70. See generally HOLMES' APPLEMAN ON INSURANCE LAW, *supra* note 1, §§ 9.1-9.8; STEMPER, LAW OF INSURANCE CONTRACT DISPUTES, *supra* note 1, § 4.10; Swisher, *Judicial Rationales in Insurance Law*, *supra* note 5, at 1062-66.

of contract. Although these equitable remedies traditionally were not grouped under a reasonable expectations rubric, a growing number of commentators and courts now include them as important components of any reasonable expectations doctrinal analysis and discussion.<sup>71</sup> For example, Professor Eric Holmes discusses these interrelated interpretive components as follows:

In the latter half of the 20th century, courts have been making an equitable adjustment of the rights and obligations under mass-standardized insurance contracts of adhesion. In the 19th and early 20th centuries, courts (somewhat covertly) equitably readjusted the traditional, formal contract law of interpretation and construction by applying "*contra proferentem*" (construing ambiguities against the insurers), waiver, election, reformation and rescission, as well as equitable estoppel. Modern courts, more forthrightly, are invoking their equity jurisdiction and applying equitable principles, such as good faith, unconscionability, honoring objectively reasonable expectations . . . as well as promissory estoppel.<sup>72</sup>

These equitable remedies are largely justified by the fact that insurance coverage today is sold by a multitude of insurance agents who often emphasize the insured's "peace of mind" and reasonable expectation of coverage,<sup>73</sup> even though an insured seldom reads his or her policy,<sup>74</sup> and even though there may be a number of contractual conditions, limitations, and exclusions within the insurance policy that the insurer subsequently may cite in order to void the policy and defeat coverage.<sup>75</sup> Since forfeiture of coverage is not favored under insurance law, many courts are inclined to look for any circumstance that indicates a willingness by the insurer to waive any forfeiture of coverage, or that precludes the insurer under principles of estoppel from enforcing such a forfeiture of coverage.<sup>76</sup>

In its traditional sense, waiver has been defined as the voluntary and intentional relinquishment of a known right, which may result from either the affirmative acts of the insurer or its authorized agents, or from the insurer's inaction, with knowledge of the applicable facts.<sup>77</sup>

71. See, e.g., HOLMES' APPLEMAN ON INSURANCE LAW, *supra* note 1, at 283-92; Swisher, *A Middle Ground Approach to Insurance Contract Disputes*, *supra* note 5, at 589-96.

72. See HOLMES' APPLEMAN ON INSURANCE LAW, *supra* note 1, at 364.

73. See, e.g., Robert Jerry II, *Remedying Insurers' Bad Faith Contract Performance: A Reassessment*, 18 CONN. L. REV. 271, 298-99 (1986) (insurance agents often emphasize the catastrophic effects of loss, and the "peace of mind" that insurance provides, when attempting to convince a prospective insured to purchase insurance coverage).

74. See, e.g., Powers v. Detroit Auto. Inter-Ins. Exchange, 398 N.W.2d 411, 413 (Mich. 1986) (very few insureds read the purchased contract, and query whether they would understand it if they did).

75. See generally Tom Baker, *Constructing the Insurance Relationship: Sales Stories, Claims Stories, and Insurance Contract Damages*, 72 TEX. L. REV. 1395 (1994).

76. See, e.g., COUCH'S CYCLOPEDIA, *supra* note 1, § 22:36 (citing numerous illustrative cases).

77. See, e.g., *Kramer v. Metropolitan Life Ins. Co.*, 494 F. Supp. 1026 (D.N.J. 1980); Hen-

Professor Jerry observes that in the context of contemporary insurance contract disputes, the term “waiver” has been used in so many different ways by the courts, and with “numerous confusing and contradictory definitions” of the term. Nevertheless, Professor Jerry concludes that “from the perspective of a court that needs a principle on which to rest a particular result, the doctrine of waiver can be of considerable assistance in deciding cases. In other words, the doctrine has considerable potential for flexible application by courts to achieve justice in particular situations where other doctrines seem inappropriate.”<sup>78</sup>

Estoppel, on the other hand, does not require any actual surrender of a known right, which is generally required for waiver. Instead, the doctrine of estoppel implies some misleading act, conduct, or inaction on the part of the insurer or its agent, upon which the insured detrimentally relies.<sup>79</sup> Moreover, a growing number of courts have begun to apply the doctrine of promissory estoppel to insurance coverage disputes as well.<sup>80</sup>

The doctrine of election is a hybrid legal remedy between waiver and estoppel. It contemplates a rule of law that restricts the actor—normally the insurer—to a choice from among a limited number of legal options. It is similar to estoppel because it is an imposed rule of law, and it is similar

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son v. Celtic Life Ins. Co., 621 So. 2d 1268 (Ala. 1993); *Progressive Cas. Ins. Co. v. Ehrhardt*, 518 A.2d 151 (Md. Ct. App. 1986). See generally WINDT, *supra* note 1, at 468–73. Waiver principles have long been recognized and are well-established supplemental rules of American contract law. See ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS §§ 8.5, 8.19 (1990); ARTHUR L. CORBIN, CORBIN ON CONTRACTS §§ 752–766 (1 vol. ed. 1952); see also COUCH ON INSURANCE, *supra* note 1, § 85.1–85:64; HOLMES’ APPLEMAN ON INSURANCE LAW, *supra* note 1, §§ 8.1–8.4.

78. Jerry, *Insurance, Contract, and Doctrine*, *supra* note 1, at 147.

79. See *Loyola Univ. v. Humana Ins. Co.*, 996 F.2d 895, 902 (7th Cir. 1993) (applying Illinois law) (“estoppel occurs when one party knowingly represents or conceals a material fact and the other party, not knowing the truth, reasonably relies on the misrepresentation or concealment to his [or her] detriment”); see also COUCH’S CYCLOPEDIA, *supra* note 1, §§ 85:2–85:64; HOLMES’ APPLEMAN ON INSURANCE LAW, *supra* note 1, §§ 8.1–8.4. Increasingly, the courts are viewing estoppel in terms of the standard set forth in the *Restatement (Second) of Contracts*:

(1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.

The remedy granted for breach may be limited as justice requires.

RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981). Estoppel, like waiver, has long been recognized and established as a supplemental rule of American contract law. See FARNSWORTH, *supra* note 77, §§ 2.19, 6.12; CORBIN, *supra* note 77, §§ 93–209; STEMPEL, LAW OF INSURANCE CONTRACT DISPUTES, *supra* note 1, § 5.03.

80. Promissory estoppel evolved historically from equitable estoppel. Both forms of estoppel require the element of detrimental and reasonable reliance, but where equitable estoppel is defensive (and cannot create insurance coverage) promissory estoppel is offensive (and may affirmatively create insurance coverage). See generally 3 CORBIN ON CONTRACTS §§ 8.1–8.13; HOLMES’ APPLEMAN ON INSURANCE LAW, *supra* note 1, § 8.5; STEMPEL, LAW OF INSURANCE CONTRACT DISPUTES, *supra* note 1, § 5.05. See also Eric Mills Holmes, *Restatement of Promissory Estoppel*, 32 WILLAMETTE L. REV. 263 (1996). But see Charles L. Knapp, *Rescuing Reliance: The Perils of Promissory Estoppel*, 49 HASTINGS L.J. 1191 (1998).

to waiver because a choice must still be made by the actor.<sup>81</sup> According to Professors Keeton and Widiss, although the concept of election is more troublesome for the courts to employ than either waiver or estoppel, it is often more useful for the insured to utilize since it does not require the voluntary relinquishment element of waiver or the detrimental reliance factor of estoppel.<sup>82</sup>

The insured has a final contractual remedy to safeguard his or her reasonable expectation to coverage in the form of contract reformation. If an insurance agent makes an innocent or fraudulent representation to the insured regarding policy coverage, the insured may bring an action for reformation of the insurance contract based upon a mutual mistake of the parties, or based upon mistaken or fraudulent representations or conduct of the insurer or its agent who issued the policy.<sup>83</sup>

Thus, as this author concluded in an earlier law review article:

The legal doctrines of waiver, estoppel, election, and reformation of contract, as utilized in a realistic middle ground interpretive approach to insurance coverage disputes, therefore provide additional parameters for judicial discretion in recognizing and honoring the insured's reasonable expectation of coverage that are supplemental to—rather than at variance with—the terms of the parties' insurance contract.<sup>84</sup>

#### IV. THE WILLISTON SCHOOL OF INSURANCE CONTRACT INTERPRETATION VERSUS THE CORBIN SCHOOL AND A CONSENSUS SOLUTION

##### A. Introduction

It is generally acknowledged that the interpretation of insurance contract disputes is the function of the judge, as a matter of law, rather than of the

81. See, e.g., *Walker v. Republic Underwriters Ins. Co.*, 574 F. Supp. 686 (D. Minn. 1983); *Home Indem. Co. v. Bush*, 513 P.2d 145 (Ariz. Ct. App. 1973) (both involving property insurance elections to repair or replace the building or pay a monetary claim). The doctrine of election may also be applied against the insured. See *Dunn v. Way*, 786 P.2d 649 (Mont. 1990) (holding that the insureds' failure to elect whether they wished to replace destroyed items under their homeowners' insurance policy or seek reimbursement from the insurer on the basis of depreciated costs precluded a suit against the insurer); see also FARNSWORTH, *supra* note 77, § 8.19.

82. See generally KEETON AND WIDISS, *supra* note 1, at 618–20.

83. See, e.g., *Continental Cas. Co. v. Didier*, 783 S.W.2d 29 (Ark. 1990) (holding that a written instrument may be reformed if there has been a mistake by one party accompanied by fraud or other inequitable conduct by the other party); *Magnus v. Barrett*, 557 N.E.2d 252 (Ill. Ct. App. 1990) (holding that reformation of contract would be allowed only when clear and convincing evidence compels the conclusion that the contractual instrument as it stands does not properly reflect the intention of the parties, and that there has been either a mutual mistake by the parties or a mistake by one party and fraud by the other). See generally FARNSWORTH, *supra* note 77, § 7.5; COUCH'S CYCLOPEDIA, *supra* note 1, §§ 26:1–28:21; Irwin J. Schiffres, Annotation, *Reformation of Insurance Policy to Correctly Identify Risks and Causes of Loss*, 32 A.L.R. 3d 661–735 (1970).

84. Swisher, *A Middle Ground Approach to Insurance Contract Disputes*, *supra* note 5, at 596.

jury.<sup>85</sup> But what interpretive principles should a judge utilize in order to resolve insurance coverage disputes? Throughout most of the twentieth century, and arguably well into the twenty-first century, many courts, practitioners, and legal scholars have battled for what Professor Robert Jerry calls “the soul of contract law”:

On one side are the formalists or classicists, whose champions are Professor Williston and the first *Restatement of Contracts*. The formalists care mightily about texts and the four corners of documents. They believe that words often have a plain meaning that exists independently of any sense in which the speaker or writer may intend the words. They insist that a court or a party can discern the meaning of contractual language without asking about the intentions or expectations of the parties. They contend that interpretation is appropriate only if an ambiguity appears on the face of the document, which means that the parties by their own testimony about what they intended or expected cannot create an ambiguity where none exists. . . . In the world of the formalists, an insurer that drafts a clear form should be entitled to rely on that form in setting rates without worrying that a court will disregard the finely tuned, clear language. . . .

The other contestants in the battle for the soul of contract law are the functionalists, who are sometimes also labeled as the progressives, the realists, or the post-classicists. The champions of this side are Professor Corbin and the *Restatement (Second) of Contracts*. The functionalists care less about the text of contracts, believing it to be most useful as an articulation of the objective manifestations of the contracting parties and as a means to understanding their intentions and expectations. . . . Text does not have inherent meaning, but text means what the drafter or speaker knows or should know the other side will understand those words to mean in context. . . . Where a form is standardized, the functionalists substitute objectively reasonable expectations for whatever the particular recipient of the form understood, given that the recipient has less reason to know what the drafter means, while the drafter has insights into what the ordinary, reasonable recipient of the form is likely to understand.<sup>86</sup>

### B. *The Williston School of Insurance Contract Interpretation*

In an insurance law context, legal formalism is best exemplified by the seminal writings and major influence of Professor Samuel Williston relat-

85. See, e.g., *Parsons v. Bristol Dev. Co.*, 402 P.2d 839, 842 (Cal. 1965) (according to Justice Traynor, insurance contract interpretation is “solely a judicial function” unless the interpretation turns on the credibility of extrinsic evidence.). See generally COUCH’S CYCLOPEDIA, *supra* note 1, at § 21:3 (the construction and effect of a written contract of insurance is a matter of law, to be determined by the court and not by the jury); RESTATEMENT (SECOND) OF CONTRACTS § 212 (1981) (interpretation of an integrated agreement to be determined by trier of fact if it depends on credibility of extrinsic evidence or on a choice among reasonable inferences to be drawn from extrinsic evidence; otherwise it is a question of law).

