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The Reasonable Expectations Doctrine: An Alternative to Bending and Stretching Traditional Tools of Contract Interpretation

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THE REASONABLE EXPECTATIONS DOCTRINE: AN ALTERNATIVE TO BENDING AND STRETCHING TRADITIONAL TOOLS OF CONTRACT INTERPRETATION

I. INTRODUCTION 1113
II. OVERVIEW AND HISTORY 1115
A. *Traditional Tools of Contract Interpretation* 1117
1. *Doctrine of Ambiguity* 1117
2. *Adhesion* 1119
3. *Reformation* 1119
B. *Other Doctrines Affecting Coverage Disputes* 1120
1. *Waiver and Estoppel* 1120
2. *Unconscionability* 1121
C. *Emergence of Reasonable Expectations Doctrine* 1122
III. THE REASONABLE EXPECTATIONS DOCTRINE IN MINNESOTA 1124
A. *The* Atwater *Case* 1124
B. *Supreme Court Decisions Since* Atwater 1126
C. *Court of Appeals Decisions Since* Atwater 1129
IV. SUGGESTED STANDARDS FOR APPLICATION OF THE REASONABLE EXPECTATIONS DOCTRINE 1133
A. *When the Doctrine Applies* 1133
B. *How the Doctrine Applies* 1135
V. CONCLUSION 1138

I. INTRODUCTION

The majority of Americans own insurance policies. They pay premiums for insurance coverage that is difficult if not impossible to understand. In fact, most Americans find their policies so confusing that they do not even read them.[1] As a result, insurance companies can present a policyholder with standard policies without ever giving the policyholder the opportunity to negotiate the terms. Negotiating policies individually would likely put insurance companies out of business because of the enormous cost or render insurance coverage so costly that only the rich could afford it. Presently, policyholders have to accept the standard forms because the only alternative is to forego insurance, which could be disastrous.

Courts interpret insurance policies with this inequality in mind,[2]

1. Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 968 (1970).

2. ROBERT H. JERRY, II, UNDERSTANDING INSURANCE LAW § 25C, at 104 (1987).

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recognizing that policyholders rarely have an opportunity to negotiate their policies and often are forced to accept provisions or exclusions which they do not want.[3] Since insurance policies are standardized forms, usually the only differences from policy to policy are marketing, service, and premiums. By using traditional contract interpretation tools, the courts attempt to effectuate the intent of the parties while giving the policyholder an extra measure of protection.[4] Often these tools create rights for the policyholder that extend beyond those discernable from the actual language of the policy.[5]

Although courts frequently use traditional tools to interpret insurance contracts, these tools sometimes are inadequate to determine the parties' intent or resolve the inequality created by the policyholder's lack of bargaining power.[6] Insurance policies may require additional safeguards in situations where the traditional tools do not apply.[7] By recognizing that the policyholder may have expectations of coverage different from the explicit language of the policy, courts further protect policyholders from their lack of bargaining power. This additional safeguard is the reasonable expectations doctrine.[8] The doctrine of reasonable expectations allows the court to impose liability on the insurer for misleading the policyholder or to mandate coverage when it seems fair to do so.[9]

Jerry correctly observes that no real contract negotiation occurs in the sale and marketing of insurance policies. Instead, policyholders are confronted with a take-it-or-leave-it choice. In most transactions, the policyholder does not even receive the policy until after the policyholder pays the first premium. *Id.* § 25C, at 104-05.

3. Mark C. Rahdert, *Reasonable Expectations Reconsidered*, 18 CONN. L. REV. 323, 326 (1986) (quoting Dover-Glass Works Co. v. American Fire Ins. Co., 29 A. 1039, 1041 (Del. 1894)). Rahdert recognizes that this inequality comes from the absence of bargaining power, common use of standard preprinted forms, and mass marketing by powerful, sophisticated underwriters. The individual policyholder, by contrast, has few assets or resources with which to bargain. *Id.*

4. For further discussion of the traditional tools of contract interpretation, *see infra* parts II.A-B. These traditional tools have been brought over to insurance law from ordinary contract law. As with waiver and estoppel, many of these tools have developed over time into entirely different theories from what they once were.

5. Keeton, *supra* note 1, at 962.

6. Rahdert, *supra* note 3, at 341. Insurers find it relatively easy to insert definitions, conditions, and exclusions to reduce their risk and regularly do so. Insurers face, and may yield to, the temptation to shift more and more risk to the policyholder. *Id.*

7. Keeton, *supra* note 1, at 973.

8. JERRY, *supra* note 2, § 25D, at 109.

9. Kenneth S. Abraham, *Judge-Made Law and Judge-Made Insurance: Honoring the Reasonable Expectations of the Insured*, 67 VA. L. REV. 1151, 1155 (1981). Abraham groups cases involving the reasonable expectations doctrine into two categories: the "misleading impression" theme and the "mandated coverage" theme. The "misleading impression" theme includes automated marketing cases, accident insurance coverage bearing a misleading name, and temporary life insurance. *Id.* at 1155-62.

Unfortunately, application of the doctrine of reasonable expectations has been inconsistent.[10] Courts often confuse it with other tools of contract interpretation or simply misapply it.[11] In Minnesota, the supreme court has embraced the reasonable expectations doctrine but has not provided adequate guidelines for its application.[12] As a result, litigants and the lower courts are frequently confused about how to apply the doctrine.[13]

This Note clarifies the doctrine of reasonable expectations and provides guidelines for its future application. Part II examines both the traditional tools of contract interpretation and the development of the reasonable expectations doctrine. Part III discusses the application of the doctrine in Minnesota, and part IV provides guidelines for future application of the doctrine, including sample jury instructions.

II. Overview and History

A contract for insurance is an agreement in which the insurer assumes the policyholder's risk in exchange for consideration.[14] Like

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The mandated coverage theme includes the duty to defend and the extension of duration of coverage. *Id.* at 1162-68.

10. *See infra* notes 64-65 for discussion of judicial treatment of the doctrine in other states.

11. *See infra* notes 94-97 for Minnesota cases that confuse the reasonable expectations doctrine with the doctrine of ambiguity. This confusion appears to make some courts reluctant to use the doctrine of reasonable expectations. Unless remedied, courts may eventually stop using the doctrine altogether. In light of the special nature of insurance policies, the doctrine is too important to be ignored.

12. The court attempted to provide guidelines for the doctrine's application in Atwater Creamery Co. v. Western Nat'l Mut. Ins. Co., 366 N.W.2d 271, 277 (Minn. 1985). As discussed below, the resulting confusion indicates a need for more guidance.

13. *See infra* part III for a discussion of Minnesota's application of the doctrine.

14. Jerry, *supra* note 2, § 11[2][d], at 15. When people are averse to the risk of loss, they are willing to pay someone else to assume that risk. Insurance companies can afford to assume the risk by pooling many risks together. This pooling results in a distribution of the individual's risk throughout the pool. *Id.* § 10C, at 12.

This pooling of risks can be traced back to the primitive forms of insurance in ancient societies. Social or religious groups gave assistance to the needy from a common fund. Commercial insurance has been found in the Code of Hammurabi, the Hindu Laws of Manu and the laws of the ancient Greeks. Jerry, *supra* note 2, § 11, at 16-18.

By the twelfth century, insurance contracts were already significantly used in medieval maritime Italy. By 1688, Lloyd's Coffee House in London used insurance contracts to protect merchants' cargo. Anyone interested in insuring cargo could write a bid on a slip of paper which was passed around. The merchant usually accepted the lowest bid. Policyholders in the United States were paying 253 billion dollars annually in premiums by 1984. In 1985, the United States insurance industry had assets exceeding 1.3 trillion dollars. *Id.*; *see also* William R. Vance, Handbook of the Law of Insurance, at 7-35 (Buist M. Anderson ed., 3d ed. 1951).

any contract, insurance policies are subject to interpretation by the courts.[15] Initially insurance policies were interpreted in the same manner as any other contract.[16] By determining the meaning of a contract, a court attempts to effectuate the intent of the contracting parties.[17] However, by the early twentieth century, courts recognized that insurance contracts were unique because of their esoteric nature and the lack of opportunity for the policyholders to participate in the negotiation of their own policy.[18] Insurers frequently sought to construe words in the policy as terms of art despite the fact that few policyholders could be expected to understand their meaning.[19]

Courts frequently use traditional tools of contract interpretation to determine the parties' intent in an insurance policy. The doctrines of ambiguity, adhesion, reformation, waiver, estoppel, and unconscionability are the interpretive tools most often applied to insurance contracts.[20] However, these doctrines have limitations and cannot be applied in every case.

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15. The courts use various principles to resolve interpretation disputes. These principles include: 1) giving great weight to the purpose of the parties; 2) interpreting a writing as a whole and interpreting separate writings from the same transaction together; 3) giving language its generally understood meaning; 4) interpreting technical terms according to their technical meaning if used in a transaction in that technical field; 5) giving great weight to course of performance; 6) interpreting terms of an agreement consistently with each other; 7) when possible, interpreting terms in a way that gives them relevance in their setting; 8) favoring interpretations that make a contract legal over those that make it illegal; 9) attributing greater weight to specific terms than to standardized terms; 10) attributing greater weight to express terms than implied terms; 11) attributing greater weight to express terms than to terms implied by course of performance, course of dealing, or usage of trade; 12) if alternative meanings exist, preferring the one favoring the non-drafting party; and 13) when choosing among alternative means, preferring the one favoring public interest over one that does not. JERRY, *supra* note 2, § 25A, at 101-02.