86. Jerry, *Insurance, Contract, and Doctrine*, *supra* note 1, at 55–56. See also JERRY, UNDERSTANDING INSURANCE LAW, *supra* note 1, § 25a at 129–34; Swisher, *A Middle Ground Approach to Insurance Contract Disputes*, *supra* note 5, at 1037–58; *infra* note 99 and accompanying text.

ing to American contract law in general, and American insurance law in particular.<sup>87</sup> The bedrock principle underlying Williston's formalistic view of insurance contract interpretation is that an insurance policy must be construed and enforced according to general principles of contract law,<sup>88</sup> and courts therefore are not at liberty to reinterpret or modify the terms of a clearly written and unambiguous insurance policy, but must look at the "plain meaning" of the insurance contract:

Under the guise of interpretation, courts are repeatedly importuned to give a meaning to the writing under consideration, which is not to be found in the instrument itself, but which is based entirely on direct evidence of intention. And just as steadfastly, the courts reiterate the well-established principle that it is not the function of the judiciary to change the obligations of a contract which the parties have seen fit to make.<sup>89</sup>

Nevertheless, Professor Williston also recognized a number of contractual rights and remedies under this formalistic and textual interpretive approach to American contract law in order to ascertain and protect the reasonable expectations of the insured to coverage, when appropriate, including recognition of the doctrine of ambiguities,<sup>90</sup> contract unconscionability and public policy factors,<sup>91</sup> and other equitable contractual remedies.<sup>92</sup> Indeed, Professor Williston always recognized that judges do have the discretion to modify the terms of a contract when justice requires:

When it is said that courts will neither make nor modify contracts, nor dispense with their performance, it is meant that such power will not be exercised except in accordance with legal principles, the statement is sound; but if the meaning is that parties to contracts are always liable in accordance with their terms, it is far too narrow a limitation of the functions of the common law, and a court which insists upon such a statement obliges itself in various situations to use the confusing language of fiction in order to achieve correct

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87. See, e.g., SAMUEL WILLISTON, *THE LAW OF CONTRACTS* (1921); WILLISTON ON CONTRACTS, *supra* note 38 (3d ed.); WILLISTON ON CONTRACTS, *supra* note 56 (4th ed.). Professor Williston was also the Reporter for the *Restatement of the Law of Contracts* (1928).

88. See, e.g., 7 WILLISTON ON CONTRACTS § 900, at 28, *supra* note 38 (3d ed.) (unless contrary to statute or public policy, contract of insurance will be enforced according to its terms).

89. See *id.* § 610, at 511; see also 2 WILLISTON ON CONTRACTS § 6:3, *supra* note 56 (4th ed.) ("[S]ince the formation of . . . contracts depends not upon an actual meeting of the minds, but merely upon manifestations of assent, an actual intention to accept is unimportant except where the acts or words of the offeree are ambiguous.").

90. See *supra* notes 20–51 and accompanying text; see also 4 WILLISTON ON CONTRACTS §§ 621, 627, *supra* note 38 (3d ed.).

91. See *supra* notes 55–70 and accompanying text; see also 14 WILLISTON ON CONTRACTS §§ 1632–1633, *supra* note 38 (3d ed.).

92. See *supra* notes 71–84 and accompanying text; see also 5 WILLISTON ON CONTRACTS, §§ 275–279, 678–679, 745, 752, 763, *supra* note 38 (3d ed. 1961). Professor Williston also recognized the doctrine of promissory estoppel. *Id.* §§ 691–692.

results. Under the name of implied contracts (quasi-contracts) courts have wisely imposed obligations on parties to contracts which they never agreed to assume; and because of fraud, mistake, duress, impossibility and illegality, have modified contracts or dispensed with their performance, simply because justice required it.<sup>93</sup>

Thus, a wise judge can still openly “do justice” under Professor Williston’s formal and textual interpretive approach to insurance contract law, as long as that judge operates within the established parameters of recognized contractual rights, rules, obligations, and remedies.

It may not be readily apparent to many jurists, practitioners, and academic lawyers studying insurance law today, but in the early years of the twentieth century, American insurance law was in sorry shape and badly needed some uniformity and predictability in order to establish realistic and viable legal rules for settling insurance coverage disputes. Professor William Vance described this interpretive conundrum in 1911:

Policies became overgrown with a wilderness of warranties [and other limitations to coverage], many of the most trivial character, in which the rights of the policyholder, however honest and careful, were in grave danger of being lost. It was necessary for the courts to go to the rescue of the public. . . . The unseemly struggle that ensued between the unwise insurers who sought so to frame their policies as to compel the courts to allow them the dishonest benefit of forfeitures unsuspected by the insured, and the courts who sought by liberal construction, and sometimes distortion of the language of the policies, to do justice in spite of the [policy language], resulted in a mass of litigation and confused precedent, the likes of which cannot be found in any other field of our law.<sup>94</sup>

Professor Williston’s “plain meaning” approach was thus meant to address and alleviate some of these serious problems of uncertainty and unpredictability in the judicial interpretation of insurance contract disputes, including some serious interpretive problems that arguably still exist today.<sup>95</sup>

93. 3 SAMUEL WILLISTON, WILLISTON ON CONTRACTS §§ 281–282 (1920) (footnotes omitted).

94. William Vance, *The History of the Development of the Warranty in Insurance Law*, 20 YALE L.J. 523, 534 (1911). John A. Appleman, author of the well-respected multivolume insurance law treatise *INSURANCE LAW AND PRACTICE* (rev. ed. 1981), was former head of the legal department of the State Farm Insurance Company during the 1930s when he also found “much of the insurance field in chaotic condition.” *Id.* at V, XI. This may have influenced his treatise’s pro-Williston philosophy of emphasizing a more formalistic and textual approach to insurance contract disputes. Mr. Appleman also may have viewed insurance coverage disputes more from the perspective of a former insurance defense attorney than from the perspective of a policyholder attorney or an academic lawyer.

95. Compare, for example, the interpretive conundrum expressed by Professor Vance in 1911, *supra* note 94 and accompanying text, with the contemporary interpretive conundrum of Professor Keeton’s rights at variance with the insurance policy language doctrine, *supra* note 13 and accompanying text.

Although some commentators believe that Professor Williston's interpretive rules covering insurance contract disputes are from a "now bygone era,"<sup>96</sup> other commentators recognize that his "plain meaning" doctrine is still being applied by a number of American courts today, at least in an insurance law context.<sup>97</sup> So, although Professor Williston's formalistic and textual approach to insurance contract interpretation has been widely rejected by a majority of academic lawyers and scholars today<sup>98</sup> in favor of Professor Corbin's more functionalistic and contextual approach,<sup>99</sup> a number of courts and commentators in the "real world" context of contemporary insurance law and practice continue to follow Professor Williston's oft-cited legal axioms.<sup>100</sup>

96. See James Fischer, *Why Are Insurance Contracts Subject to Special Rules of Interpretation? Text Versus Context*, 24 ARIZ. ST. L.J. 995, 1001 (1992); see also Symposium, *Reconsidering Grant Gilmore's THE DEATH OF CONTRACT*, 90 NW. U. L. REV. 1-266 (1995).

97. See, e.g., Stempel, *supra* note 21, at 810-11:

The plain meaning [Williston] approach [for interpreting insurance contract disputes] is, however, far from extinct. . . . The potential implications of a large-scale refusal to enforce boilerplate insurance policy clauses are apparently too daunting for the judiciary. Instead, judges intervene on an ad hoc basis through other doctrines—for example, waiver, estoppel, *contra proferentem*, and reasonable expectations—to police insurance policies when perceived as necessary to avoid unfairness.

*Id.*; see also Swisher, *A Middle Ground Approach to Insurance Contract Disputes*, *supra* note 5, at 546-48.

98. See, e.g., 3 CORBIN ON CONTRACTS § 535: *Do Words Used in a Contract Have Only One True Meaning?*, (1960 and 1999 Cum. Supp.). Corbin states:

The question in the title to this section is a small piece of sophistry on Professor Corbin's part, of course, allowing him to decry further the injustices done by those who have rigid, unsophisticated views of language and its function. By now, everyone is convinced: the problem has become one of hyper-sophistication, and result-oriented opinions relying on nothing more than subjective infusions of values into the language used by the parties.

*Id.* see also Stempel, *Unmet Expectations*, *supra* note 1, at 276 n.260.

99. See *infra* notes 107-17 and accompanying text.

100. See, e.g., Schultz v. Hartford Fire Ins. Co., 569 A.2d 1131, 1134 (Conn. 1990) (insurance policy is to be interpreted by same general rules that govern construction of any written contract in accordance with intent of the parties as expressed in the policy); *Showers v. Allstate Ins. Co.*, 222 S.E.2d 198, 199 (Ga. Ct. App. 1975) (an insurance policy, which by clear and unambiguous terms is limited in its coverage, cannot be so construed as to expand coverage beyond its stated terms); *American Family Mut. Ins. Co. v. National Ins. Ass'n*, 577 N.E.2d 969, 971 (Ind. Ct. App. 1991) (court must ascertain the parties' intent as manifested in the insurance contract and may not rewrite plain and unambiguous language). See also *Insurance Co. of N. Am. v. Adkisson*, 459 N.E.2d 310, 313-14 (Ill. Ct. App. 1984); *Duke v. Mut. Life Ins. Co.*, 210 S.E.2d 187, 247 (N.C. 1974); *Hybrid Equip. Corp. v. Sphere Drake Ins. Co.*, 597 N.E.2d 1096, 1102 (Ohio 1992); *Standard Venetian Blind Co. v. American Empire Ins. Co.*, 469 A.2d 563, 566 (Pa. 1983); *Transit Cas. Co. v. Hartman's Inc.*, 239 S.E.2d 894 (Va. 1978) (similar holdings). See generally 13 JOHN A. APPLEMAN AND JEAN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 7386, 7402 (rev. ed. 1976) (an insurance contract will be enforced according to its terms, unless ambiguous); 1-2 GEORGE COUCH, *CYCLOPEDIA OF INSURANCE LAW* §§ 1:4, 2:1, 2:12-2:13, 15:1-15:97 (Mark S. Rhodes ed., rev. 2d ed. 1984); WINDT, *supra* note 1, at 352-58. Barry Ostrager and Thomas Newman restate Professor Williston's interpretive "plain meaning" doctrine in this manner:

As a general rule, the language of an insurance policy will be given its plain meaning and there will be no resort to rules of construction unless an ambiguity exists. . . . Whenever



Why is this formalistic interpretation of insurance contract disputes still recognized and applied in so many American jurisdictions today? The answer may lie, in part, in the rather surprising resurgence of legal formalism as a viable theory of contemporary American jurisprudence,<sup>101</sup> in tort law<sup>102</sup> as well as in contract law.<sup>103</sup> The answer may also lie, in part, in the fact that Professor Williston's formalistic "plain meaning" interpretive approach has never been fully supplanted by Professor Corbin's functionalistic interpretive approach in many jurisdictions, at least in an insurance law context.<sup>104</sup>

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there is any question of interpretation of a written contract, the court will seek to determine the intention of the parties as derived from the language employed. . . . In short, any clause which has been inserted in an insurance policy with the insured's consent is valid as long as it is clear, unambiguous, and not in contravention of public policy.

OSTRAGER AND NEWMAN, *supra* note 1, at 3-5.

101. See, e.g., GARY JAN AICHELE, *LEGAL REALISM AND TWENTIETH CENTURY AMERICAN JURISPRUDENCE X* (1990) ("Impossible only a decade ago, 'mechanical jurisprudence' has made a remarkable comeback, and a new legal formalism may yet triumph as the principal mode of [judicial] interpretation."); JOHN AGRESTO, *THE SUPREME COURT AND CONSTITUTIONAL DEMOCRACY* (1984); ROBERT BORK, *THE TEMPTING OF AMERICA: THE POLITICAL SEDUCTION OF THE LAW* (1990); MARIO JORI, *LEGAL POSITIVISM* (1992). See also David Charny, *The New Formalism in Contract*, 66 U. CHI. L. REV. 842 (1999); G. Richard Shell, *Contracts in the Modern Supreme Court*, 81 CAL. L. REV. 433, 436 (1993) (finding the U.S. Supreme Court's contractual jurisprudence in the 1980s and 1990s to be very formalistic and textual and driven by "pro-market jurisprudence," making the assumption that a more formalistic focus on contractual text generally aids commerce); Swisher, *Judicial Rationales in Insurance Law*, *supra* note 5, at 1039-47; Swisher, *A Middle Ground Approach to Insurance Contract Disputes*, *supra* note 5, at 555-65.

102. See, e.g., RICHARD A. EPSTEIN, *TORTS* xviii (1999):

Over the last 10 or 15 years, tort doctrine has, if anything, reversed field. The more recent cases have retreated cautiously from the great transformations of the 1960s and 1970s. Stabilization and modest retrenchment were brought on in part by judicial decision, and in part by legislative intervention that addresses, in addition to basic standards of liability, such important topics as joint and several liability, defenses based on plaintiff's conduct, and damages. . . . [F]or better or worse, since roughly 1985, doctrinal issues were more closely contested, and the direction and pace of legal innovation were no longer preordained.

*Id.*; see also James A. Henderson and Theodore Eisenberg, *The Quiet Revolution in Products Liability: An Empirical Study of Legal Change*, 37 UCLA L. REV. 479 (1990); Theodore Eisenberg and James A. Henderson, *Inside the Quiet Revolution in Products Liability*, 39 UCLA L. REV. 731 (1992).

103. See, e.g., Stempel, *supra* note 1, *Unmet Expectations*, at 272-77 (concluding that after a period of "unusual progressive ferment" in the 1960s and 1970s, "these social forces receded before the more established social tide of ongoing commercial and political interests, who successfully re-established the hegemony of the neoclassical contract paradigm").