16. Early courts simply looked to the contract language to determine the intent of the parties. *See, e.g.*, Dover-Glass Works Co. v. American Fire Ins. Co., 29 A. 1039, 1041 (Del. 1894); Drilling v. New York Life Ins. Co., 137 N.E. 314, 316 (N.Y. 1922).

17. *Id.* § 25, at 94. Jerry defines interpretation as a "process by which a court determines the meaning that it will give the language used by the parties in a contract." *Id.*

18. *See, e.g.*, Darner Motor Sales v. Universal Underwriters Ins. Co., 682 P.2d 388, 393 n.6 (Ariz. 1984) (noting that it is time to remove insurance from the land of make-believe); Raulet v. Northwestern Nat'l Ins. Co. of Milwaukee, 107 P. 292, 293-94 (Cal. 1910) (recognizing that the numerous conditions and exclusions were traps for the unwary insured who did not understand the language of an insurance contract which he had no role in negotiating).

19. The mass-marketing of insurance policies to policyholders who are dependent on insurance allows insurance companies to manipulate the fine print. Rahdert, *supra* note 3, at 326.

20. *See infra* part II.A-C for a discussion of these tools and doctrines.

The reasonable expectations[21] doctrine evolved out of the notion that policyholders may have rights not necessarily found within the four corners of the policy. These rights may even be at variance with the policy language.[22] Unlike the other tools, the reasonable expectations doctrine is used only in the interpretation of insurance policies. A careful examination of the limitations of traditional tools and doctrines that apply to insurance contracts helps explain the emergence of the reasonable expectations doctrine.

A. Traditional Tools of Contract Interpretation

1. Doctrine of Ambiguity

The first place a court looks in interpreting a contract is the writing itself. If the writing appears clear on its face, its meaning will be determined from the four corners of the document.[23] If a term is not clear, the court applies the doctrine of ambiguity.[24] Recognizing that the drafter has the best opportunity to prevent ambiguity, the doctrine resolves ambiguous terms against the party that drafted the contract.[25] The doctrine represents the court's effort to prevent sharp drafting and to factor in the drafter's ability to correct any problems.[26]

The doctrine of ambiguity is widely used by courts to "ameliorate harsh effects that would otherwise result from insurance policy terms."[27] This doctrine provides the court with a means for interpreting unclear policy language, to protect the policyholder,[28] while remaining within the bounds of a legal theory of contract interpretation.[29]

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21. "Expectations" refers to the rights a policyholder believes he or she has against the insurer at the time the parties form their agreement. Abraham, *supra* note 9, at 1169 n.73.

22. Keeton, *supra* note 1, at 961.

23. RESTATEMENT (SECOND) OF CONTRACTS §§ 200-204 (1981); *see also* Morris v. Weiss, 414 N.W.2d 485, 488 (Minn. Ct. App. 1987).

24. The doctrine of ambiguity is often referred to by its Latin name, *contra proferentum. See* BLACKS LAW DICTIONARY 327 (6th ed. 1990).

25. 2 G. COUCH, CYCLOPEDIA (SECOND) OF INSURANCE LAW § 15:74 (rev. 2d ed. 1984); *see also* Goucher v. John Hancock Mut. Life Ins. Co., 324 A.2d 657, 662 (R.I. 1974) (construing ambiguities in policy against the insurer).

26. Rahdert, *supra* note 3, at 328-29.

27. ROBERT F. KEETON & ALAN I. WIDISS, INSURANCE LAW 629 (1978).

28. The California Supreme Court, for example, has used the doctrine of ambiguity as follows:

> [I]f the insurer uses language which is uncertain any reasonable doubt will be resolved against it; if the doubt relates to extent or fact of coverage, whether as to peril insured against . . . the amount of liability, or the person or persons protected, the language will be understood in its most inclusive sense, for the benefit of the insured.

Continental Casualty Co. v. Phoenix Constr. Co., 296 P.2d 801, 809-10 (Cal. 1956).

29. One commentator argues that application of the doctrine of ambiguity pro-

When a case arises where the other traditional rules of contract interpretation do not apply, courts often stretch to find an ambiguity where none existed in order to achieve a fair result.[30] However, inventing ambiguities to arrive at a "proper" result undermines confidence in the judicial system by creating unpredictability and giving an impression of judicial prejudice in favor of the policyholder.[31] The reasonable expectations doctrine is a way to avoid manufacturing ambiguities in order to apply the doctrine of ambiguity. Unfortunately, the courts often confuse the doctrine of ambiguity with the reasonable expectations doctrine.[32]

Minnesota courts recognize the doctrine of ambiguity and often fall into the trap of confusing it with the reasonable expectations doctrine.[33] Minnesota courts address the two doctrines together by applying the doctrine of reasonable expectations only in the presence of an existing ambiguity.[34] This application is incorrect. The doctrine of ambiguity is a separate doctrine. As a tool of first resort, the doctrine of ambiguity should be applied before even considering the reasonable expectations doctrine. The doctrine of reasonable expectations is a tool of last resort for interpreting insurance contracts: the policyholder's expectations should be considered only when no ambiguity exists.[35]

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vides the court with consistent results in cases involving insurance disputes, which in time could induce the industry to respond by clarifying the policy language. Rahdert, *supra* note 3, at 329. If so, one would expect to see the doctrine of ambiguity used less frequently after those policies are clarified.

30. *See* Morgan v. State Farm Life Ins. Co., 400 P.2d 223, 224-25 (Cal. 1965) (noting cases that have been decided on the basis of ambiguity where none, in fact, existed).

31. KEETON & WIDISS, *supra* note 27, at 632-34. Keeton and Widiss note that if the result in such cases is supportable at all, it must be due to application of the principles of the reasonable expectations doctrine, whether or not expressly stated by the court. *Id.*

32. For example, some courts require ambiguity before the doctrine of reasonable expectations can be invoked. *See, e.g.*, Carley v. Lumbermens Mut. Casualty Co., 521 A.2d 1053, 1058 (Conn. App. Ct. 1985) (declining to consider policyholders' expectations in the absence of an ambiguity in the policy provisions).

33. Minnesota case law generally finds two types of ambiguity in insurance contracts. Either the ambiguity results from policy terms that are susceptible to more than one meaning, or it results from irreconcilable conflicts between terms or provisions in the policy. Morris v. Weiss, 414 N.W.2d 485, 487 (Minn. Ct. App. 1987); *see also* Nordby v. Atlantic Mut. Ins. Co., 329 N.W.2d 820, 822 (Minn. 1983).

34. *See* Bob Useldinger & Sons v. Hangsleben, 483 N.W.2d 495 (Minn. Ct. App. 1992); Morris v. Weiss, 414 N.W.2d 485, 488 (Minn. Ct. App. 1987); Curtis v. Home Ins. Co., 392 N.W.2d 44, 46 (Minn. Ct. App. 1986).

35. It is possible for the court to use both tools in interpreting different portions of the same policy. An excellent example is found in Wessman v. Massachusetts Mut. Life Ins. Co., 929 F.2d 402 (8th Cir. 1991). In *Wessman*, the court granted summary judgment to the insurance company. The Wessmans appealed, and the Eighth Circuit remanded the case for factfinding on the reasonable expectations of the policy-

2. *Adhesion*

Insurance contracts are almost always contracts of adhesion because they are drafted by the insurer.[36] As Professor Williston observed, to deny this fact is to deny the realities of the drafting and marketing of insurance policies:

> [Insurance contracts are drafted] with the aid of skillful and highly paid legal talent, from which no deviation desired by an applicant will be permitted. The established underwriter is magnificently qualified to understand and protect its own selfish interests. In contrast, the applicant is a shorn lamb driven to accept whatever contract may be offered on a "take-it-or-leave-it" basis if he wishes insurance protection.[37]

In the context of insurance policy coverage disputes, the doctrine of adhesion is a mechanism used to implement the important social policy of leveling the playing field for the policyholder. Recognizing the fact that insurance policies are contracts of adhesion allows courts to apply pro-policyholder interpretive techniques.[38] Using these techniques on insurance policies often creates rights for the policyholder that are at variance with the policy.[39] The use of the adhesion doctrine to protect the policyholder is an essential justification for applying the pro-policyholder interpretive tools such as the doctrine of reasonable expectations. The doctrine of adhesion supports the use of the reasonable expectations doctrine because it is the adhesive nature of insurance contracts that allows the courts to consider and give effect to the reasonable expectations of the policyholder.

3. *Reformation*

Reformation is an equitable remedy available when the written agreement is inconsistent with the actual agreement of the parties.[40]

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holder. *Id.* at 407. In addition, the court found independent grounds for reversal based on the ambiguous terms in the policy. *Id.*

36. *See* Eric M. Holmes, *A Contextual Study of Commercial Good Faith: Good-Faith Disclosure in Contract Formation*, 39 U. PITT. L. REV. 381, 387-400 (1978). Holmes points out that insurance contracts are adhesive because of "the inequality in bargaining power and knowledge as between insurer and applicant, the technical character of the insurance contract, the fact that delivery of the policy often occurs after contract formation and premium payment, and the mass-standardized nature of insurance contracts." *Id.* at 397 (footnotes omitted).

37. SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 900, at 19-20 (W. Jaeger ed., 3d ed. 1973).

38. *See, e.g.*, Cairns v. Grinnell Mut. Reins. Co., 398 N.W.2d 821, 824-25 (Iowa 1987) (employing pro-policyholder presumption of adhesion contract to interpret policy to provide coverage based on techniques commonly used in statutory interpretation).

39. JERRY, *supra* note 2, § 25C, at 106.

40. *Id.* § 25H.

The classic application of the reformation remedy is a situation where fraud or mistake by one or both parties results in an inconsistency between the intended agreement and the actual written contract.[41] The inconsistent writing will be cured by reforming the contract to reflect the parties' intent or the intent of the innocent party.[42] However, reformation is limited to situations of mutual mistake or when the parties at least share knowledge of a mistake. To avoid rewriting the contract for the parties, the court uses reformation with great caution.[43]

B. Other Doctrines Affecting Coverage Disputes

1. Waiver and Estoppel

Although waiver and estoppel are separate theories, they are often treated as one doctrine in insurance contracts. It is unclear whether this merging of the doctrines by courts is intentional.[44]

Waiver is the voluntary relinquishment of a known right.[45] Courts use it when an insurer acts as if the insurance policy is valid but knows that a ground exists upon which the policy should be voided.[46] Estoppel is the imposition of liability for a misleading statement or action upon which the other party has detrimentally relied.[47] Generally, the act of one party creates waiver, while operation of law creates estoppel.[48] Collectively, both doctrines create rights for the policyholder that are at variance with the policy itself.[49] They constitute additional methods to effectuate the true intent of the parties.

Waiver and estoppel are limited in many ways. They cannot be used to affect rights that exist for a public purpose. Both may be limited by the parol evidence rule.[50] In addition, some courts will not allow waiver or estoppel to expand coverage,[51] holding instead

41. *Id.*
42. KEETON & WIDISS, *supra* note 27, at 616.
43. JERRY, *supra* note 2, § 25H.
44. KEETON & WIDISS, *supra* note 27, at 617.
45. JERRY, *supra* note 2, § 25E[a].
46. *Id.* § 25E[b]. The most common example of waiver occurs when the company accepts a premium for coverage, knowing that the insured has already breached a warranty. A less common example occurs when the insurer pays a claim with full knowledge of the facts. Hartford v. Doubler, 434 N.E.2d 1189, 1192 (Ill. 1982). For example, the court in *Hartford* held that this payment constituted a waiver of the policy exclusion. *Id.* Some courts, however, refuse to apply the doctrine of waiver where it will expand coverage.
47. JERRY, *supra* note 2, § 25E[a].
48. *Id.*
49. KEETON & WIDISS, *supra* note 27, at 618.
50. JERRY, *supra* note 2, § 25E, at 114.
51. *Id.* § 44, at 194. In Minnesota, for example, waiver and estoppel cannot be

that they can be used only to prevent rescission or to defend a claim within the policy.[52] Waiver and estoppel are further limited by the relative rarity of factual situations to which they can apply.

Waiver and estoppel focus on rights and conduct that the policyholder may have voluntarily given away, not on the policyholder's expectations of coverage. As a result, they do not reach the heart of the cases that are best decided by the reasonable expectations doctrine. Rarely does the policyholder ever form an intention to waive or not to waive. The doctrine of waiver is particularly ill-suited because no one thinks about it until there is a loss. Waiver may become an issue, but only after it has been decided that the policyholder's expectations were reasonable. In some cases the policyholder may have waived that element of coverage.

2. *Unconscionability*

All insurance contracts run the risk of having unconscionable terms because they are drafted solely from the insurer's perspective, and the language chosen is not subject to negotiation.[53] The lack of negotiation, coupled with the vast experience of the insurer with prior claims, results in language which strongly favors the insurer.[54] Insurance contracts provide insurers with many opportunities for overreaching when drafting their policies,[55] and courts at times refuse to enforce these terms even if they are clear and unambiguous.[56]

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used to expand coverage, but can only affect rights reserved in the policy. *See, e.g.*, Shannon v. Great American Ins. Co., 276 N.W.2d 77, 78 (Minn. 1979); Minnesota Federal Savings & Loan Ass'n v. Iowa Nat'l Mut. Ins. Co., 372 N.W.2d 763, 767 (Minn. Ct. App. 1985); Minnesota Mut. Fire & Casualty Co. v. Rudzinske, 347 N.W.2d 848, 851 (Minn. Ct. App. 1984).

52. JERRY, *supra* note 2, § 25E[c].

53. *See* Keeton, *supra* note 1, at 963.

54. Rahdert, *supra* note 3, at 339 n.50 (citing U.C.C. § 2-302 (1978) and RESTATEMENT (SECOND) OF CONTRACTS § 268 (1981)); *see generally* John E. Murray, *Unconscionability: Unconscionability* 31 U. PITT. L. REV. 1 (1969).

55. Keeton, *supra* note 1, at 963.

56. *See, e.g.*, Smith v. Werland Life Ins. Co., 539 P.2d 433, 443-44 (Cal. 1975) (adopting rule that insurance can only be terminated by insurer giving both notice of rejection and a refund of the premium because it is unconscionable for an insurance company to hold premium without providing coverage); C & J Fertilizer v. Allied Mut. Ins. Co., 227 N.W.2d 169, 179-81 (Iowa 1975) (holding that unconscionability is alternative basis for achieving the same result mandated by reasonable expectations doctrine); American Fidelity Fire Ins. Co. v. Williams, 263 N.W.2d 311, 315 (Mich. Ct. App. 1977) (awarding coverage in the absence of ambiguity because policy provision was unconscionable); Glarner v. Time Ins. Co., 465 N.W.2d 591, 595-96 (Minn. Ct. App. 1991) (holding that conditional receipts creating illusory coverage are unconscionable); Storms v. United States Fidelity & Guar. Co., 388 A.2d 578, 580 (N.H. 1987) (holding that insured's reasonable expectations will not be delimited by policy language even if such language is clear so long as reliance is reasonable); Mills

C. *Emergence of the Reasonable Expectations Doctrine*

While the traditional doctrines of interpretation have been important in determining rights at variance with the policy, a void nevertheless remains which the reasonable expectations doctrine fills. Cases abound in which no ambiguity was present, no rights were waived, and no basis for estoppel can be found. Unequal bargaining power is present, but the stringent requirements of the doctrine of adhesion may not be present.

In the past, courts had to "bend and stretch" these doctrines in order to decide in favor of the policyholder.[57] Today, the reasonable expectations doctrine solves many of the problems posed by the inequality of the parties. The doctrine of reasonable expectations allows courts, as a last resort, to bring fairness to the insurance contract by giving legal effect to the policyholder's expectations.

The courts began looking at the reasonable expectations of policyholders in order to find rights that could not be found in the policy. One of the first cases to employ this principle was *Kievit v. Loyal Protective Life Insurance Co.*[58] In *Kievet*, the New Jersey Supreme Court noted, "When members of the public purchase policies of insurance they are entitled to the broad measure of protection necessary to fulfill their reasonable expectations."[59]

The principles that were developed in these early cases were for-

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v. Agrichemical Aviation, 250 N.W.2d 663, 668-69 (N.D. 1977) (invoking doctrine of reasonable expectations to allow coverage despite clear and unambiguous policy language); *see also* Kenneth S. Abraham, *Judge-Made Law and Judge-Made Insurance: Honoring the Reasonable Expectations of the Insured*, 67 VA. L. REV. 1151, 1152 n.2 (1981); Arthur A. Leff, *Unconscionability and the Code: The Emperor's New Clause*, 115 U. PA. L. REV. 485 (1967).

57. The language "bend and stretch" is taken from the Minnesota Supreme Court's description of what courts do to find justice in these cases. *See* Atwater Creamery Co. v. Western Nat'l Mut. Ins. Co., 366 N.W.2d 271, 278 (Minn. 1985).

58. 170 A.2d 22 (N.J. 1961). In *Kievit*, the policyholder suffered from body tremors after being hit on the head with a piece of wood. The tremors were the result of a preexisting, but latent, Parkinson's disease which the blow triggered. The policy covered loss "resulting directly and independently of all other causes from accidental bodily injur[y]," excluding disability resulting from or contributed to by any disease or ailment. *Id.* at 24. The policyholder recovered based on his reasonable expectations of coverage. *Id.* at 23-26.

59. *Id.* at 26. Other early cases include Gray v. Zurich Ins. Co., 419 P.2d 168, 171 (Cal. 1966) (holding that provision regarding duty to defend should be construed to honor the insured's reasonable expectations of coverage); Steven v. Fidelity & Casualty Co., 377 P.2d 284, 288 (Cal. 1962) (holding that insured may reasonably expect coverage for whole trip when he buys flight insurance from a vending machine at the airport); Prudential Ins. Co. v. Lamme, 425 P.2d 346, 348 (Nev. 1967) (holding that conditional receipt creates temporary life insurance, fulfilling the insured's reasonable expectations of coverage); Gerhardt v. Continental Ins. Cos., 225 A.2d 328, 334 (N.J. 1966) (stressing that reasonable expectations are to be determined and fulfilled solely from the perspective of a local policy in a local relationship); Allen v.

mally articulated as an insurance law doctrine by Professor Keeton in 1970. "The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations."[60] The policy thus defined does not inherently depend on the language of the policy. Keeton concluded that although the doctrine was too broad to be universally true, it was a principle that should be adopted into insurance law.[61]

Application of the reasonable expectations doctrine revolves around several factors: the likelihood that the policyholder expected coverage, the insurer's responsibility for creating the expectation, and the substantive unfairness of the policy provision.[62] Courts invoke the doctrine where the insurer has misled the policyholder, where coverage is desirable, and perhaps most importantly, where the court perceives itself as possessing the power and duty to provide coverage.[63]

Although the reasonable expectations doctrine has been adopted by the majority of states, it is not uniformly applied. Two variations of the doctrine are prevalent. The original formulation by Keeton applies the reasonable expectations doctrine extensively to broaden coverage at all levels of policy interpretation. A more restricted view of the doctrine limits its application, for example, to cases in which ambiguous policy language is at issue.[64] Finally, some states have

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Metropolitan Life Ins. Co., 208 A.2d 638, 644-45 (N.J. 1965) (recognizing that in the interests of justice the expectations should not be frustrated).

60. Keeton, *supra* note 1, at 967.

61. *Id.*

62. Abraham, *supra* note 9, at 1154. Abraham notes four situations where the doctrine applies: 1) when the policy itself creates an expectation; 2) when the insurer is directly responsible for the policyholder's expectations; 3) when the insured is indirectly responsible for the policyholder's expectations; and 4) when the expectations are created by forces for which the insurer is not responsible. *Id.* at 1181-85.

63. *Id.* at 1154-63.

64. States that have considered and adopted the reasonable expectations doctrine have generally done so in one of the following two ways:

Many states have based the doctrine on Keeton's formula: Alaska Rural Elec. Coop. v. INSCO Ltd., 785 P.2d 1193, 1194 (Alaska 1990); Gordinier v. Aetna Casualty & Sur. Co., 742 P.2d 277, 283 (Ariz. 1987); AeroJet General Corp. v. Superior Court, 211 Cal. App. 3d 216, 224-25 (Cal. Ct. App. 1989); Sanchez v. Connecticut Gen. Life Ins. Co., 681 P.2d 974, 977 (Colo. App. 1984); Hawaiian Ins. & Guar. Co. v. Brooks, 686 P.2d 23, 27 (Haw. 1984); Penalosa Coop Exch. v. Farmland Mut. Ins. Co., 789 P.2d 1196, 1198 (Kan. Ct. App. 1990); Simon v. Continental Ins. Co., 724 S.W.2d 210, 212-13 (Ky. 1986); State Farm Mut. Auto. Ins. Co. v. Estate of Braun, 793 P.2d 253, 255-56 (Mont. 1990); Town of Epping v. St. Paul Fire & Marine Ins. Co., 444 A.2d 496, 498 (N.H. 1982); Great American Ins. Co. v. C.G. Tate Constr., 279 S.E.2d 769, 771 (N.C. 1981); Soliva v. Shand, Morahan & Co., 345 S.E.2d 33, 35 (W. Va. 1986).

Other states have indicated a mixed acceptance either by limiting the doctrine or

simply rejected the doctrine.[65]

III. The Reasonable Expectations Doctrine in Minnesota

Although the Minnesota Supreme Court has clearly adopted the Keeton formula, subsequent decisions have not applied the formula consistently. The complexity of the doctrine requires the supreme court to form standards to guide litigants and the lower courts. The doctrine must be clarified to achieve more effective consumer protection for the policyholder and more predictable results for the insurer. Analysis of the Minnesota cases utilizing the doctrine provides a clear view of how the courts have strayed from a useful application of the doctrine.

A. The Atwater *Case*

Atwater Creamery Co. v. Western National Mutual Insurance Co.[66] is considered the seminal reasonable expectations case in Minnesota.[67] *Atwater* involved a burglary of chemicals worth $15,587.40 from Atwater's warehouse.[68] Atwater's policy excluded coverage for bur-

by accepting it at one level and not at another. Carley v. Lumbermen's Mut. Casualty Co., 521 A.2d 1053, 1057-58 (Conn. App. Ct. 1987); Richards v. Hanover Ins. Co., 299 S.E.2d 561, 563 (Ga. 1983); Standard Mut. Ins. Co. v. General Casualty Cos., 525 N.E.2d 965, 967 (Ill. App. Ct. 1988); Lepic v. Iowa Mut. Ins. Co., 402 N.W.2d 758, 762 (Iowa 1987); Falgout v. Wilson, 531 So. 2d 492, 493 (La. Ct. App. 1988); Baybutt Contr. Corp. v. Commercial Union Ins. Co., 455 A.2d 914, 921-22 (Me. 1983); Massachusetts Insurers Insolvency Fund v. Continental Casualty Co., 506 N.E.2d 118, 120 (Mass. 1987); Werner Indus. Inc. v. First State Ins. Co., 548 A.2d 188, 192 (N.J. 1988); Raybestos-Manhattan, Inc. v. Industrial Risk Insurers, 433 A.2d 906, 908 (Penn. 1981); Elliott Leases Cars, Inc. v. Quigley, 373 A.2d 810, 814 n.1 (R.I. 1977); Mary Kay Cosmetics Inc. v. North River Ins. Co., 739 S.W.2d 608, 613 (Tex. Ct. App. 1987); *see also* Farm Bureau Mut. Ins. Co. v. Sandbulte, 302 N.W.2d 104 (Iowa 1981). In *Sandbulte*, for example, the court held that the doctrine of reasonable expectations would only apply if the exclusion either 1) is bizarre or oppressive, 2) eviscerates terms explicitly agreed to, or 3) eliminates the dominant purpose of the transaction. 302 N.W.2d at 112.

65. In the following decisions, the courts have explicitly rejected the doctrine: Casey v. Highlands Ins. Co., 600 P.2d 1387, 1391 (Idaho 1979) (refusing to adopt the reasonable expectations doctrine because the plain wording of the insurance policy should control); Sterling Merchandise Co. v. Hartford Ins. Co., 506 N.E.2d 1192, 1197 (Ohio Ct. App. 1986) (refusing to adopt reasonable expectations doctrine because it requires courts to rewrite insurance contracts); Allstate Ins. Co. v. Mangum, 383 S.E.2d 464, 467 (S.C. Ct. App. 1989) (stating that the reasonable expectations doctrine would not be applied to insurance policies where the intention of the parties is clear); Keenan v. Industrial Indem. Ins. Co. of N.W., 738 P.2d 270, 275 (Wash. 1987) (holding that the reasonable expectations doctrine did not apply to insurance contracts that contained no ambiguity).

66. 366 N.W.2d 271 (Minn. 1985).

67. *See* Gerald J. Morris, Comment, *Great Expectations for the Reasonable Expectation Doctrine*, 12 Wm. Mitchell L. Rev. 371, 371 (1986) (analyzing *Atwater*).

68. *Atwater*, 366 N.W.2d at 274.

glaries unless the building showed visible signs of forced entry.[69] Western National, Atwater's insurer, denied the claim because the exterior of the building showed no visible marks of physical damage at the point of entrance. The court stated that the policy's definition of "burglary" was clear, precise, and unambiguous.[70] Nevertheless, the parties in the case did not dispute that a burglary had occurred.[71] In order to honor Atwater's expectation that its policy would cover a burglary, the court adopted the doctrine of reasonable expectations.[72] In doing so, the court defined the doctrine[73] and gave its reasons for adopting it: "The reasonable-expectations doctrine gives the court a standard by which to construe insurance contracts without having to rely on arbitrary rules which do not reflect real-life situations and without having to *bend and stretch* those rules to do justice in individual cases."[74]

The *Atwater* court gave examples where the doctrine would apply, such as when the policyholder was not told of important, but obscure, conditions or exclusions in the insurance policy or when a provision is common enough that the general public expects their risks to be covered.[75] In a statement responsible for much of the

69. The provisions of the policy included the following definition of burglary:

> The felonious abstraction of insured property (1) from within the premises by a person making felonious entry therein by actual force and violence, of which force and violence there are visible marks made by tools, explosives, electricity or chemicals upon, or physical damage to, the exterior of the premises at the place of such entry, or . . . (3) from within the premises by a person making a felonious exit therefrom by actual force and violence as evidenced by visible marks made by tools, explosives, electricity or chemicals upon, or physical damage to, the interior of the premises at the place of such exit.

Id. at 275.

70. The *Atwater* court rejected the analysis by other courts that have concluded that this definition of burglary is ambiguous. *Id.* at 276, (citing United States Fidelity & Guar. Co. v. Woodward, 164 S.E.2d 878 (Ga. Ct. App. 1968)).

71. The trial court found no fraud and determined that it was not an inside job. *Id.*

72. *Id.* at 278. Atwater's expectation of coverage came from its 30-year relationship with Western. Evidence also existed that Western's agent did not tell Atwater about the exclusion. *Id.* The court also pointed out that a business which purchases insurance for burglaries is seeking coverage whether the burglary is done by an "inept burglar" or a "highly skilled burglar." *Id.*

73. The court used Keeton's definition of the reasonable expectation doctrine word for word. *Id.* at 277. *See supra* note 5 for reference to Keeton's definition.