104. See Swisher, *A Middle Ground Approach to Insurance Contract Disputes*, *supra* note 5, at 555-65. The pervasive influence of a number of insurance law treatises, as well as well-entrenched (and often unexamined) legal precedent in a number of states, supporting this formalistic and textual interpretive approach to insurance contract disputes likewise helped to sustain the Williston "plain meaning" approach to insurance coverage disputes. *Id.*; see also *supra* note 100 and accompanying text. Finally, the continuing influence of the Williston on *Contracts* treatise itself on the legal community cannot be minimized. As editor Walter Jaeger wrote in his Preface to 1 WILLISTON ON CONTRACTS, *supra* note 38:

### C. The Corbin School of Insurance Contract Interpretation

Where the formal and textual *Williston on Contracts* treatise begins with a definition of traditional contractual terms<sup>105</sup> and the traditional offer, acceptance, and consideration contractual trilogy,<sup>106</sup> the more functional and contextual *Corbin on Contracts* treatise succinctly states that “The Main Purpose of Contract Law Is the Realization of Reasonable Expectations Induced by Promises.”<sup>107</sup> Moreover, within this continuing, and often contentious, clash for the “soul of contract law,”<sup>108</sup> Professor Corbin was not shy about criticizing Professor Williston’s “plain meaning” interpretive approach to contract disputes. For example, in answering his rhetorical—and crucial—interpretive question “Do Words Used in a Contract Have Only One True Meaning?” Professor Corbin answered:

There is no single rule of interpretation of language, and there are no rules of interpretation taken all together, that will infallibly lead to the one correct understanding and meaning. In understanding the variable expressions of others, men must do the best they can and results must be determined even though the understanding may be faulty. There is in fact no “one correct” meaning of an expression; and the party choosing the expression may have no clear and conscious meaning of his own. In reading each other’s words, men certainly see through a glass darkly; and yet it is necessary for men to act upon their understanding, and it is necessary to hold men responsible for inducing others to act. . . .<sup>109</sup>

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From the time of publication of the original treatise, it gained increasing recognition throughout common law jurisdictions as a great legal classic of modern times. Many years of painstaking effort have been given to the preparation of this new edition. The editor has striven without stint to continue in the true WILLISTON tradition and to make this treatise not only the leading authority on contracts, but a compact library on the ever-expanding range of subjects involving contractual relations.

*Id.* at vii. Professor Richard Lord is the present editor of WILLISTON ON CONTRACTS, *supra* note 56 (4th ed. 1990–1999).

105. See 1 WILLISTON ON CONTRACTS § 1:1 *et seq.*, *supra* note 56 (4th ed.).

106. *Id.* § 4:1.

107. 1 CORBIN ON CONTRACTS § 1.1 (Joseph M. Perillo ed., 1993 rev. ed.); see also *supra* note 18. Corbin’s reasonable expectation interpretive concept has been adopted by most contracts scholars and commentators today. See GORDON D. SCHABER AND CLAUDE D. ROWHER, CONTRACTS § 88 at 147, § 6 at 11 (3d ed. 1990) (“One purpose of contract law is to protect the reasonable expectation of persons who become parties to a bargain”). Other scholars who have identified and reiterated this reasonable expectation interest include: E. ALAN FARNSWORTH, CONTRACTS (2d ed. 1990); LON FULLER AND MELVIN EISENBERG, BASIC CONTRACT LAW (5th ed. 1990); and FRIEDRICH KESSLER, GRANT GILMORE, AND ANTHONY KRONMAN, CONTRACTS (3d ed. 1986).

108. See *supra* notes 86 and 98 and accompanying text.

109. 3 CORBIN ON CONTRACTS § 535 at 15–16 (1960). In the 1999 Cumulative Supplement to volume three, Professors Lawrence Cunningham and Arthur Jacobson state:

The significance of this [concept] in contract law, and what Professor Corbin accurately perceived, is that words operate similarly. They have an *expressive* function, and that is what modern jurists, legal theorists, and lawyers honor when they throw away as archaic

In the 1998 revised edition of *Corbin on Contracts*, Professor Margaret Kniffin is even more straightforward with her assessment of the “plain meaning” rule of contract interpretation:

The plain meaning rule is inconsistent with a number of general [contract interpretation] rules that are universally accepted. The cardinal rule with which all interpretation begins is that the purpose of interpretation is to ascertain the intention of the parties. The plain meaning rule can exclude proof of their actual intention. There is universal agreement that the first duty of the court is to put itself in the position of the parties at the time the contract was made. It is wholly illogical for the court to do this without being informed by extrinsic evidence of the circumstances surrounding the making of the contract.<sup>110</sup>

Does this mean that an irreconcilable conflict exists, and must continue to exist, between the Williston School and the Corbin School of insurance contract interpretation? Not necessarily. Just as Professor Williston was not as formalistic and textual as some courts and commentators have generally assumed,<sup>111</sup> Professor Corbin, on the other hand, was not an unbridled contextual functionalist, as other commentators have generally assumed.<sup>112</sup> For example, Professor Corbin cautiously wrote:

If, after a careful consideration of the words of a contract, in the light of all the relevant circumstances, and of all the tentative rules of [contract] interpretation based upon the experience of the courts and linguists, a plain and definite meaning is achieved by the court, a meaning actually given by one party as the other party had reason to know, it will not disregard this plain and definite meaning and substitute another that is less convincing. . . .<sup>113</sup>

In another part of his treatise, Professor Corbin also wrote:

Interpretation will not be described in this treatise as either strict or liberal. The effort will be made to look at [contract] language and its limitations realistically and to state tentative working rules of interpretation and construc-

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the “plain meaning” doctrine. Those words are also possessed of an *evocative* function, and it is this which is lost. Without it, all expression is gibberish. There must be a superimposition, to a greater or lesser extent, of objective reality on the expressions of the parties’ expectations. It is this which adds the word *reasonable* to Corbin’s formula.

*Id.* at 19.

110. 5 CORBIN ON CONTRACTS § 24.7, at 37 (1998 rev. ed). It is questionable, however, whether all these interpretive rules have been “universally accepted” to date. See *supra* notes 97, 98, 100 and accompanying text.

111. See *supra* note 93 and accompanying text; see also Jean Braucher, *The Afterlife of Contract*, 90 N.W. U. L. REV. 49, 58–60 (1995) (pointing out that Professor Williston was more concerned with the fairness of the contractual bargain than has been commonly believed).

112. See *supra* note 98.

113. 3 CORBIN ON CONTRACTS § 535 at 19–22 (1960). See also SCHABER AND ROHWER, *supra* note 107, at 148 (“There is nothing wrong with ‘plain meaning’ and it may be a satisfactory answer to interpretation questions in some cases, but the problem may be more difficult than this expression indicates.”).

tion, drawn from the decisions of courts, that will measurably attain the purposes for which contract law exists. Usually the meaning that will be given to expressions used in a contract transaction is the meaning that one of the parties in good faith gave to them, if the other party knew or had reason to know that he gave it. The meaning so adopted by the court should be reasonably "plain and clear" after all the relevant evidence is in. It serves no useful purpose, after adopting this meaning, to describe it as either "strict" or "liberal."<sup>114</sup>

Accordingly, Professor Corbin—like Professor Williston—was not willing to reject a number of well-established rules of contract interpretation in pursuit of his more functional and contextual approach to contract law, and Professor Corbin—like Professor Williston—therefore continued to recognize a large number of traditional interpretive rules of contract interpretation to help ascertain the parties' reasonable expectation to coverage, including: contract ambiguity and the doctrine of *contra proferentem*,<sup>115</sup> contract unconscionability and public policy issues,<sup>116</sup> and equitable remedies such as waiver, equitable estoppel, promissory estoppel, election, and reformation of contract.<sup>117</sup> A fair reading of both *Williston on Contracts* and *Corbin on Contracts* therefore suggests that there are far more similarities than differences in their respective approaches to contract law in general, and insurance coverage disputes in particular.

D. *Is There a Consensus Solution to This Interpretive Conundrum Between the Williston and Corbin Approaches to Insurance Contract Interpretation?*

A realistic consensus solution to this interpretive conundrum involving Professor Williston's "plain meaning" formalist approach versus Professor Corbin's functionalist reasonable expectations approach is to recognize that, in the real world, the interpretation of insurance contracts can be neither wholly objective nor wholly subjective—and a judge necessarily must take into account both the subjective and objective intent of the parties.

On one hand, a fully objective approach would permit a court to determine what it believed both parties meant given the usual meaning of the disputed contract term. The court could therefore disregard the parties' own understanding, or what they reasonably believed each other to understand.<sup>118</sup> On the other hand, a fully subjective approach would limit a court only to inquire into what each party actually believed. This approach

114. 3 CORBIN ON CONTRACTS § 533 at 6–7 (1960), cited with approval in *Garden State Plaza Corp. v. S.S. Kresge Co.*, 189 A.2d 448, 455 (N.J. Super. 1963). See also 5 CORBIN ON CONTRACTS § 24.4 at 14–15 (1998 rev. ed.) (similar text).

115. See 3 CORBIN ON CONTRACTS § 559 (1960).

116. See *id.* at vol. 6, §§ 1421–1454.

117. See *id.* at vol. 3A, §§ 752–766.

118. See 5 CORBIN ON CONTRACTS § 24.6 at 25 (1998 rev. ed.)

in the real world would be an exercise in futility.<sup>119</sup> Thus, a majority of courts today now follow what has been called a “modified objective approach,”<sup>120</sup> including elements of both objectivity and subjectivity, but with primary emphasis on the parties’ objective manifestation of intent as found in the terms of the contract.<sup>121</sup>

In an insurance law context, Professor Jeffrey Stempel has fairly and comprehensively summarized this modern consensus approach to insurance coverage disputes in this manner:

The general rule of both contract law and insurance contract law is that words used in a contract are to be given their ordinary and plain meaning. Where an insurer uses contract language that is clear, broad, and unaffected by other factors or notions of public policy or unconscionability, courts enforce this language even where it dramatically limits coverage.

Of course, meaning is not always so universally plain that it can be objectively agreed upon; case reports of contract disputes attest to that. As a consequence, despite expressed admiration for the plain meaning rule, courts often must resolve contract disputes based on material other than contract text. A general rule at least as prominent and venerable as plain meaning posits that the goal of contract interpretation is to give effect to the intent of the contracting parties. Like textual meaning, however, discerning intent is often difficult, particularly where one or both parties seemingly had no specific intent about the unforeseen issue that is now the subject of a coverage dispute.

Insurance policies present an interpretive situation both more and less favorable for plain meaning and intent than found with ordinary contracts. On one hand, insurance policies are better candidates for the plain meaning approach because they are carefully drafted by a number of authors and issued in standardized form, reducing the chances for ambiguity through oversight. On the other hand, standardized policies inherently sweep broadly in language,

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119. *Id.* at 26–27. See also *Mellon Bank v. Aetna Bus. Credit*, 619 F.2d 1001, 1006 (3d Cir. 1980). The *Mellon* court stated:

It would be helpful if judges were psychics who could delve into the parties’ minds to ascertain their original intent. However, courts neither claim nor possess psychic power. Therefore, in order to interpret contracts with some consistency, and in order to provide contracting parties with a legal framework which provides a measure of predictability, the courts must eschew the ideal of ascertaining the parties’ subjective intent.

*Id.* See generally *Petroleo Brasileiro S.A. v. Nalco Chem. Co.*, 784 F. Supp. 160, 166 (D.N.J. 1992) (courts look to objective intent in language of contract in light of circumstances surrounding the transaction).

120. This term is employed in KNAPP AND CRYSTAL, *PROBLEMS IN CONTRACT LAW* 416 (3d ed. 1993).

121. See, e.g., *RESTATEMENT (SECOND) OF CONTRACTS* § 201 cmt. a (1981):

a. “Objective” and “subjective” meaning. . . . When a party is . . . held to a meaning of which he has reason to know, it is sometimes said that the “objective” meaning of his language or other conduct prevails over his “subjective” meaning. Even so, the operative meaning is found in the transaction and its context rather than in the law or in the usages of people other than the parties.

*Id.*; see also *supra* note 119 and accompanying text.

having been designed to apply in a variety of situations and drafted by someone who was not involved at all in the particular situation that has now come to court.

Ultimately, solicitude for the consumer, the adhesive nature of insurance policies, and judicial concern for the equities of the situation have made plain meaning too difficult to apply as an across-the-board rule of decision, while a pure intent-based approach has been restrained by the uncertainty resulting from overly general draft language, lack of evidence (due to the nature of the insurance contracting process), and concerns of equity in consumer cases.

Nonetheless, the allure of objective and formal contract law has driven much of contract interpretation, and insurance law is no exception. The general rule is that insurance policies are to be construed like any other contract. Modern contract theory readily acknowledges that determining meaning is largely a process of choice, laced with subjectivity and context, and views contract interpretation as the task of determining the intent of the parties; [and] it readily turns to the text of the contract as the best evidence of that intent. . . .<sup>122</sup>

Of course, a judge cannot make these interpretive decisions, or resolve insurance coverage disputes, in a vacuum. A judge cannot rely on Grant Gilmore's *The Death of Contract*<sup>123</sup> as precedential authority (even though he or she may wish to do so) any more than a judge can rely on Jimmy Buffet's *Changes in Latitudes, Changes in Attitudes*<sup>124</sup> as precedential authority (even though he or she may wish to do so). In the real world, judges' interpretive decisions involving insurance coverage disputes are constrained, controlled, and largely determined by the judicial and legislative parameters found within each particular jurisdiction.<sup>125</sup> Yet judges in juris-

122. STEMPEL, LAW OF INSURANCE CONTRACT DISPUTES, *supra* note 1, § 4.04, at 4–14 to 4–17.

123. GRANT GILMORE, *THE DEATH OF CONTRACT* (2d ed. 1995):

In a nutshell, Gilmore posited that nonconsensual tort law in this century absorbed the nineteenth-century contract-law construct. Gilmore was influenced by the legal realists, who, although varying in their degree of skepticism, generally posited a lack of objectivity and determinacy in our legal system. The realists believed that courts based their decisions not on abstract legal rules, but on the pragmatic evaluation of the context. Gilmore asserted that the “death of contract” was inevitable: Contract law was an artificial “ivory tower abstraction” improvised by Langdell in his famous casebook, nurtured by Holmes in *The Common Law*, and restated by Williston to reflect late nineteenth- and early twentieth-century society's dalliance with free-market economics and individualism.

Robert A. Hillman, *The Triumph of Gilmore's THE DEATH OF CONTRACT*, 90 NW. U. L. REV. 32, 33 (1995). On the other hand, some torts scholars now argue that American tort law is becoming more contractually based. See RICHARD EPSTEIN, *supra* note 102, at xxvii.

124. See JIMMY BUFFET, *A PIRATE LOOKS AT FIFTY* 61 (1998).

125. See *U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 513 U.S. 18, 26 (1994) (judicial precedents are presumptively correct); see also Swisher, *A Middle Ground Approach to Insurance Contract Disputes*, *supra* note 5, at 555–65 (discussing judicial precedent in insurance coverage disputes):

Other commentators have complained that state insurance law case precedent is often misleading since such precedent may be outdated, may have a pro-insurer bias, or a

dictions that continue to recognize a pro-Williston “plain meaning” approach to insurance contract disputes, as well as judges in jurisdictions that have adopted a more pro-Corbin functionalistic approach to insurance contract disputes, are both still able to “do justice and equity” in recognizing and validating the reasonable expectations of the parties to coverage<sup>126</sup> through well-recognized contractual rights and remedies, including: the doctrine of ambiguities, contract unconscionability and public policy defenses, and the application of waiver, equitable estoppel, promissory estoppel, election, and contract reformation principles.<sup>127</sup>

This so-called modified objective approach for interpreting insurance contract disputes therefore provides additional parameters for judicial discretion in recognizing and honoring the insured’s reasonable expectation to coverage that is supplemental to—rather than at variance with—the terms of the parties’ insurance contract, while allowing a court to consider evidence extrinsic to the insurance contract itself.

#### V. STANDARDIZED INSURANCE CONTRACTS AS CONTRACTS OF ADHESION AND A CONSENSUS SOLUTION

Most insurance contracts are not negotiated by parties with equal bargaining power. Rather, insurance policies are often contracts of adhesion, where the insurance company has a superior bargaining position and the insured has to accept the policy on a “take it or leave it” basis if the insured desires coverage.<sup>128</sup> The negative aspect of contracts of adhesion, therefore, is that

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number of recent insurance law decisions holding in favor of the policyholder may have been vacated by state appellate courts or settled under seal. See, e.g., Roger Parloff, *Rigging the Common Law*, THE AMERICAN LAWYER AT 76 (March 1992). Parloff states: “Eugene Anderson has been especially critical of the practices involved [in a number of insurance coverage dispute cases]. ‘You see brief after brief where [the insurer’s lawyers] say ‘The weight of authority is . . .’ or ‘most of the cases hold that. . . .’ The fact that they can manipulate the goddamn numbers is beyond belief.’”

*Id.*; see also Jill E. Fisch, *Rewriting History: The Propriety of Eradicating Prior Decisional Law Through Settlement and Vacatur*, 76 CORNELL L. REV. 589 (1991).

126. See *supra* notes 93 and 107 and accompanying text.

127. See *supra* notes 21–84, 90–93, 115–17, 122 and accompanying text.

128. See Edwin W. Patterson, *The Interpretation and Construction of Contracts*, 64 COLUM. L. REV. 833, 856 (1964) (describing the concept of a “contract of adhesion” as a rule of construction where the court favors the weaker party whenever drafting party was in stronger position); Arthur Leff, *Contract as a Thing*, 19 AM. L. REV. 131, 143 (1970) (stating that the process of entering a contract of adhesion “is not one of haggle and cooperative process but rather of a fly and flypaper”). See generally Fredrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943); Todd Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173 (1983); W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529 (1971). See also Healy Tibbitts Constr. Co. v. Employers’ Surplus Lines Ins. Co., 140 Cal. Rptr. 375, 379 (Cal. Ct. App. 1977) (insurance contracts regarded as contracts of adhesion expressing superior bargaining power of insurer); Powers v. Detroit Auto. Inter-Ins. Exchange, 398 N.W.2d 411, 413 (Mich. 1986) (an insurance contract is “not a hard-bargained contract drafted by

the contractual terms may be drafted to protect the insurer to the maximum degree and to minimize the insured's right to coverage.<sup>129</sup> Accordingly, the state legislatures, in order to require substantive fairness in contracts of adhesion, have a long history of dictating specific terms of insurance policies,<sup>130</sup> and contemporary courts, under newly empowered doctrines of contract unconscionability and public policy defenses,<sup>131</sup> also have played an important role in protecting the adhering party from contractual oppression.<sup>132</sup>

On the other hand, standardized insurance adhesion contracts "are not necessarily bad, although lawyers for policyholders often talk that way."<sup>133</sup> Professor David Slawson, for example, estimates that approximately 99 percent of all contracts are standard form contracts,<sup>134</sup> and according to Professor Friedrich Kessler, the benefits of standard form contracts are fivefold: (1) saving contract formation costs; (2) reducing an agent's authority to modify the terms of the contract; (3) allowing collection of necessary underwriting data; (4) reducing performance costs; and (5) allowing an insured to purchase packages of coverage that meet the insured's basic needs, even when an insured is unable to identify all of his or her basic insurance needs.<sup>135</sup> Thus, as the most recent edition of *Corbin on Contracts* readily concedes:

Despite the potential that contracts of adhesion have for abuse, there are important advantages to their use. Indeed, they are essential to the functioning

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two negotiators with equal bargaining skills and resources"; rather it "is a contract of adhesion, a take-it-or-leave-it insurance policy not drafted by the buyer or even by the seller of the policy, but by legal experts of a state, national, or international organization, hundreds and maybe thousands of miles away"); *Prudential Ins. Co. v. Lamme*, 425 P.2d 346, 347 (Nev. 1967) ("insurance contracts are contracts of adhesion, complex instruments unilaterally prepared by the insurer and seldom understood by the insured"). *But see* Fischer, *supra* note 96, at 1014-15 (1992). Fischer states:

Even if insurance contracts involve standardized agreements provided in the proverbial "take it or leave it" fashion, the pro-insured bias may amount to excessive correction if courts fail to accurately and precisely identify the danger that standardized agreements present. Use of the term "adhesion contracts" invites courts to employ a pro-insured bias without first determining whether the contract terms, in fact, reflect a pro-insured or pro-insurer bias.

*Id.*

129. See generally 1 CORBIN ON CONTRACTS § 1.4 at 13-15 (1993 rev. ed.). See also STEMPEL, LAW OF INSURANCE CONTRACT DISPUTES, *supra* note 1, § 4.06.

130. See generally JERRY, UNDERSTANDING INSURANCE LAW, *supra* note 1, §§ 20-25; KEETON AND WIDISS, *supra* note 1, §§ 8.1-8.6.

131. See generally *supra* notes 55-70 and accompanying text.

132. 1 CORBIN ON CONTRACTS, *supra* note 129, at 15 (1993 rev. ed.).

133. STEMPEL, LAW OF INSURANCE CONTRACT DISPUTES, *supra* note 1, § 4.06 at 4-38.

134. W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 529 (1971).

135. Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 631-32 (1943). See also KEETON AND WIDISS, *supra* note 1, § 2.8; STEMPEL, LAW OF INSURANCE CONTRACT DISPUTES, *supra* note 1, § 4.06 (both discussing the advantages and disadvantages of standardized insurance contracts).



of the economy. We live in an era of mass production of standardized goods and services. . . . The standardization of forms for contracts is a rational and economically efficient response to the rapidity of market transactions and the high cost of negotiations.<sup>136</sup>

Is there any consensus solution in the way that contemporary courts should interpret adhesion-type standardized insurance policies? Professor Karl Llewellyn offers one realistic and viable approach to the judicial interpretation of standardized insurance policies:

The answer, I suggest, is this: Instead of thinking about "assent" to boilerplate clauses, we can recognize that so far as concerns the specific, there is no assent at all. What has in fact been assented to, specifically, are the few dickered terms, and the broad type of the transaction, but one thing more. That one thing more is a blanket assent (not a specific assent) to any not unreasonable or indecent terms the seller may have on his form, which do not alter or eviscerate the reasonable meaning of the dickered terms. The fine print which has not been read has no business to [undercut] the reasonable meaning of those dickered terms which constitute the dominant and only real expression of agreement . . . .<sup>137</sup>

This common sense interpretive approach to standardized insurance contracts postulates that the consumer-policyholder and the insurer are both aware that the consumer probably has not read the standardized adhesion insurance policy in its entirety. This "real world" knowledge by both consumers and insurers therefore creates an additional element to a traditional "bargained for" or "dickered" contractual assent. Thus, according to Professor Llewellyn, standardized "boilerplate" terms in a contract should be honored to the extent that: (1) they do not undercut the meaning of the bargained-for terms and (2) they are not manifestly unfair.<sup>138</sup> A number of commentators have cited Professor Llewellyn's interpretive approach to standardized contracts with approval, specifically as applied to insurance coverage disputes involving standardized insurance policies.<sup>139</sup>

136. 1 CORBIN ON CONTRACTS, *supra* note 129, at 15 (1993 rev. ed.).

137. KARL LLEWELLYN, *THE COMMON LAW TRADITION: DECIDING APPEALS* 370-71 (1960).

138. *Id.*; see also *Mutual of Omaha Ins. Co. v. Russell*, 402 F.2d 399 (10th Cir. 1968); *Frank Lucas Ins. Agency Inc. v. Fireman's Fund Ins. Co.*, 425 A.2d 1378, 1381 (Md. Ct. App. 1981) (an interpretation that is fair and reasonable is preferred to one that leads to an unreasonable result); *Dixon v. Gunter*, 636 S.W.2d 437, 441 (Tenn. Ct. App. 1982) (an insurance contract should not be given a forced, unnatural, or unreasonable construction that would extend or restrict the policy beyond what is fairly within its terms, or that would lead to an absurd conclusion or render the policy nonsensical or ineffective).

139. See, e.g., Fischer, *supra* note 1, at 174; William M. Lashner, *A Common Law Alternative to the Doctrine of Reasonable Expectations in the Construction of Insurance Contracts*, 57 N.Y.U. L. REV. 1175, 1196-97 (1982); Swisher, *A Middle Ground Approach to Insurance Contract Disputes*, *supra* note 5, at 550-51 n.22, and 570 n.77; see generally ERIC MILLS HOLMES, *HOLMES' APPLEMAN ON INSURANCE LAW*, § 8.6 at 418-19 (2d ed. 1996).

This important interpretive principle for standardized insurance contracts is found in *Restatement (Second) of Contracts, Section 237, comment f*:

[A] party who adheres to the other party's standard terms does not assent to a term if the other party had 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 by the prior negotiations or inferred from the fact that the term is bizarre and oppressive, from the fact that it eviscerates the nonstandard terms explicitly agreed to, or from the fact that it eliminates the dominant purpose of the transaction. [This] inference is reinforced if the adhering party never had an opportunity to read the term, or if it is illegible or otherwise hidden from view.<sup>140</sup>

Another equally important interpretive rule involving standardized insurance contracts of adhesion is that in order to further validate the reasonable expectations of the insured to coverage, such coverage will be liberally construed by the court, and any exclusion, exception, or limitation to coverage therefore must be clearly, expressly, and unambiguously stated in the insurance contract.<sup>141</sup> This crucially important, but often overlooked, interpretive rule provides additional protection to the insured in further validating his or her reasonable expectation to coverage.<sup>142</sup>

These final interpretive rules under a traditional, contractually based doctrine of reasonable expectations realistically recognize that "provisions of mass-produced standardized agreements are not automatically given ef-

140. RESTATEMENT (SECOND) OF CONTRACTS § 237 cmt. f (1981).

141. See, e.g., *Farmer's Alliance Mut. Ins. Co. v. Bakke*, 619 F.2d 885 (10th Cir. 1980) (applying New Mexico law); *Steamboat Dev. Corp. v. Bacjac Indus. Inc.*, 701 P.2d 127 (Colo. Ct. App. 1985); *Northwest Airlines Inc. v. Globe Indem. Co.*, 225 N.W.2d 831 (Minn. 1975). See generally 2 COUCH ON INSURANCE § 15:93 (Mark S. Rhodes ed., rev. 2d ed. 1984) ("A risk that comes naturally within the terms of a policy is not deemed to be excluded unless the intent of the parties to exclude it appears clearly [in the policy].") (citing numerous case authority supporting this interpretive rule). As a corollary to this interpretive rule, a clearly drafted and unambiguous exclusion or limitation to coverage generally will be enforced by most courts:

[I]n the majority of cases, even in states enamored of the [Keeton] reasonable expectation approach, it appears that when insurers have drafted reasonably clear [exclusionary] language, it has been enforced by the courts. See, e.g., *New Hampshire Ins. Co. v. Power-O-Peat, Inc.*, 907 F.2d 58, 59 (8th Cir. 1990) (applying Minn. law) (enforcing CGL exclusion for liability for advertising injury); *Foremost Ins. Co. v. Putzier*, 606 P.2d 987, 991 (Ida., 1980) (holding that insurer exclusion for loss "arising out of riot, civil commotion or mob action" prevents coverage of promoter for loss suffered by concessionaires from unruly mob); *Cochran v. MFA Mut. Ins. Co.*, 271 N.W.2d 331, 333 (Neb. 1978) (upholding insurer exclusion of theft coverage unless "visible marks of forcible entry" present on exterior of vehicle when a car was taken with a "jiggle key" that left no marks).