74. *Atwater*, 366 N.W.2d at 278 (emphasisi added). The court's use of the words "bend and stretch" are a particularly appropriate description of what courts do with traditional insurance interpretive tools in order to achieve a fair result. *Id.* Cynics may disparagingly refer to this process as "result-oriented." *See* John E. Simonett, *The Use of The Term "Result-Oriented" To Characterize Appellate Decisions*, 10 WM. MITCHELL L. REV. 187 (1984). The reasonable expectations doctrine, however, frees the court from going through hoops to get the result it wants.

75. This list by the court does not appear to be all-inclusive, as evidenced by the

ensuing confusion, the court noted that an ambiguity is not a condition precedent to use the doctrine but merely a factor to be considered.[76]

The holding of *Atwater* allowed the creamery to recover for the burglary loss, giving the creamery the coverage it believed it had when it purchased the insurance policy. While *Atwater* signaled the beginning of Minnesota's use of the reasonable expectations doctrine, it failed to adequately formulate explicit standards for its application. Since *Atwater*, the courts have struggled with application of the reasonable expectations doctrine.[77]

B. *Supreme Court Decisions Since* Atwater

If the seeds of confusion were sown in *Atwater*, subsequent supreme court decisions did nothing to stop the growth of that confusion. Although the supreme court has discussed the reasonable expectations doctrine several times since *Atwater*, it has not actually used the doctrine exclusively either to provide or to limit coverage. For example, the supreme court in *Rusthoven v. Commercial Standard Insurance Co.*[78] used the reasonable expectations doctrine to justify interpreting an ambiguity in favor of the policyholder. The court of appeals limited coverage to an underinsured motorist by concluding that the policy was not ambiguous and had only one reasonable interpretation.[79] The court of appeals did not discuss the reasonable expectations doctrine or refer to *Atwater*. The holding was based solely on the determination that the policy was not ambiguous.[80]

The supreme court reversed the court of appeals and granted the policyholder more substantial coverage.[81] The court found the policy to be ambiguous, and thus it strictly construed the ambiguity

court's use of the language "such as." Atwater Creamery Co. v. Western Nat'l Mut. Ins. Co., 366 N.W.2d 271, 278 (Minn. 1985).

76. *See id.* This analysis has led to many of the problems in later applications of the doctrine.

77. A telling example is found in Merseth v. State Farm Fire & Casualty Co., 390 N.W.2d 16 (Minn. Ct. App. 1986). After examining *Atwater*, the *Merseth* court stated, "We are uncertain how the reasonable expectations doctrine applies in a case where the provision at issue is clear and unambiguous. . . . In light of this uncertainty we decline to apply the reasonable-expectations-regardless-of-ambiguity doctrine beyond the facts of *Atwater*." *Id.* at 18.

78. 387 N.W.2d 642 (Minn. 1986).

79. Rusthoven v. Commercial Standard Ins. Co., 363 N.W.2d 496 (Minn. Ct. App. 1985).

80. *Id.* at 497. In one part of the policy, the coverage was limited to $25,000 per vehicle involved in an accident. The language in another part of the policy suggested that the amounts of coverage for each insured vehicle could be stacked. *Id.* In light of these different and contradictory clauses, the conclusion by the court that the policy was not ambiguous is questionable.

81. 387 N.W.2d 642 (Minn. 1986).

against the insurer.[82] The court then noted that construction of ambiguities must not be beyond the reasonable expectations of the insured. In support of this novel proposition, the court cited both *Atwater*[83] and Professor Keeton.[84] Professor Keeton's quotation was taken out of context by the *Rusthoven* court to be seemingly in support of their new proposition that ambiguities are limited by the reasonable expectations doctrine.[85]

The *Rusthoven* court could have reached the same result by relying solely on the doctrine of ambiguity. Instead the court expounded a new proposition that the doctrine of reasonable expectations is a limitation on the doctrine of ambiguity. The result has been even more confusion about when and how to use the doctrine of reasonable expectations.[86]

The dissent in *Rusthoven* objected to the majority's incorrect use of the doctrine.[87] The dissent pointed out that the rule adopted in *Atwater* "does not provide a way to validate a decision already made under the doctrine of ambiguity."[88] The dissent then concluded that despite the unartful assembly of the policy, the policyholder could not have reasonably expected it was purchasing insurance based on the number of vehicles the policyholder owned at any given time.[89]

The confusion generated by *Rusthoven* continued in the next supreme court decision[90] that discussed the doctrine of reasonable

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82. *Id.* at 644-45.

83. *Id.* at 645.

84. The court quoted Professor Keeton;

> It seems likely, however, that, even though not often expressed, there has always been an implicit understanding that ambiguities, which in most cases might be resolved in more than just one of the other of two ways, would be resolved favorable to the insured's claim only if a reasonable person in his position would have expected coverage.

Id. at 645 (quoting Keeton, *supra* note 1, at 969).

85. In the quoted material, Professor Keeton explained that ambiguities are not necessary to invoke the doctrine of reasonable expectations because ambiguities do not even exist unless there are two or more reasonable interpretations. *See* Keeton, *supra* note 1, at 969-74. The doctrine of ambiguity simply provides the court a way to choose between two or more reasonable interpretations. Thus, ambiguities are always resolved in favor of the non-drafting party. *See supra* notes 23-34 and accompanying text.

86. *See infra* part III.C.

87. *Rusthoven*, 387 N.W.2d at 645-47.

88. *Id.* at 647. The dissent further stated "it seems to me that the majority has abandoned a contract theory adopted only a year ago in *Atwater*. *Id.* at 646. To further muddy the waters, the author of the dissent, Justice Coyne, put another twist on the doctrine: "[I]nherent in the doctrine of reasonable expectations is the rejection of the traditional rule that ambiguities are automatically construed most favorably to the insured." *Id.* Apparently, Justice Coyne sees the doctrine as a substitution for traditional contract doctrines altogether. *Id.*

89. *Id.* at 647.

90. An intervening decision, American Family Mut. Ins. Co. v. Peterson, 405

expectations, *Hubred v. Control Data Corp.*[91] The Hubreds had health and accident insurance from Control Data through Mrs. Hubred's employment at Control Data.[92] Mr. Hubred was not employed by Control Data. Injured at his job, Mr. Hubred filed a claim for coverage to his wife's Control Data insurance plan. Control Data denied coverage, basing its denial on a clause in the contract which excluded coverage for injuries sustained at work by non-Control Data employees.[93] The court found that the clause was not ambigious and clearly excluded coverage for Mr. Hubred's injuries. The court discussed but did not apply the reasonable expectations doctrine because the Hubreds failed to prove any facts or circumstances that would justify a reasonable expectation of coverage.[94]

In dicta, the court revealed instances in which it believed the doctrine of reasonable expectations would apply. The court would consider the following factors: 1) whether the policyholder is held to an unreasonable level of understanding of the policy; 2) whether the policy is ambiguous; 3) whether the policy contains language which operates as a hidden exclusion; 4) whether oral communications from the insurer explaining important but obscure conditions or exclusions lead to an expectation of coverage; and 5) whether the general public is aware that provisions in the policy provide coverage.[95]

The most recent supreme court decision discussing the doctrine of reasonable expectations is *State Farm Fire & Casualty Co. v. Wicka.*[96] The central issue in *Wicka* was whether the intentional act exclusion of the policy applied where the policyholder's act was the product of

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N.W.2d 418 (Minn. 1987), refers to the reasonable expectations doctrine but does not analyze it. The court points out that its task is to interpret the contract language at hand in light of the reasonable expectations of the insured. *Id.* at 422. In doing so, the court concluded that a policyholder could not reasonably expect coverage for an assault committed while the policyholder was voluntarily intoxicated. *Id.* Conceivably, the court blurred its determination of the reasonable expectations of the insured with its interpretation of the contract term, "bodily injury which is expected or intended by an insured." *See id.* at 421.

91. 442 N.W.2d 308 (Minn. 1989).

92. *Id.* at 309.

93. *Id.* The policy excluded the following expenses from coverage: "Medical expenses necessary because of an injury or disease incurred during employment for wages or profit at or outside of Control Data, or covered by the Workers' Compensation Act or similar laws, statutes or decrees." *Id.* at 310.

94. *Id.* at 311.

95. For example, the common law, statutes and common usage define "burglary" as entering into and stealing from a structure, even if entry was not forced. *Id.* As the Hubreds were unable to show these factors the court did not apply the doctrine. The court also noted the fact that the Hubreds were not orally informed of the exclusion did not, standing alone, free them from the responsibility of reading it. *Id.* at 311.