Stempel, *supra* note 21, at 824 n.106.

142. See generally Swisher, *A Middle Ground Approach to Insurance Contract Disputes*, *supra* note 5, at 597-604.

fect if they are at variance with the reasonable expectations of the party who did not prepare the document,"<sup>143</sup> and therefore, with standardized insurance policies at least, "courts have been less likely to exclude boilerplate from the contract but are more likely to interpret the standardized term narrowly or in accord with the policyholder's viewpoint in order to maximize coverage."<sup>144</sup>

VI. JUDICIAL UTILIZATION OF A CONTRACTUALLY BASED  
DOCTRINE OF REASONABLE EXPECTATIONS REMAINS A REALISTIC  
AND VIABLE WAY TO SETTLE MOST INSURANCE CONTRACT  
DISPUTES TODAY

A contractually based insurance law doctrine of reasonable expectations has been successfully developed and adopted by the vast majority of American courts over the past half century, predating the more modern Keeton insurance law doctrine of reasonable expectations by at least three or four decades.<sup>145</sup>

In order to recognize the reasonable expectations of the parties to coverage within this overarching contractual context, various rules of insurance contract interpretation were formulated, recognized, and incorporated into the case law of most American jurisdictions, including: (1) the contra proferentem doctrine of ambiguities; (2) contract unconscionability and public policy defenses; (3) the application of certain equitable remedies such as waiver, equitable estoppel, promissory estoppel, election, and reformation of contract; and (4) additional interpretive rules applicable to standardized insurance contracts of adhesion.

Over the past six decades, these interpretive rules have been applied by utilizing one of two competing jurisprudential approaches: (1) a more classical, formalistic, and textual contractual approach as propounded by Professor Samuel Williston and his legal disciples; or (2) a more functionalistic and contextual "reasonable expectations" contractual approach as propounded by Professor Arthur Corbin and his legal disciples. Although the

143. 1 CORBIN ON CONTRACTS, *supra* note 129, § 1.1 (1993 rev. ed.).

144. STEMPER, LAW OF INSURANCE CONTRACT DISPUTES, *supra* note 1, § 4.06[d]. Concludes Professor Stempel:

The courts and to some extent the legislatures have made a peace pact with the commercial community, particularly the insurance industry. Standardized contracts are allowed to flourish and will be enforced so long as they are sufficiently clear and fair, and without trickery accompanying the sale. However, the legislature may be more inclined to regulate insurance and other areas heavy with adhesion contracting. Courts view adhesion contracts, particularly insurance contracts, with somewhat more scrutiny in determining whether to invoke any special judicial doctrines [of insurance contract interpretation].

*Id.* at 4-50.

145. See *supra* notes 16-18 and accompanying text.

Williston and Corbin schools of insurance contract interpretation continue to spar contentiously over the fundamental question of whether “plain meaning” realistically can be ascertained from the “four corners” of an insurance contract, *Williston on Contracts* and *Corbin on Contracts* share many more similarities than differences in analyzing and resolving insurance contract disputes. Both Williston and Corbin believed, for example, that important interpretive contract rules and remedies existed, based upon underlying rationales of contractual fairness, when extrinsic evidence, parole evidence, and the parties’ reasonable expectations to coverage could, when appropriate, override clear textual provisions within a standardized insurance contract.

Neither Professor Williston nor Professor Corbin were prepared to “throw out the contractual baby with the bath water.” Both endeavored to construct their interpretive rules within well-recognized parameters of American contract law. It remained for Professor Robert Keeton in his 1970 *Harvard Law Review* article to construct a new and revolutionary reasonable expectations model of consumer rights at variance not only with the policy language, but also with these generally recognized contractual rights, remedies, and obligations.

#### VII. THE MODERN KEETON INSURANCE LAW DOCTRINE OF REASONABLE EXPECTATIONS

The insurance law doctrine of reasonable expectations was not a new concept<sup>146</sup> when Professor Keeton wrote his influential law review article in 1970,<sup>147</sup> although most courts and commentators now tend to analyze, support, or criticize the insurance law doctrine of reasonable expectations only from Professor Keeton’s doctrinal perspective.<sup>148</sup> This failure to adequately distinguish between a more traditional, contractually based doctrine of reasonable expectations on the one hand and Professor Keeton’s 1970 “rights at variance with the policy provisions” doctrine on the other hand, has led to a number of confusing interpretive conclusions in trying to ascertain exactly which reasonable expectations doctrine has been adopted—or has not been adopted—in the various jurisdictions.<sup>149</sup>

146. See, e.g., *supra* notes 16–19 and accompanying text; *supra* notes 20–144 and accompanying text.

147. See Keeton, *Insurance Law Rights*, *supra* note 1.

148. See *supra* note 1 and accompanying text.

149. For example, two commentators have stated that no fewer than thirty-eight states “have recognized some variation of the reasonable expectations doctrine.” OSTRAGER and NEWMAN, *supra* note 1, § 1.03[b] at 22. However, a large number of these judicial decisions cited by Ostrager and Newman actually deal with ambiguous insurance contracts and other contractually based interpretive rules, rather than with Professor Keeton’s reasonable expect-

Professor Keeton's doctrine of reasonable expectations is based upon a two-pronged rationale: (1) that an insurer should be denied any unconscionable advantage in an insurance contract; and (2) that the reasonable expectations of the insurance applicants and intended beneficiaries regarding the terms of an insurance contract should be honored, even though a painstaking study of the policy provisions contractually would have negated those expectations.<sup>150</sup>

The first principle of Professor Keeton's reasonable expectation doctrine, that an insurer should be denied any unconscionable advantage in an insurance contract, was firmly based on the depth and breadth of a more traditional, contractually based doctrine of reasonable expectations involving elements of contract ambiguity, unconscionability, and waiver and es-

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tations doctrine. See, e.g., Swisher, *A Middle Ground Approach to Insurance Contract Disputes*, *supra* note 5, at 561. See also Stempel, *Unmet Expectations*, *supra* note 1, at 192 ("Commentators listing up to 38 states as approving the reasonable expectations doctrine characterize the [Keeton] reasonable expectations approach too broadly.")

In his 1990 assessment of the reasonable expectations doctrine after two decades, Professor Roger Henderson opined that "[a]s many as sixteen states may be viewed as having adopted the [Keeton] doctrine, but it is not clear whether every court intended to embrace the broadest formulation." Henderson, *supra* note 1, at 825 n.5. According to Professor Henderson, ten states arguably had adopted the Keeton reasonable expectation doctrine by 1990: Alabama, Alaska, Arizona, California, Iowa, Montana, Nebraska, Nevada, New Hampshire, and New Jersey. Six additional jurisdictions—Colorado, Delaware, Hawaii, North Carolina, Pennsylvania, and Rhode Island—may or may not have adopted the Keeton reasonable expectation doctrine, but "the decisions from these six jurisdictions are not entirely free from ambiguity themselves and require [further] analysis." *Id.* at 828–34.

Today, however, only a handful of jurisdictions have actually adopted the "pure" version of Professor Keeton's "rights at variance with the policy language" reasonable expectations doctrine:

[T]he number of jurisdictions that has adopted [the] "pure" [rights at variance with the policy language] version of the Keeton [reasonable expectations] doctrine is relatively small, numbering approximately a half-dozen. It includes states generally regarded as more progressive and favorable to consumers and claimants: California, New Jersey, Pennsylvania, and the District of Columbia. Also appearing at least one time to endorse the full dress form of the [Keeton] reasonable expectations doctrine are Hawaii, Idaho, Iowa, Minnesota, and Nevada. Today, however, Idaho, Iowa, and Pennsylvania have since disapproved the pure [Keeton] reasonable expectations doctrine and instead appear to use [traditional contractual] expectations analysis only when contested policy language is ambiguous or otherwise problematic. Minnesota does not require ambiguous language as a trigger for expectations analysis but does require that the exclusionary language at issue be in some way hidden or surprising to the policyholder. New Jersey is seen by some commentators as similarly having moved from pure [Keeton] reasonable expectations analysis to expectations as a tool for resolving ambiguous language and then back again.

Stempel, *Unmet Expectations*, *supra* note 1, at 193–95. But see Croskey, *supra* note 1, at 470–73 (arguing that since 1990 California courts no longer use the doctrine of reasonable expectations to justify a broad, proinsured rule of construction, but instead apply a more traditional, contractually based "middle ground" interpretive approach to insurance contract disputes). See, e.g., *Bank of the West v. Superior Court*, 833 P.2d 545 (Cal. 1992).

150. Keeton, *Insurance Law Risks*, *supra* note 1, at 963–64. See also *supra* notes 8–15 and accompanying text.

toppel principles.<sup>151</sup> Indeed, Professor Keeton wrote that this unconscionability principle “explains much that is called waiver or estoppel in insurance law, in circumstances involving neither voluntary relinquishment nor detrimental reliance—the essence of waiver and estoppel respectively. It also accounts for most of the distinctive controls over defenses based on warranty, representation or concealment. . . [and] the doctrine of election.”<sup>152</sup> As Professor Mark Rahdert explains:

With nearly thirty years of accumulated hindsight, one is tempted to regard this unconscionability version of the reasonable expectations principle as representing a fairly modest development. As its champion Professor Keeton himself demonstrated, the doctrine is firmly rooted in both common law and long-standing judicial practice.<sup>153</sup> It grows naturally from the principles of legal realism that have enjoyed wide acceptance in our legal system for over half a century. And it reflects the proconsumer orientation that has animated much commercial law development in the post-World War II period of American law. Just as importantly, it does not significantly challenge the primary [traditional contractual] assumption that the language of the insurance policy sets the terms of the bargain; rather it treats that assumption as a basic guiding rule, to which, however, the objective of contract fairness may require occasional judicially crafted exceptions.<sup>154</sup>

A majority of contemporary courts and commentators, therefore—whether they be proponents of a more formalistic<sup>155</sup> or a more functionalistic<sup>156</sup> interpretive approach to insurance contract disputes—are able to recognize and apply this unconscionability variant of Professor Keeton’s reasonable expectations doctrine in resolving insurance coverage disputes.<sup>157</sup>

151. Professor Robert Jerry notes, for example, that Professor Keeton “discovered” his doctrine “in the more traditional [contractual] doctrines with which lawyers are more familiar and comfortable.” JERRY, *UNDERSTANDING INSURANCE LAW*, *supra* note 1, § 25D at 144–45. See also *supra* notes 21–144 and accompanying text.

152. Keeton, *Insurance Law Risks*, *supra* note 1, at 963–64.

153. Citing to Keeton, *Insurance Law Risks*, *supra* note 1, at 963–65, 974–77.

154. Rahdert, *Reasonable Expectations Revisited*, *supra* note 1, at 130–31.

155. See *supra* note 14 and accompanying text; see also *supra* notes 85–104 and accompanying text.

156. See *supra* note 15 and accompanying text; see also *supra* notes 107–17 and accompanying text.

157. I agree with Professor Rahdert’s assessment of Professor Keeton’s unconscionability principle, although Professor Rahdert apparently believes that I am among those commentators who are opposed to the adoption of Professor Keeton’s unconscionability principle. Rahdert, *Reasonable Expectations Revisited*, *supra* note 1, at 131 n.70. However, my criticism of Professor Keeton’s doctrine of reasonable expectations for “generating uncertainty by deviating from the express contract terms, and for being applied by the courts in an inconsistent and uneven manner” was primarily addressed at Professor Keeton’s *second* doctrinal principle of “rights at variance with the policy language.” See Swisher, *A Middle Ground Approach to Insurance Contract Disputes*, *supra* note 5, at 552. I have little quarrel with Professor Keeton’s unconscionability variant, since it parallels so closely a more traditional contractually based reasonable expectations unconscionability doctrine. See generally *supra* notes 55–70 and accompanying text.

The second principle of Professor Keeton's doctrine of reasonable expectations, however, has been much more controversial: that the reasonable expectations of the insured should be honored, even though a "painstaking study" of the policy provisions contractually would have negated those expectations.<sup>158</sup> Criticism of this "rights at variance with the policy language" principle in its "strong" form<sup>159</sup> has been threefold. First, under this principle, the insurance policy need not be interpreted according to its contractual language—which is anathema to a formalistic theory of insurance contract interpretation.<sup>160</sup> Second, those courts that purportedly do apply this "rights at variance expectations" principle have been unable to agree on what specific factors actually constitute such a reasonable expectation of coverage, and what factors do not.<sup>161</sup> Third, a growing number of courts and commentators have questioned the underlying doctrinal justification purportedly supporting this "rights at variance" interpretive approach to insurance coverage disputes.<sup>162</sup>

158. Keeton, *Insurance Law Risks*, *supra* note 1, at 963–64. The courts also have split on how "painstaking" this judicial "study" should be. See Rahdert, *Reasonable Expectations Reconsidered*, *supra* note 1, at 335–36.