96. 474 N.W.2d 324 (Minn. 1991).

mental illness.[97] The reasonable expectations doctrine was not central to this analysis, but the court did note its decision that the exclusion did not apply was consistent with the reasonable expectations of the policyholder.[98] The court saw no difference between injuries caused by a mentally ill person who lacked the intent to injure and other unintentional injuries that the policyholder would reasonably expect to be covered.[99]

C. *Court of Appeals Decisions Since* Atwater

The court of appeals has discussed the reasonable expectations doctrine in many cases since *Atwater*. First are those cases that limit the doctrine to the facts of *Atwater* by requiring either an ambiguity or a hidden exclusion.[100] The first case in which a court of appeals determined that the doctrine of reasonable expectations required either an ambiguity or hidden exclusion was *Merseth v. State Farm Fire & Casualty Co.*[101] In *Merseth*, the policyholder crushed his son's leg between his truck and a utility pole.[102] The trial court found that the homeowner's insurance policy excluded coverage for any injuries arising out of the use of a motor vehicle.[103]

On review, the court of appeals first found the exclusion was not ambiguous and then analyzed whether the doctrine of reasonable expectations applied.[104] In finding that it did not, the court expressed its frustration with the absence of guidelines for the using the doctrine.[105] Pointing to *Atwater*, the court concluded that since the reasonable expectations doctrine was applied to a hidden major

97. *Id.* at 325.

98. *Id.* at 331.

99. *Id.*

100. *See* Levin v. Aetna Casualty & Sur. Co., 465 N.W.2d 99, 102 (Minn. Ct. App. 1991); Centennial Ins. Co. v. Zylberger, 422 N.W.2d 18, 23 (Minn. Ct. App. 1988); Ross v. City of Minneapolis, 408 N.W.2d 910, 914 (Minn. Ct. App. 1987); Sonneman v. Blue Cross & Blue Shield of Minn., 403 N.W.2d 701, 708 (Minn. Ct. App. 1987); Gunderson v. Classified Ins. Corp., 397 N.W.2d 922, 925 (Minn. Ct. App. 1986); Merseth v. State Farm Fire & Casualty Co., 390 N.W.2d 16, 18 (Minn. Ct. App. 1986). *See also* National Indem. Co. v. Ness, 457 N.W.2d 755 (Minn. Ct. App. 1990). In *Ness*, the court declined to apply the reasonable expectations doctrine beyond the facts of *Atwater*. 457 N.W.2d at 758. The dissent in *Ness* pointed out that this case was clearly a reasonable expectations case. "The doctrine of reasonable expectations should have been applied and the finder of fact should now be required to decide whether Ness' . . . expectations were reasonable." *Id.* at 760. The dissent noted that the policyholder's reasonable expectations stemmed from inconsistency between the insurance application, the binder, the policy declaration, and the endorsements. *Id.*

101. 390 N.W.2d 16 (Minn. Ct. App. 1986).

102. *Id.* at 17.

103. The exclusion provided that coverage did not apply to "bodily injury . . . arising out of the use of a motor vehicle." *Id.*

104. *Id.* at 17-18.

105. "[a]bsent more specific direction from the supreme court, we cannot extend

exclusion, the doctrine should be limited to the facts of *Atwater*.[106] Subsequent court of appeals cases following *Merseth* have done just that. By restricting the doctrine only to policies with ambiguities or hidden major exclusions, the court slammed the door on cases where policyholders had a reasonable expectation of coverage from some other circumstances.[107]

Other court of appeals decisions have followed the *Rusthoven* proposition.[108] In *Curtis v. Home Insurance Co.*,[109] the policyholder's employee was unable to obtain coverage for injuries received when his car collided with another vehicle.[110] The trial court determined that the policy contained an ambiguous clause and found coverage based on the sum of the underinsured motorist coverage on all the vehicles covered by the policy. The court of appeals reversed, finding that although the clause was ambiguous, the policyholder could not have reasonably expected the liability limit to be the sum of all the covered vehicles.[111]

The court relied on *Rusthoven* in its reasoning.[112] It distinguished this case from *Rusthoven* because there were affidavits which showed that the policyholder only intended the maximum amount of coverage to be based on one vehicle.[113] Thus, even though the policy was ambiguous and under the doctrine of ambiguity would have been construed in favor of the policyholder, the court found the policyholder could not have reasonably expected coverage.[114] The court used the *Rusthoven* proposition to limit coverage that would have ordinarily existed under the traditional contract doctrine of ambiguity.

In some cases, the court of appeals has declined to find coverage based on the reasonable expectations doctrine because the facts of the case do not warrant it.[115] Although this application of the doc-

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the doctrine of reasonable expectations to find coverage under these circumstances." *Id.*; *see also supra* note 75.

106. *Id.*

107. *See, e.g.*, Levin v. Aetna Casualty & Sur. Co., 465 N.W.2d 99 (Minn. Ct. App. 1991) (affirming trial court decision not to apply the doctrine without an ambiguity or hidden major exclusion); Centennial Ins. Co. v. Zylberger, 422 N.W.2d 18 (Minn. Ct. App. 1988) (reading *Atwater* to require a finding of either an ambiguity or hidden major exclusion prior to consideration of the doctrine).

108. *See* Bob Useldinger & Sons v. Hangsleben, 483 N.W.2d 495 (Minn. Ct. App. 1992); Morris v. Weiss, 414 N.W.2d 485, 488 (Minn. Ct. App. 1987); Curtis v. Home Ins. Co., 392 N.W.2d 44, 46 (Minn. Ct. App. 1986).

109. 392 N.W.2d 44 (Minn. Ct. App. 1986).

110. *Id.* at 45.

111. *Id.* at 46.

112. *Id.* at 45.

113. *Id.* at 46.

114. *Id.*

115. *See* Minnesota Mut. Fire & Casualty Ins. Co. v. Manderfeld, 482 N.W.2d 521, 525 (Minn. Ct. App. 1992); Sicoli v. State Farm Mut. Auto Ins. Co., 464 N.W.2d 300,

trine is seemingly correct, the court does not always find coverage when in fact they should have. In *Minnesota Mutual Fire & Casualty Insurance Co. v. Manderfeld*,[116] the court incorrectly found that the policyholder's expectations of coverage were not reasonable. Greg Manderfeld was injured when his mother ran over his foot with a lawnmower.[117] The Manderfeld's insurance policy included an exclusion providing that the policy did not provide coverage for bodily injury caused to an insured by another insured under the policy.[118] The Manderfelds argued that the exclusion violated their expectations of what the policy covered.[119]

The court of appeals disagreed and found that there was no coverage for the injury because the exclusion was clear.[120] The court erroneuosly based its holding on the fact that Michael Manderfeld was a certified public accountant and should have understood the exclusion without "painstaking study."[121] The court recognized the weakness of its holding when it stated,

> Although we hold that the household exclusion was not shown to violate the Manderfeld's reasonable expectations, we question whether the general public contemplates such an exception when purchasing homeowner's or renter's coverage. While we are aware of no objective evidence that laypersons would not expect such exclusions, as a practical matter this exclusion seems somewhat counterintuitive. It seems difficult to argue that it is entirely unreasonable to expect a homeowner's insurance policy to provide coverage for family members injured by another family member's negligence; they are after all those most likely to be found about the home.[122]

Several decisions have properly applied the reasonable expectations doctrine.[123] In *Wessman v. Massachusetts Mut. Life Ins. Co.*,[124] the

303 (Minn. Ct. App. 1990); Engel v. American Family Mut. Ins. Co., 455 N.W.2d 486, 488 (Minn. Ct. App. 1990); Marschall v. Reinsurance Ass'n of Minn., 447 N.W.2d 460, 462 (Minn. Ct. App. 1989); Empire State Bank of Cottonwood v. St. Paul Fire & Marine Ins. Co., 441 N.W.2d 811 (Minn. Ct. App. 1989); Farmers Union Oil Co. v. Mutual Serv. Ins. Co., 422 N.W.2d 530 (Minn. Ct. App. 1988); Seaway Port Auth. of Duluth v. Midland Ins. Co., 430 N.W.2d 242, 249 (Minn. Ct. App. 1988).

116. 482 N.W.2d 521 (Minn. Ct. App. 1992).

117. *Id.* at 523.

118. *Id.*

119. *Id.*

120. *Id.* at 525.

121. *Id.* The court did not explain why a certified public accountant should have more knowledge about insurance policy exclusions.

122. *Id.*; *see also* Sicoli v. State Farm Mut. Auto Ins. Co., 464 N.W.2d 300 (Minn. Ct. App. 1990). In *Sicoli*, the court declined to find coverage for a husband's loss of consortium when definition of "bodily injury" could have given rise to a reasonable expectation of coverage. *Id.* at 303.

123. Accordingly, there have been several decisons that have properly declined to use the doctrine because other traditional contract doctrines apply. *See* Glarner v.

United States Court of Appeals for the Eight Circuit, applying Minnesota law, correctly found that the life insurance policy in question provided coverage under the reasonable expectations doctrine.[125] They determined that the ordinary reader of the policy would have thought there was coverage.[126] In *Grinnel Mutual Reinsurance Co. v. Wasmuth*,[127] the court interpreted an exclusion in a liability policy to determine if it excluded coverage for damages to a home and its occupants from formaldeyde.[128] The court found coverage under the reasonable expectations doctrine:

> [T]his is the unusual case requiring application of *Atwater*. The ordinary reader of the exclusion would reasonably conclude that it would not limit coverage for respondents' unexpected damage due to installation of building materials in a home, but would exclude pervasive environmental pollution problems such as hazardous waste dumping.[129]

Another example of proper application of the doctrine can be found in *State Farm Insurance Cos. v. Seefeld*.[130] In *Seefeld*, the court found that the policyholder could not have had a reasonable expectation of coverage because of an extraordinary fact situation centered around the use of a utility trailer and its negligent design.[131]

Time Ins. Co., 465 N.W.2d 591 (Minn. Ct. App. 1991) (dismissing the doctrine because coverage was found based on unconscionability); Amatuzio v. United States Fire Ins. Co., 409 N.W.2d 278 (Minn. Ct. App. 1987) (declining to apply the reasonable expectations doctrine because coverage was found under the doctrine of ambiguity); Home Mut. Ins. Co. v. Thalman, 387 N.W.2d 219 (Minn. Ct. App. 1986) (determining doctrine of reasonable expectations not applicable because coverage existed under the doctrine of ambiguity).