159. Professor Mark Rahdert describes this Keeton "rights at variance with the policy language" principle that would confer on the courts "substantial new powers to set forth the contours of coverage" as the "strong" application of the doctrine. A "weaker" reading of this doctrine "would do little more than generate a new variant of the ambiguity principle." Professor Rahdert concludes that it "seems from Professor Keeton's analysis that he preferred the stronger view of his formula" although "courts that have adopted the reasonable expectations principle, however, have not always shared this broad interpretation." Rahdert, *Reasonable Expectations Reconsidered*, *supra* note 1, at 335–36.

160. See, e.g., WINDT, *supra* note 1, at 376. Windt states:

The [Keeton] reasonable expectation rule, therefore, abandons the general contract principle that the insured's legitimate expectations are necessarily governed and limited by the terms of the policy. That principle will, instead, be applied only when it is fair to do so. As a result, in a proper case, an insured may be held to be entitled to coverage despite unambiguous language in the policy to the contrary.

*Id.*; see also *supra* note 13 and accompanying text.

161. See Rahdert, *Reasonable Expectations Reconsidered*, *supra* note 1, at 335. Rahdert states:

The Keeton formula gives no hint at what factors other than the policy provisions courts might use to define the "terms" of the insurance arrangement, or how the courts are to measure the force of these external factors against the force of restrictive policy provisions to determine which should prevail in any given instance.

*Id.*; see also Abraham, *Judge-Made Law*, *supra* note 1, at 1153. Abraham notes:

The courts [following the Keeton doctrine of reasonable expectations] have employed the expectations principle in cases where the insured's expectation of coverage was probably real and reasonable. They have also employed it where an expectation of coverage was less probable, but the policy's denial of coverage seemed unfair. Finally, they have relied on the principle even where an expectation of coverage was improbable and the denial of coverage would not appear unfair. In short, the [Keeton] judicial concept of an "expectation" of coverage is not a monolithic one.

*Id.*

162. See Thomas, *supra* note 1, at 333 (concluding that the Keeton reasonable expectations

Accordingly, as Professor Rahdert correctly observes, the Keeton doctrine of reasonable expectations “represents not a single concept but a bundle of related ideas” that “can be invoked in at least four different ways”:

For the most part, courts rely on the reasonable expectations of the insured (a) as an interpretive device for ascertaining the meaning of policy language. This use of the principle, which is by far the most common, fits comfortably within traditional precepts of insurance law and the common law tradition. It is closely aligned with what I call the “ambiguity principle,” the time-honored invocation of the maxim *contra proferentem* that courts routinely and universally apply to interpret “ambiguous” insurance policy language. This use of the reasonable expectations concept as an interpretive device really should not be controversial.

On fewer occasions, but still fairly often, courts employ reasonable expectations (b) to adjust contract terms that, as applied to the insured’s situation, would otherwise have an unfair or “unconscionable” effect. . . . While this idea might have been controversial thirty years ago, it really ought not to be so today. . . . [B]y now it is a relatively longstanding and accepted power of the courts that has put out fairly deep common-law roots. In an insurance context, it is also typically not a very big leap from traditional thinking, especially in the application of the ambiguity principle, because in most instances what makes the insured’s expectation “reasonable” is that it rests on a *plausible* interpretation of the policy language. . . .

On still fewer occasions, courts employ the reasonable expectations principle (c) to avoid enforcing policy language that, no matter how clearly expressed or fully explained, would defeat what the court believes are the essential objectives of the insurance policy. In these instances, which occur quite rarely, the language unambiguously fails to support the insured’s interpretation, but in the court’s judgment it is so completely at odds with the basic purpose the insurance policy was intended to serve that enforcing it would work substantial injustice. The question whether courts should have the power to do this has remained controversial; how controversial it should be depends heavily on one’s jurisprudential perspective toward contract adjudication, and the insurance-law facet of this question is part of a larger contract-law debate between formalists and functionalists, legal economists and consumer protectionists that has been raging for the last decade. The fate of this version of the reasonable expectations idea is likely to hang in the balance of these contract-theory culture wars.

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doctrine “rests on dubious assumptions” since “consumer research and empirical data tends to show that the insureds do not rationally evaluate insurance information or arrive at specific expectations of coverage”); see also Fischer, *supra* note 1, at 179–80 (concluding that the Keeton doctrine of reasonable expectations “tells us so little about why courts decide coverage disputes the way they do” with its primary deficiency being “the muting of decisional accountability”). The doctrine of reasonable expectations, according to Professor Fischer, “needs to shed its disguise of policyholder expectations and sustain itself on its true grounding of insurance as a public good and the corollary that coverage decisions should be based on public good [rather than policyholder expectations.]” *Id.*



Finally, in what for emphasis I will term a “truly tiny trickle” of very, very rare instances (so rare that they approach zero), courts may invoke the reasonable expectations concept (d) to avoid policy limitations that would contravene important overriding public policies regarding assured compensation. In these cases, the court is not so much concerned with the dynamics of the arrangement between insurer and insured as it is with making insurance “work” for the good of others who depend on it, or for the good of society.

Only the more aggressive uses of the reasonable expectation principle [particularly uses (c) and (d)] ought to stir sharp controversy. Given the infrequency with which these aggressive uses of the reasonable expectations idea occur, one is tempted to characterize the fight over them as something of a tempest in a teapot. The vast majority of reasonable expectations applications ought not to be perceived as threatening, in any substantial way, to either the traditions of insurance law adjudication or the ability of insurers to prescribe the limits of coverage for their policies.<sup>163</sup>

If Professor Rahdert’s analysis of Professor Keeton’s doctrine of reasonable expectations is a fair, comprehensive, and realistic discussion of the four ways in which the Keeton doctrine may be judicially invoked and applied by most courts today, as I believe it is, then it is also an excellent illustration of how a traditional and a modern consensus approach to the insurance law doctrine of reasonable expectations can successfully co-exist in contemporary insurance coverage disputes. Under either the more traditional, contractually based interpretive approach,<sup>164</sup> or under a more modern functionalistic Keetonian interpretive approach,<sup>165</sup> the final result, in the vast majority of insurance coverage disputes, will be fundamentally the same, even though the courts’ interpretive rationales may differ in reaching and justifying these similar results.<sup>166</sup> Like the Williston school

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163. Rahdert, *Reasonable Expectations Revisited*, *supra* note 1, at 112–14. Professor Rahdert, however, subsequently cautions:

Yet from another perspective the controversiality of the reasonable expectations principle seems well-deserved, because even its mildly aggressive applications challenged some of the most time-honored contract-law boilerplate on which much of the basic structure of insurance law depends. . . . Since courts and commentators are, for the most part, quite unwilling to overhaul insurance law in its entirety or to rethink its most basic assumptions, they have found it difficult to reconcile any but the most tepid applications of the reasonable expectations idea with the other insurance law principles that routinely guide their decisions. The result is a continuing sense of instability about the role that reasonable expectations ought to play in insurance analysis.

*Id.* at 114.

164. See *supra* notes 21–144 and accompanying text.

165. See *supra* note 163 and accompanying text.

166. See Rahdert, *Reasonable Expectations Revisited*, *supra* note 1, at 114 n.18 (citing to Swisher, *Judicial Rationales in Insurance Law*, *supra* note 5, at 1050–51):

Professor Swisher’s formal/substantive dichotomy actually cuts across all the different uses of the reasonable expectations principle I have identified. Even when a court takes the modest step of using the insured’s reasonable expectations as a guide to discerning the meaning of policy language, it is to some extent acknowledging the fact that the

versus the Corbin school of contract interpretation,<sup>167</sup> a traditional contractually based doctrine of reasonable expectations and the Keeton doctrine of reasonable expectations, on closer analysis, possess many more interpretive similarities than differences.

#### VIII. STRENGTHS AND WEAKNESSES OF THE KEETON DOCTRINAL APPROACH

It is beyond the scope of this present article to comprehensively analyze and discuss all the doctrinal strengths and weaknesses of Professor Keeton's insurance law doctrine of reasonable expectations, since a number of very able legal commentators have already debated this contentious topic, supporting<sup>168</sup> and criticizing<sup>169</sup> Professor Keeton's interpretive approach. Instead, I will briefly summarize the most recent legal commentary and trends, and the most recent judicial retrenchment—and rejection—of Professor Keeton's doctrine of reasonable expectations to date.

In a recent symposium on *The Insurance Law Doctrine of Reasonable Expectations After Three Decades*,<sup>170</sup> policyholder attorneys Eugene Anderson and James Fournier argue that to a policyholder, an insurance policy "is not a widget, and it is not simply a contract to pay money." It is a product,<sup>171</sup> and a significant part of this insurance product "is peace of mind and an expectation that the policyholder is protected."<sup>172</sup> Thus, they reason, "courts apply the reasonable expectations doctrine as one way to minimize

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policy is a contract of adhesion, the terms of which are determined unilaterally by the insurer. To this extent it is departing from the formal, Willistonian approach to contract construction, which at least in pure form would treat the parties' relative negotiating strength as irrelevant.

*Id.*

167. See *supra* notes 86–126 and accompanying text.

168. See, e.g., Abraham, *Judge-Made Law*, *supra* note 1; Anderson and Fournier, *supra* note 1; Fett, *supra* note 1; Henderson, *Reasonable Expectations After Two Decades*, *supra* note 1; Henderson, *Forces Outside Insurance Law*, *supra* note 1; Jerry, *Insurance, Contract, and Doctrine*, *supra* note 1; Mayhew, *supra* note 1; Rahdert, *Reasonable Expectations Reconsidered*, *supra* note 1; Rahdert, *Reasonable Expectations Revisited*, *supra* note 1; Stempel, *Unmet Expectations*, *supra* note 1.

169. See, e.g., Fadel, *supra* note 1; Fischer, *supra* note 1; Ingram, *supra* note 1; Lashner, *supra* note 1; Leitner, *supra* note 1; Lucas, *supra* note 1; Popik and Quackenbos, *supra* note 1; Perlet, *supra* note 1; Squires, *supra* note 1; Thomas, *supra* note 1; Ware, *supra* note 1.

170. *Symposium on the Insurance Law Doctrine of Reasonable Expectations After Three Decades*, 5 CONN. INS. L. J. 1–473 (1998–1999).

171. See Anderson and Fournier, *supra* note 1, at 379 n.130.

172. *Id.* at 379–80. See also Jerry, *supra* note 72 (stating that insurers and their agents often emphasize the catastrophic effects of loss and the "peace of mind" that insurance provides when attempting to convince a prospective insured to purchase insurance coverage); *D'Ambrosio v. Penn. Nat'l Mut. Ins. Co.*, 396 A.2d 780, 786 (Pa. Super. 1978) ("The insurer's promise to insured to 'simplify his life,' to put him in 'good hands,' to back him with 'a piece of the rock,' or to be 'on his side' hardly suggests that the insurer will abandon the insured in his time of need.")

insurance industry control and to more fully protect the policyholder's rights as the purchaser of an insurance product.<sup>173</sup> Nevertheless, a majority of courts today still continue to utilize an insurance-as-contract baseline for resolving insurance sales/coverage disputes, rather than an insurance-as-product rationale.<sup>174</sup> But, assuming that insurance policies do gain more judicial recognition in the near future as a "product" rather than as a "contract" based upon an implied warranty of fitness for a particular purpose,<sup>175</sup> the probable remedy would still arguably sound in contract under the Uniform Commercial Code.<sup>176</sup>

On the other hand, insurance defense attorneys Susan Popik and Carol Quackenbos argue that reasonable expectations after thirty years is a "failed doctrine" since, from the beginning, "there has been a striking lack of agreement among the courts and commentators as to what the reasonable expectations doctrine is, how it should be applied, or when it should be invoked."<sup>177</sup>

Arguing that Professor Keeton's reasonable expectations doctrine is unnecessary in light of other existing contractual remedies,<sup>178</sup> the authors

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173. Anderson and Fournier, *supra* note 1, at 337. Applying such a "strong" Keetonian reasonable expectations doctrine, they believe, would help curb unfair insurance industry control and domination over policyholders, and help curb "opportunistic breaches" on the part of insurance companies. *Id.* at 377-85.

174. See, e.g., Tom Baker, *Construing the Insurance Relationship: Sales Stories, Claims Stories, and Insurance Contract Damages*, 72 TEX. L. REV. 1395, 1417 (1994) ("The insurance-as-contract story is typically the baseline [for judging an insurance relationship]. Many, if not most courts—whether deciding in favor of insurance companies or insureds—rely heavily on a straightforward interpretation of the insurance company's printed form.") See also JEFFREY STEMPER, INTERPRETATION OF INSURANCE CONTRACTS: LAW AND STRATEGY FOR INSURERS AND POLICYHOLDERS 298 (1994) ("Although insurance marketing involves sales force solicitation, mass advertising, and efforts to build a secure, positive image rather than to promote a given coverage scheme or contract language, the insurance policy still figures prominently in the manner in which insurance is usually sold.")

175. See *supra* note 170.

176. See, e.g., U.C.C. § 2-315 (1966).

177. Popik and Quackenbos, *supra* note 1, at 427. See also Ware, *supra* note 1, at 1466-67 ("Construing an insurance policy to protect the insured's 'reasonable expectations' means different things to different courts. . . . [The different versions of the doctrine] form a rough continuum from purported adherence to the policy's language to open disregard of the written contract."); Henderson, *Reasonable Expectations After Two Decades*, *supra* note 1, at 823 ("Even after two decades, there still seems to exist a great deal of uncertainty as to the doctrinal content and when the principle may be invoked, including most of the jurisdictions that have professed to have adopted it.")