124. 929 F.2d 402 (8th Cir. 1991).

125. *Id.* at 106.

126. *Id.*

127. 432 N.W.2d 494 (Minn. Ct. App. 1988).

128. The policy exclusion stated,

> This insurance does not apply . . .(f) to bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, contaminants or pollutants into or upon land, the atmosphere or any water course or body of water.

Id. at 498. However there was an exception to this exclusion when the discharge or release was sudden and accidental. *Id.*

129. *Id.* at 499.

130. 472 N.W.2d 170 (Minn. Ct. App. 1991).

131. *Id.* at 174. The insured towed a utility trailer behind an all-terrain vehicle. The trailor was attached to the all-terrain vehicle by a bolt through a make-shift hitch. No cotter pin was used, and the bolt came loose during travel, causing injury to a passenger in the trailer. *Id.* at 171.

Correct application of the doctrine can be found in other jurisdictions as well. The Idaho Supreme Court properly applied the doctrine in Corgatelli v. Globe Life & Accident Ins. Co., 533 P.2d 737 (Idaho 1975). In *Corgatelli*, the list of risks covered in a rodeo rider's insurance policy was so complete that failure to include acromioclavicular separation would have escaped notice; therefore, the policyholder had a reasonable expectation of coverage. Ironically, after applying the doctrine correctly,

The inconsistency and vagueness of the reasoning behind these decisions clearly indicates courts' confusion about the doctrine. Additionally, it emphasizes the necessity of developing clear standards of when and how to apply the doctrine.

IV. Suggested Standards for Application of the Reasonable Expectations Doctrine

The doctrine of reasonable expectations serves an important purpose in insurance policy interpretation. The doctrine protects policyholders from inequality in bargaining power. Proper use of the doctrine promotes an informed choice by the policyholder and permits the court to look beyond the contract and hold the insurer liable for any expectation of coverage the contract may have created.[132] Furthermore, the doctrine is a risk-distributing tool which spreads the costs of otherwise uninsured loss.[133]

The reasonable expectations doctrine was developed in response to situations in which judges wanted to protect policyholders from inequality of bargaining power but the expected coverage was unavailable from other sources. The doctrine is one of last resort, to be used only after equitable tools and doctrines of interpretation such as the doctrine of ambiguity, estoppel and waiver, unconscionability, and reformation are found not to apply. After the other tools have been rejected, the court should address the reasonable expectations of the policyholder, looking both to the policy itself and the surrounding facts and circumstances. The standard for determining what expectations are reasonable should be an objective inquiry for the fact finder.

A. When the Doctrine Applies

The first issue to be clarified is when the reasonable expectations doctrine applies. The doctrine should be used when other rules of interpretation and construction are exhausted.

Idaho has abandoned the doctrine altogether. *See* Casey v. Highland Ins. Co., 600 P.2d 1387 (Idaho 1979).

Iowa and Pennsylvania also apply the doctrine correctly. *See* C & J Fertilizer, Inc. v. Allied Mut. Ins. Co., 227 N.W.2d 169, 172 (Iowa 1975) (holding that extrinsic evidence of conversations with an agent prior to purchase of the policy formed a basis for expectation even though the policy was ambigious in its exclusion of theft with no visible signs of entry); Hionis v. Northern Mut. Ins. Co., 327 A.2d 363, 366 (Pa. 1974) (holding that policyholders are not held to policy exclusions unless they were given actual notice of the exclusion at the time of purchase).

132. Abraham, *supra* note 9, at 1169. The doctrine is concerned with accurate information. The benefit of accurate information is that the policyholder can make a better choice about which policy to choose. *Id.*

133. *Id.* Abraham includes an in-depth discussion of the risk distributing attributes of the reasonable expectations doctrine. *Id.* at 1185-89.

One source of confusion is the way *Atwater* treated ambiguity.[134] In *Atwater*, the court stated that ambiguity is *not* a condition precedent to the reasonable expectations doctrine.[135] The court further indicated that although ambiguity in the language of the contract is not irrelevant, it is a factor in determining the reasonable expectations of the policyholder.[136] However, ambiguity should be wholly irrelevant to the doctrine of reasonable expectations because it is neither necessary nor sufficient for application of the doctrine. Moreover, since an ambiguity can be resolved by a traditional interpretation of the policy under the doctrine of ambiguity, resort to the reasonable expectations doctrine is not necessary. This issue may have caused the confusion in later cases.

The reasonable expectations doctrine should be applied only when other interpretive and constructive doctrines such as the doctrine of ambiguity do not apply and the facts indicate a need for consumer protection. For example, a situation may arise where the policy interpretation does not revolve around two different interpretations of a provision or word but instead focuses on the way the policy was marketed. If the court cannot use the doctrine of ambiguity or any other traditional device, it must look to the reasonable expectations of the policyholder.[137]

When the *Atwater* court stated that ambiguity in the policy was a factor for determining whether the policyholder's expectations were reasonable, it is logical that the court referred to ambiguities not in the language that is at issue, but instead ambiguities in the policy or arising from the marketing of the policy. For example, a policy may contradict itself on a point not related to the coverage being litigated. That type of ambiguity is then one more factor in determining the complicated nature of the policy and the policyholder's inability to understand the coverage.

Another example of when an ambiguity should be considered is when the policy is marketed in a manner that contrasts with its written terms. That conflict creates an ambiguity which, when combined with other factors, may have led the policyholder to reasonably expect coverage even if there was a clear exclusion in the policy itself. That disparity is not strictly an "ambiguity" and should not be referred to in that way. In contrast, if the policy contains a term which

134. Atwater Creamery Co. v. Western Nat'l Mut. Ins. Co., 366 N.W.2d 271, 277 (Minn. 1985).

135. *Id.* at 277-78.

136. *Id.* at 278.

137. *See, e.g.*, Steven v. Fidelity & Casualty Co., 377 P.2d 284, 298 (Cal. 1962) (holding that airline insurance policy created a reasonable expectation of coverage because among other things it was purchased at a vending machine in an airport, could not be read prior to purchase and a purchaser would be in a hurry and not have time to peruse it for hidden exclusions).

in itself is ambiguous or inconsistent with another term, then it should be resolved according to the doctrine of ambiguity without ever employing the reasonable expectations doctrine.

Similarly, the reasonable expectations doctrine should not be used as a limitation on the ambiguity doctrine, as the court did in *Rusthoven*.[138] The doctrine of ambiguity has an inherent limitation: it considers only reasonable alternative interpretations of the supposedly ambiguous provisions.[139] The simpler approach is to ignore the reasonable expectations doctrine if an ambiguity exists and to determine coverage based solely on the doctrine of ambiguity.

The reasonable expectations doctrine should be a substantive but limited tool. It should be used to balance the inequality in bargaining power in insurance contracts as well as to protect consumers who cannot understand the difficult language in their policies. The doctrine of reasonable expectations should apply only in situations where other rules of construction and interpretation do not suffice.

B. How the Doctrine Applies

Litigants and the lower courts need guidelines for proper application of the reasonable expectations doctrine. Two recurring problems must be resolved: whether the standard is objective or subjective, and whether the question is one of fact or law.

In defining the reasonable expectations doctrine, Professor Keeton said, "an idea of this principle incorporates the proposition that policy language will be construed as laymen would understand it and not according to the interpretation of sophisticated underwriters."[140] Although Keeton took the view that the consumer's expectations should be analyzed under an objective standard, courts have used a subjective standard when determining whether the policyholder's interpretation was reasonable.[141]

In Minnesota, the courts have used both an objective and a subjective standard to determine whether the policyholder's expectations were reasonable.[142] When the Minnesota Supreme Court adopted

138. Minnesota has used the doctrine in this manner. *See supra* note 91. Keeton points out there has always been an implicit understanding that ambiguities will be resolved in the policyholder's favor only if a reasonable person would have expected coverage. Keeton, *supra* note 1, at 969.

139. Implicitly, ambiguities are understood to be resolved in the policyholder's favor only if a reasonable person in the same situation would expect coverage. Keeton, *supra* note 1, at 969.

140. Keeton, *supra* note 1, at 967.

141. *See, e.g.*, Stewart-Smith Haidinger Inc. v. AVI-Truck, Inc., 682 P.2d 1108, 1117-18 (Alaska 1984).