178. Popik and Quackenbos, *supra* note 1, at 447-48:

There will always, of course, be circumstances in which a determination of the parties' intent cannot be made from the language of the policy alone. In those instances, the existing rules of contract interpretation, such as waiver, estoppel, unconscionability, and *contra proferentem* are all that is necessary to interpret the contract—and even to protect insureds from overreaching insurers. Applicable to all contracts, these equitable principles do not suffer from the same infirmities as the reasonable expectations doctrine and are thus preferable to that doctrine, with its unavoidable vagaries and uncertainties.

*Id.*

conclude that despite thirty years of effort “neither courts nor commentators have been able to provide a real analytic framework for the doctrine. The inescapable conclusion may be that it is just not possible to do so—and that perhaps it is time to stop trying.”<sup>179</sup>

One of the most thought-provoking and comprehensive defenses of Professor Keeton’s doctrine of reasonable expectations in recent years appears in a 1998 article written by Professor Jeffrey Stempel.<sup>180</sup> Briefly, Professor Stempel’s thesis is that the Keeton reasonable expectations doctrine has never really been fully utilized as an analytical tool, and has not yet been fully deployed in a thoughtful and comprehensive manner. In large part, this underutilization of reasonable expectations thinking, Professor Stempel believes, has resulted from judicial fear of creating new legal rights “at variance” with clearly worded insurance policy language, rather than properly utilizing the doctrine as a potential tool for addressing uncertain policy language and application.<sup>181</sup> For example, Professor Stempel notes that:

Many courts had difficulty embracing a concept that they regarded as turning too quickly away from the traditional contract law principles positing that contract language should be enforced as written if it is sufficiently clear. These courts were willing to consider policyholder expectations only if policy language was ambiguous. Other courts were willing to utilize the Keeton form of reasonable expectations analysis to overcome clear text, but only where

179. *Id.* at 449.

180. See Stempel, *Unmet Expectations*, *supra* note 1, at 182, stating, “I hope to explain to some degree the doctrine’s seemingly sudden emergence, attraction to academics but resistance from elements of bench and bar, early growth, subsequent retreat, current status, and continuing controversy.”

181. Stempel, *Unmet Expectations*, *supra* note 1, at 183. Professor Stempel continues:

Properly seen, however, the reasonable expectations doctrine, even in its strong “rights at variance” form, is actually consistent with the prevailing jurisprudential ethos [of judicial restraint] because of the context of insurance coverage. Determining the “correct” meaning of an insurance policy inevitably requires not only a sharp focus on policy text but also full consideration of the reasonable expectations of *both insurer and insured*, even where those expectations to some extent run counter to the text, and certainly when text is unclear, insufficiently certain, or applied to unanticipated situations. Contrary to the assertions of some courts and commentators, strong judicial invocation of the reasonable expectations concept poses no threat to separation of powers and little serious obstacle toward vindicating the intent of the parties to the insurance contract and the purpose of the insuring agreement.

Viewed comprehensively, the reasonable expectations of the parties to an insurance contract can be used not only to construe ambiguous policy text or to overcome clear text violative of the insured’s reasonable expectations, but also to serve as a check on absurd hyperliteral interpretations of policy text. In addition, the reasonable expectations approach can assist courts in determining whether policy provisions are ambiguous or whether “painstaking” study of the policy suggests a clear meaning for problematic text. All of these varieties of the reasonable expectations approach merit more frequent, more expansive, and more self-consciously reflective use by the courts.

*Id.* at 183–84.

[policy] language favorable to insurers was complex, hidden, arguably unfairly surprising, or where the insured was a consumer or small business.

Courts have for decades and perhaps centuries been using the policyholder's understanding of the policy as a tool for resolving coverage disputes. However, the conventional wisdom held that these considerations only applied if the policy language at issue was unclear or unconscionable. Keeton both debunked this conventional wisdom and attempted to synthesize case law finding coverage despite policy language favorable to insurers denying coverage. According to Keeton, these cases could not be solely explained by reference to traditional doctrines such as unconscionability, waiver, estoppel, or construction of ambiguities in favor of the policyholder. Rather, the common thread of these cases was the court's willingness to provide coverage consistent with the objectively reasonable expectations of the policyholder even if policy text read literally would foreclose coverage.<sup>182</sup>

Unfortunately, however, neither Professor Keeton nor Professor Stempel nor numerous other commentators and courts over the past thirty years have been able to persuasively explain and justify the parameters of such an overarching, understandable, and reasonably predictable reasonable expectations doctrine of "rights at variance with the policy language," as most of the doctrine's critics and supporters alike readily admit.<sup>183</sup> This conundrum, in conjunction with the resurgence of legal formalism in American

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182. *Id.* at 189-90. RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981) also contains a model version of the Keeton reasonable expectations doctrine that does not require an ambiguity in the policy to utilize extrinsic evidence of the parties' intent. Section 211 states with respect to standard form contracts:

(1) Except as stated in Subsection (3), where a party to an agreement signs or otherwise manifests assent to a writing and has reason to believe that like writings are regularly used to embody terms of agreements of the same type, he adopts the writing as an integrated agreement with respect to the terms included in the writing.

(2) Such a writing is interpreted wherever reasonable as treating alike all those similarly situated, without regard to their knowledge or understanding of the standard terms of the writing.

(3) Where the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement.

*Id.* Thus, under this *Restatement* version of the Keeton reasonable expectations doctrine, terms "beyond the range of reasonable expectations" are not enforceable against the adhering party.

183. RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. f (1981). To date, however, only one court has expressly adopted section 211 of the *Restatement* in an insurance law context. See *Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co.*, 682 P.2d 388 (Ariz. 1984). For a discussion of the application of this *Restatement* version of reasonable expectations to the Keeton "rights at variance" doctrine of reasonable expectations, see Cabbage, *supra* note 1. See *supra* notes 12, 13, 160-62, 177, 179 and accompanying text. See also WINDT, *supra* note 1, at 376 ("Unfortunately, however, the courts have had little success in formulating a test for determining when equity necessitates that the [Keeton] reasonable expectations rule be applied."); Henderson, *Reasonable Expectations After Two Decades*, *supra* note 1, at 837-38 ("even after two decades, there still seems to exist a great deal of uncertainty as to the doctrinal content and when the [reasonable expectations] principle may be invoked, including most of the jurisdictions that have professed to have adopted it").

jurisprudence today,<sup>184</sup> helps explain the widespread judicial reluctance to embrace Professor Keeton's "strong"<sup>185</sup> "rights at variance" doctrine of reasonable expectations.<sup>186</sup>

Consequently, in the 1980s and 1990s, and as we cross over that fabled bridge into the twenty-first century, the Keeton doctrine of reasonable expectations—at least in its "strong" "rights at variance with the policy language" variant—has suffered a significant decline in its theoretical credibility and its practical application. Only a small handful of states currently recognize the Keeton doctrine in its "strong" variant,<sup>187</sup> and various proponents of the Keeton reasonable expectations doctrine in the past, such as Professor Kenneth Abraham<sup>188</sup> and Professor Mark Rahdert,<sup>189</sup> now con-

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184. See *supra* notes 101–03 and accompanying text. See also Stempel, *Unmet Expectations*, *supra* note 1, at 263–77:

The reasonable expectations doctrine is regarded (wrongly in my view) as overly liberal, result-oriented, and anti-free market anti-freedom of contract, and even at odds with the norm of judicial deference to the legislature. Republican-appointed judges and conservative judges are generally reluctant to embrace a doctrine with this sort of image. But . . . the retreat from reasonable expectations or the reluctance to further embrace it stems from a more metapolitical aspect of our culture than the relative strengths of the political parties or their primary ideologies. Rather, the growth of reasonable expectations analysis has been pared to a large degree by the prevailing view that judges must generally be restrained strict constructionists who do as little as possible to interfere with textual instruments and markets.

*Id.* at 266.

185. See *supra* note 159 and accompanying text.

186. See, e.g., Stempel, *supra* note 21, at 828:

[A number] of the states appear receptive to the underlying notion of vindicating the reasonable expectations of the policyholder but stop short of treating the notion as a distinct doctrine or principle for decision. Instead, these courts introduce reasonable expectation thinking into their opinions, often combining it with the ambiguity doctrine, and relatively broad notions of promissory and equitable estoppel, waiver, unconscionability, and public policy review, but stop short of using the policyholders' expectations, however reasonable, to override policy language viewed as clear.

*Id.* see also Stempel, *Unmet Expectations*, *supra* note 1, at 183:

A complete and open embrace of the pure version of the doctrine as enunciated in Judge Keeton's famous article—which expressly provides for finding coverage consistent with the objectively reasonable expectations of the policyholder even where those expectations are contradicted by apparently clear policy language—is viewed by much of the legal and political mainstream as too inconsistent with the prevailing American paradigm of judicial restraint, strict construction of disputed texts, and minimal government involvement in market activity. Some of this resistance to reasonable expectations is the product of an unrealistic reification of the prevailing American politico-legal philosophy of judicial restraint. Some of the resistance results from legitimate concerns about political lawmaking less tethered to text (of insurance policies, contracts, statutes, treaties, or documents in general). But although excessively reified and deified, the judicial restraint paradigm is unlikely to shift significantly unless American society incurs radical change. The resilience of the judicial restraint construct is understandable in that, for the most part, it has proven sound and apt for the American system.

*Id.*

187. See *supra* note 149 and accompanying text.

188. See Abraham, *Judge-Made Law*, *supra* note 1.

189. See Rahdert, *Reasonable Expectations Reconsidered*, *supra* note 1.

cede only a very limited role for the Keeton doctrine of reasonable expectations in the vast majority of insurance coverage disputes today.<sup>190</sup> Finally, two recent commentators, Professor Jeffrey Thomas and Professor James Fischer, have both seriously questioned the underlying doctrinal justification and rationale for Professor Keeton's "rights at variance" doctrine of reasonable expectations.<sup>191</sup>

This contemporary reassessment and rejection, dilution, and decline in the theoretical justification, and the practical application, of the Keeton doctrine of reasonable expectations is also mirrored in a current trend of judicial reassessment—and rejection—of the Keeton "rights at variance" reasonable expectations doctrine over the past twenty years.

For example, prior to 1990, California viewed the reasonable expectations doctrine as a viable rationale for the application of a broad proinsured interpretive approach in resolving insurance coverage disputes.<sup>192</sup> Since 1990, however, and largely based upon the *AIU*<sup>193</sup> and *Bank of the West*<sup>194</sup> cases, California courts now apply a more contractually oriented interpretive approach to insurance coverage disputes.<sup>195</sup> Pennsylvania,<sup>196</sup> Idaho,<sup>197</sup>

190. See, e.g., Abraham, *A Regulative Ideal*, *supra* note 1, at 61–62:

The [Keeton] expectations "doctrine" is limited to the point of being of minor significance. For a number of reasons, this doctrine rarely determines or even directly influences the outcome of insurance coverage disputes. First, the doctrine has been adopted in only one-third of the states. In most states, therefore, the doctrine does not and cannot affect the outcome of a coverage dispute. Second, as Roger C. Henderson has so effectively shown, the courts in a number of states that have [purportedly] adopted the doctrine probably do not fully appreciate what they have done and may not adhere fully to their stated position. . . . Third, my own reading of the case law leads me to conclude that even in the states that have adopted and continue to adhere to the expectations doctrine, the courts rarely invoke the doctrine in practice. Very few cases turn on application of the doctrine. Finally, the doctrine is even more rarely invoked in commercial coverage disputes than in consumer cases.

*Id.* Professor Abraham concludes, however, that "even as the expectations 'doctrine' remains in obscurity, the 'principle' at the heart of the doctrine [as a regulative ideal] has a powerful effect on the broader normative posture of insurance law." *Id.* at 68. Professor Abraham's observations are consistent with Professor Mark Rahdert's similar observations of a "tiny trickle of very, very rare instances (so rare that they approach zero)" where a "strong" Keeton "rights at variance" doctrine would arguably apply. See generally *supra* note 163 and accompanying text.

191. See *supra* note 162 and accompanying text.

192. See, e.g., *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 171–72 (Cal. 1966); *Insurance Co. of North America v. Sam Harris Constr. Co.*, 583 P.2d 1335, 1336–37 (Cal. 1978); *White v. Western Title Ins. Co.*, 710 P.2d 309, 314 (Cal. 1985). See also *Croskey*, *supra* note 1, at 453–59.

193. 799 P.2d 1253 (Cal. 1990).

194. 833 P.2d 545 (Cal. 1992).

195. See *Croskey*, *supra* note 1, at 472–73:

This new approach by California's Supreme Court represents the adoption of something very close to what Professor Swisher calls the "middle ground interpretive approach to insurance contract disputes" [citing to Peter Nash Swisher, *Judicial Interpretations of In-*

and Iowa<sup>198</sup> also have recently disapproved the “strong” Keeton “rights at variance” reasonable expectations approach that they once arguably embraced, and instead now appear to use a “weaker” expectations analysis only when contested insurance policy language is ambiguous or otherwise problematic.<sup>199</sup>

A growing number of other courts have expressly rejected the “strong” “rights at variance” Keeton doctrine of reasonable expectations.<sup>200</sup> For example, the Florida Supreme Court in 1998, in its landmark *Deni Associates* case,<sup>201</sup> declared:

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*insurance Contract Disputes: Toward a Realistic Middle Ground Approach*, 59 OHIO ST. L.J. 543, 634 (1996)]. The insurance contract will be interpreted according to general principles of contract construction and clear and plain meaning will be enforced according to the ordinary and popular usage of the words utilized; but if ambiguity still remains it will be resolved by looking to the insured’s objectively reasonable expectations and then *only* if a construction in favor of coverage is consistent with those expectations will the disputed policy language be construed against the insurer. At least from this judge’s perspective, this was a sea change of considerable significance.