142. *See, e.g.*, Wessman v. Massachusetts Mut. Life Ins. Co., 929 F.2d 402, 406 (8th Cir. 1991) (applying Minnesota law; objective standard); Atwater Creamery Co. v. Western Nat'l Mut. Ins. Co., 366 N.W.2d 271, 276-77 (Minn. 1985) (objective stan-

the reasonable expectations doctrine in *Atwater*, it clearly viewed the reasonableness of the expectations as objective. The court stated, "The insured may show what actual expectations he or she had, but the fact finder should determine whether those expectations are reasonable under the circumstances."[143]

To be fair to all policyholders, the reasonable expectations doctrine should be applied in an objective manner.[144] An objective standard eliminates some of the difficulty of factual issues and curbs the potential for abuse. Furthermore, it promotes certainty and predictability.[145] In contrast, if a subjective standard is applied, policyholders have no idea whether their premium dollars are paying the claims of others, claims which they reasonably believed were not covered under their own policy.[146] Under the subjective standard, it

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dard); Schmidt v. St. Paul Fire & Marine Ins. Co., 376 N.W.2d 237, 241 (Minn. Ct. App. 1985) (subjective standard).

Some critics have advanced alternatives for determining expectations. For example, reasonable expectations arguably could be determined by measuring the attitude of the insured against the conduct of the insurer. Applying the standard this way allows the insurance company more latitude in proving what it had intended to cover in the policy. To date, this concept has not been accepted by any jurisdiction. *See* Rahdert, *supra* note 3, at 387.

143. *Atwater*, 366 N.W.2d at 278; *see also Wessman*, 929 F.2d at 406 (applying *Atwater*'s application of reasonable expectation's doctrine); DeLand v. Old Republic Life Ins. Co., 758 F.2d 1331, 1337 (9th Cir. 1985) (applying Alaska law; finding that resolution of dispute as to surrounding circumstances is for the trier of fact).

Minnesota courts have demonstrated a willingness to use the objective standard in other areas of law as well. For example, some Minnesota courts have recognized that Rule 11 of the Minnesota Rules of Civil Procedure embodies an objective standard. Uselman v. Uselman, 464 N.W.2d 130, 143 (Minn. 1990) (citing Brown v. Federation of State Medical Bds. of the U.S., 830 F.2d 1429, 1435 (7th Cir. 1987), and Eastway Constr. Corp. v. City of New York, 762 F.2d 243, 253 (2d Cir. 1985)). In *Uselman*, the court's inquiry focused on the objective reasonableness of a prefiling investigation by plaintiff's attorney. *Uselman*, 464 N.W.2d at 143. Negligence is another area where reasonableness is a central issue. In negligence cases, the court has held that the inquiry into the actor's reasonableness should always be objective. Fallin v. Maplewood-North St. Paul Dist. No. 622, 362 N.W.2d 318, 321-22 (Minn. 1985) (holding school district to a duty of objective reasonable care when supervising shop students). The inquiry made in reasonable expectations cases is essentially the same—what a reasonable person in the same circumstances would have expected the coverage to be. *Wessman*, 929 F.2d at 406.

144. See the following works for discussion of the objective versus subjective standards: ROBERT BERNSTEIN, BEYOND OBJECTIVISM AND RELATIVISM: SCIENCE, HERMENEUTICS AND PRAXIS 19 (1983); Dennis M. Patterson, *Interpretation in Law-Toward a Reconstruction of the Current Debate*, 29 VILL. L. REV. 671 (1983) (arguing that the dichotomy between objective and subjective interpretations of legal texts is false); Warran F. Schwartz, *Objective and Subjective Standards of Negligence: Defining the Reasonable Person to Induce Optimal Care and Optimal Populations of Injurers and Victims*, 78 GEO. L. J. 241 (1990) (demonstrating through use of an economic analysis that both the objective and subjective standards attempt to achieve the same results).

145. Keeton, *supra* note 1, at 969.

146. *Id.*

would no longer be possible for an insurance company to know or limit its risks because interpretation of the policy would be decided on an individual basis. Such an approach is neither fair to the insurer nor to other policyholders. The policyholder is protected from unfairness in his or her individual dealings by other equitable doctrines such as estoppel.[147]

The objective standard, however, has created another area of confusion in the application of the reasonable expectations doctrine: whether the reasonableness of the policyholder's expectations is a question of law or a question of fact.

When the Minnesota Supreme Court adopted the reasonable expectations doctrine in *Atwater*,[148] it stated that whether the expectations were reasonable was a question of fact.[149] Despite *Atwater*, many courts have subsequently applied the doctrine as a question of law.[150] However, the Eighth Circuit has applied it as a question of fact, pointing out that *Atwater* mandated such an application.[151] In other jurisdictions, the treatment of this issue varies.[152] For example, the Iowa Supreme Court has determined that whether the doctrine should be applied is a question of law, but the extrinsic facts are

147. Rahdert, *supra* note 3, at 387.

148. 366 N.W.2d 271 (Minn. 1985).

149. "The insured may show what actual expectations he or she had, but the fact finder should determine whether those expectations were reasonable under the circumstances." Atwater Creamery Co. v. Western Nat'l Mut. Ins. Co., 366 N.W.2d 271, 278 (Minn. 1985).

150. *See, e.g.*, Grossman v. American Family Mut. Ins. Co., 461 N.W.2d 489, 493 (Minn. Ct. App. 1990) (holding that interpretation of an insurance policy is a question of law which the trial court may properly decide on a motion for summary judgment, which is reviewed de novo on appeal); Schmidt v. St. Paul Fire & Marine Ins. Co., 376 N.W.2d 237, 239 (Minn. Ct. App. 1985) ("Determination of reasonable expectation of coverage presents a question of law and thus we are not foreclosed from considering this issue on appeal.").

Neither decision referred to *Atwater* when justifying its ruling. The *Grossman* court based its ruling on a case decided before *Atwater*, Iowa Kemper Ins. Co. v. Stone, 269 N.W.2d 885, 887 (Minn. 1978), and the *Schmidt* court based its decision on a worker's compensation case, Rautio v. International Harvester Co., 180 Minn. 400, 404, 231 N.W. 214, 216 (1930).

151. *See, e.g.*, Wessman v. Massachusetts Mut. Life Ins. Co., 929 F.2d 402, 405 (8th Cir. 1991) (applying Minnesota law; holding that under Minnesota law, whether insured understood meanings of terms in life insurance form was question of fact for the jury); Auto-Owners Ins. Co. v. Jensen, 667 F.2d 714, 717 (8th Cir. 1981) (applying Minnesota law; factual determination should be made by jury).

152. *See, e.g.*, Hancock v. New York Life Ins. Co., 899 F.2d 1131, 1135 (11th Cir. 1990) (applying Alabama law; question of law); Norton v. St. Paul Fire & Marine Ins. Co., 902 F.2d 1355, 1357 (8th Cir. 1990) (applying Arkansas law; question of law); Granite State Ins. Co. v. Degerlia, 925 F.2d 189, 191 (7th Cir 1991) (applying Illinois law; question of law). *But see* Northbrook Excess & Surplus Ins. Co. v. Procter & Gamble Co., 924 F.2d 633, 637 (7th Cir. 1991) (applying Ohio law; question of fact).

questions for the jury.[153]

If the reasonable expectations doctrine involves the determination of what is reasonable under the circumstances, that determination should be a question for the fact finder. This is basically the same reasonableness standard used in negligence cases. Where reasonable minds could differ as to whether the policyholder's expectations were reasonable, the question is for the jury.[154] The court should first determine if the reasonable expectations doctrine is applicable[155] and then instruct the jury on how to determine whether the policyholder's expectations are reasonable.

The following proposed jury instruction reflects the reasonable person standard applicable to other areas of the law:

> In question _____ of the special verdict form, you must decide whether _____ had reasonable expectations of insurance coverage for its _____ claim. Reasonable expectations of coverage are what the average policyholder would anticipate as the scope of the coverage. The subjective expectations of the insured are not determinative. However, actual expectations can be considered as evidence of what the average policyholder would anticipate. You must also consider other evidence in determining whether _____'s expectation of coverage was reasonable.

V. Conclusion

The doctrine of reasonable expectations was adopted to protect the policyholder from the greater expertise and bargaining power of the insurer where traditional tools and doctrines of contract interpretation could not be applied. In the permutations of the doctrine addressed by Minnesota courts, this purpose is not being achieved. Instead, Minnesota case law confuses the doctrine of reasonable expectations with the traditional contract interpretation tools. Further, courts apply the doctrine not as a last resort, but often as the first doctrine considered. The reasonable expectations doctrine should be applied only in the limited instances where other tools do not fairly resolve the dispute over coverage. By saving the doctrine as a

153. Farm Bureau Mut. Ins. Co. v. Sandbulte, 302 N.W.2d 104, 108 (Iowa 1981).

154. Negligence cases in Minnesota have always embodied this distinction. *See* Greenwald v. Northern States Power Co., 226 Minn. 216, 219, 32 N.W.2d 320, 323 (1948).

155. Mark Rahdert has formulated clear guidelines for the court in making this determination. First, the court should consider the character of the insurance transaction. Second, the court should conduct an inquiry seeking information about the typical insured. Third, the court should look at the policy structure and language. Fourth, the court should consider the purposes of the insurance provision in relation to the whole policy. Lastly, the court should consider the regulatory considerations. Rahdert, *supra* note 3, at 389-91.

last resort, the insurer is not subjected to case-by-case decisions of all claims.

Clear guidelines must be established as to how the doctrine should work. Allowing the factfinder to determine whether the expectations were objectively reasonable will permit the most effective use of the doctrine. Consistent application will protect the policyholder and insurer alike from unpredictable and uncertain results.

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