*Id.*; see also Blum, *The California Supreme Court: Toward a Radical Middle*, 77 A.B.A.J. 48, 50 (January, 1991):

The court has also expressed a preference for deferring policy judgments affecting important social issues and commercial relationships to legislative decision making. Some court watchers see this as a healthy return to the proper role of the court as an interpreter, rather than a maker of law. Others . . . think the court is too deferential. . . .

“In the area of the common law,” says former Justice Grodin, “I think the court’s conservatism is reflected in the notion that it is unwise to expand liability . . . [and] that contract principles should be applied strictly and without regard, or with little regard, for differences in bargaining power between the parties, and in a tendency toward the insistence upon clear, bright lines and rules.”

*Id.*

196. See, e.g., *Standard Venetian Blind Co.*, 469 A.2d at 563 (suggesting that Pennsylvania is now a “middle ground” reasonable expectations state, utilizing reasonable expectations in combination with ambiguity analysis to resolve insurance coverage disputes involving ambiguous language). See also *Tonkovic v. State Farm Auto. Ins. Co.*, 521 A.2d 920 (Pa. 1987) (similar holding). These two cases are thus a judicial retrenchment from two earlier cases that arguably recognized the “strong” Keeton “rights at variance” doctrine in *Collister v. Nationwide Life Ins. Co.*, 388 A.2d 1346 (Pa. 1978), and *Hionis v. Northern Mut. Ins. Co.*, 327 A.2d 363 (Pa. Super. 1974).

197. See, e.g., *Casey v. Highlands Ins. Co.*, 600 P.2d 1387 (Idaho 1979) (rejecting the reasonable expectations doctrine in any form, and expressly overruling the earlier case of *Corgatelli v. Globe Life & Accident Ins. Co.*, 533 P.2d 737 (Idaho 1975)).

198. See, e.g., *Farm Bureau Mut. Ins. Co. v. Sandbulte*, 302 N.W.2d 104 (Iowa 1981) (moving away from a “strong” “rights at variance with the policy language” reasonable expectations approach, and requiring that the policy language be ambiguous, bizarre, or oppressive in order to provide coverage based on policyholder expectations).

199. See generally Stempel, *Unmet Expectations*, *supra* note 1, at 191–95.

200. See, e.g., *Menke v. Country Mut. Ins. Co.*, 401 N.E.2d 539 (Ill. 1980); *Bond Bros. v. Robinson*, 471 N.E.2d 1332 (Mass. 1984); *Robbins Auto Parts v. Granite State Ins. Co.*, 435 A.2d 507 (N.H. 1981); *Sterling Merchandise Co. v. Hartford Ins. Co.*, 506 N.E.2d 1192 (Ohio Ct. App. 1986); *Allen v. Prudential Prop. & Cas. Ins. Co.*, 839 P.2d 798 (Utah 1992); *Ryan v. Harrison*, 699 P.2d 230 (Wash. Ct. App. 1985); *St. Paul Fire & Marine Ins. Co. v. Albany County School District*, 763 P.2d 1255 (Wyo. 1988).

201. *Deni Associates of Florida Inc. v. State Farm Fire & Cas. Ins. Co.*, 711 So. 2d 1135 (Fla. 1998).



We decline to adopt the doctrine of reasonable expectations. There is no need for it if the policy provisions are ambiguous because in Florida ambiguities are construed against the insurer. To apply the doctrine to an unambiguous provision would be to rewrite the contract and the basis upon which the premiums are charged. See *Sterling Merchandise Co. v. Hartford Ins. Co.*, 30 Ohio App. 3d 131, 506 N.E.2d 1192, 1197 (Ohio Ct. App. 1986) (“The reasonable expectation doctrine requires a court to rewrite an insurance contract which does not meet popular expectations. Such rewriting is done regardless of the bargain entered into by the parties to the contract.”).

Construing insurance policies upon a determination as to whether the insured’s subjective expectations are reasonable can only lead to uncertainty and unnecessary litigation. As noted in *Allen v. Prudential Property and Casualty Insurance Co.*, 839 P.2d 798, 803 (Utah, 1992):

Today, after more than twenty years of attention to the [Keeton] doctrine [of reasonable expectations] in various forms by different courts, there is still great uncertainty as to the theoretical underpinnings of the doctrine, its scope, and the details of its application.<sup>202</sup>

Although the *Deni* case has been criticized by some commentators,<sup>203</sup> this recent judicial decision by the Florida Supreme Court nevertheless illustrates the current legal trend in many American jurisdictions today of severely restricting—or expressly rejecting—the Keeton reasonable expectations doctrine.<sup>204</sup>

Finally—and most curiously, after more than thirty years of contentious debate—a majority of states still have not expressly adopted, or expressly rejected, the Keeton doctrine of reasonable expectations, and apparently have chosen to ignore this jurisprudential brouhaha.<sup>205</sup> Thus, as Professor Kenneth Abraham observes:

[E]ven in the [small minority] of states where it is in force, the [Keeton reasonable] expectations doctrine is static. It is not developing, evolving, or changing. There are very few if any decisions that apply the doctrine in a new way or uncover unrecognized implications of prior applications. On the contrary, the expectations doctrine is going nowhere.

In short, the [Keeton reasonable] expectations [doctrine] is a weapon in the insured’s arsenal in the [very small] minority of states that have adopted it, and is a threat to insurers in those states, but the doctrine is of minor significance.

202. *Id.* at 1140.

203. See, e.g., Stempel, *Unmet Expectations*, *supra* note 1, at 223–45 (“Reasonable Expectations Comes to a Crossroad in Florida—and is driven into a ditch.”).

204. See *supra* notes 182–99 and accompanying text.

205. See, e.g., Abraham, *A Regulative Ideal*, *supra* note 1, at 60: “For over three decades now, the courts of some states have followed the [Keeton] doctrine permitting them to honor the reasonable expectations of the insured to coverage, notwithstanding clear policy language to the contrary. Most courts, however, have either expressly rejected this doctrine or quietly ignore it.” *Id.*; see also Swisher, *A Middle Ground Approach to Insurance Contract Disputes*, *supra* note 5, at 554 n.34; Stempel, *Unmet Expectations*, *supra* note 1, at 223 n.118.

The doctrine should be taught in the classroom, employed by insureds where possible, and anticipated as a potential threat by insurers. But the [Keeton] doctrine is not an important feature on the landscape of insurance law.<sup>206</sup>

#### IX. A REALISTIC CONSENSUS APPROACH TO THE INSURANCE LAW DOCTRINE OF REASONABLE EXPECTATIONS

A realistic consensus approach to Professor Keeton's insurance law doctrine of reasonable expectations—an approach shared by the overwhelming majority of courts and legal commentators today—is that the “strong” Keeton doctrine of reasonable expectations at variance with clear and unambiguous insurance policy language has been relegated—in theory and in practice—to the status of an insignificant legal doctrine that is very rarely ever applied, and only then by a small handful of courts. There are a number of interrelated reasons why the Keeton doctrine of reasonable expectations has experienced a much more limited judicial application than various commentators initially had predicted: (1) under a “strong” Keeton rights at variance with the insurance policy language doctrine, the insurance policy need not be interpreted according to its clear and unambiguous contractual language—which is anathema to a more formalistic and textualistic theory of insurance contract interpretation;<sup>207</sup> (2) those courts that purportedly do recognize this “strong” rights at variance with the policy language principle have been unable to agree upon what specific factors would constitute such a reasonable expectation of coverage, and what factors would not;<sup>208</sup> and (3) a growing number of commentators have questioned the underlying doctrinal justification of reasonable policyholder expectations supporting this “rights at variance” interpretive approach to insurance coverage disputes.<sup>209</sup> Consequently, the current judicial trend in the vast majority of American states today—and the modern consensus approach to the insurance law doctrine of reasonable expectations—is to reassess and substantially restrict,<sup>210</sup> reject,<sup>211</sup> or basically ignore<sup>212</sup> Professor Keeton's “rights at variance” reasonable expectations doctrine. For all practical purposes, then, the Keeton “rights at variance” doctrine of reasonable expectations does not play an important role in the landscape of contemporary American insurance law,<sup>213</sup> and for all practical purposes it is now a dead and discarded doctrine.

206. Abraham, *A Regulative Ideal*, *supra* note 1, at 63.

207. *See supra* notes 13 and 160 and accompanying text.

208. *See supra* notes 161, 177, and 183 and accompanying text.

209. *See supra* notes 162 and 190 and accompanying text.

210. *See supra* notes 193–99 and accompanying text.

211. *See supra* notes 200–04 and accompanying text.

212. *See supra* note 205 and accompanying text.

213. *See supra* note 206 and accompanying text.

The genius of Professor Keeton's 1970 law review article,<sup>214</sup> however, was to successfully refocus the attention of American courts and legal commentators on those legal circumstances where the reasonable expectations of the insured might indeed *be* at variance with the policy language, and where the "plain meaning" of an insurance policy might *not* be dispositive in achieving a just and equitable result. This was, after all, a doctrine largely based upon Professor Corbin's pioneering "reasonable expectations" interpretive approach in *Corbin on Contracts*<sup>215</sup>—an interpretive approach that Professor Williston also recognized "when justice required it"<sup>216</sup>—though neither Corbin nor Williston was prepared to reject a number of well-established contractually based interpretive rules and remedies in order to ascertain the parties' reasonable expectations to coverage.<sup>217</sup>

The vast majority of American courts today likewise remain unwilling or unable to reject these contractually based interpretive rules and remedies in order to ascertain the reasonable expectations of the parties in insurance contract disputes. Instead of adopting Professor Keeton's "strong" "rights at variance" doctrine of reasonable expectations, the vast majority of contemporary American courts instead have rediscovered—and have more fully utilized—a growing number of contractually based reasonable expectations rights and remedies, including: (1) the doctrine of ambiguities;<sup>218</sup> (2) contract unconscionability and public policy issues;<sup>219</sup> (3) equitable remedies such as waiver, equitable estoppel, promissory estoppel, election, and contract reformation;<sup>220</sup> and (4) a number of additional interpretive rules applied to standardized insurance contracts as contracts of adhesion.<sup>221</sup> Indeed, this contractually based approach in ascertaining the reasonable expectations of the parties has many similarities to, and creates the basic underlying foundation for, the "weaker" Keeton doctrine of reasonable expectations, which is based upon "denying the insurer any unconscionable advantage in an insurance contract."<sup>222</sup>

A realistic consensus approach to the insurance law doctrine of reasonable expectations therefore provides a number of well-established contractual parameters for allowing judicial discretion, when justice and equity requires it, to recognize and honor the reasonable expectations of the parties to coverage in insurance contract disputes that are supplemental to—rather than at variance with—the terms of the parties' insurance contract.

214. See *supra* notes 8–10 and 150–58 and accompanying text.

215. See *supra* notes 105–10 and accompanying text.

216. See *supra* notes 90–93 and accompanying text.

217. See *supra* notes 111–27 and accompanying text.

218. See *supra* notes 20–52 and accompanying text.

219. See *supra* notes 55–70 and accompanying text.

220. See *supra* notes 71–84 and accompanying text.

221. See *supra* notes 128–44 and accompanying text.

222. See *supra* notes 151–57 and accompanying text.

A contractually based doctrine of reasonable expectations also serves as an interpretive shield as well as a sword to the insured policyholder since, as Professor Eric Mills Holmes aptly observes:

Finally, any rule of law can be used offensively as well as defensively. Although [few] opinions have addressed this issue, an insurance carrier (in an appropriate set of objective circumstances) could assert the [insurance law doctrine of reasonable expectations] defensively by alleging that no reasonable person would objectively expect insurance coverage.<sup>223</sup>

If the current trend continues to develop where insurance companies are prepared to litigate with their policyholders over insurance coverage disputes in ever-increasing numbers,<sup>224</sup> including a number of alleged “opportunistic breaches” by various insurance companies,<sup>225</sup> then a fortiori an insured policyholder truly needs these protective contractual rights and remedies, when justice and equity require it, in order to recognize and validate the policyholder’s reasonable expectation to coverage when it is at variance with the insurance policy language.

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223. HOLMES’ APPLEMAN ON INSURANCE LAW, *supra* note 1, § 8.6 at 421. See also *supra* note 17 and accompanying text. Professor Keeton also recognized this important corollary to the doctrine of reasonable expectations: “Several precedents among the small body of cases already decided make the point that this new doctrine is no guarantee of victory for a plaintiff against the insurer, and may even be used affirmatively by any insurer in defense against claims that are beyond reasonable expectations.” Keeton, *Reasonable Expectations*, *supra* note 1, at 279–80 (footnotes omitted).

224. See, e.g., Leslie Scism, *Tight-Fisted Insurers Fight Their Customers to Limit Big Awards*, WALL ST. J., Oct. 15, 1996, at A1 (stating that, according to the American Insurance Association, “insurers spend (conservatively) a billion dollars a year in so-called coverage litigation.”).

225. See Anderson and Fournier, *supra* note 1, at 377–85; see also Bob Works, *Excusing Nonoccurrence of Insurance Policy Conditions in Order to Avoid Disproportionate Forfeiture: Claims-Made Formats as a Test Case*, 5 CONN. INS. L.J. 505 (1998–99).