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NOTES

The Interaction of the Doctrine of Reasonable Expectations and Ambiguity in Drafting: The Development of the Kentucky Formulation

BY AMY D. CUBBAGE*

INTRODUCTION

The Company will pay on behalf of the *Insured* all sums which the *Insured* shall become legally obligated to pay as *damages* because of

...

B. property damage

to which this insurance applies

Exclusions[:]

This insurance does not apply: . . .

(i) to *property damage* to . . .

(3) property in the care, custody or control of the *Insured* or as to which the *Insured* is for any purpose exercising physical control; . . .

(l) to *property damage* to the *Named Insured's products* arising out of such products or any part of such products;

(m) to *property damage* to work performed by or on behalf of the *Named Insured* arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith;

(n) to *damages* claimed for the withdrawal, inspection, repair, replacement, or loss of use of the *Named Insured's products* or work completed by or for the *Named Insured* or of any property of which such products or work form a part, if such products, work

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or property are withdrawn from the market or from use because of any known or suspected defect or deficiency therein.¹

A typical commercial liability policy, such as the one quoted above, confronts a small business owner with complex and opaque language. Undoubtedly, most people would find the quoted passage unintelligible if they took the time to read it. Given the incomprehensibility of the language in many insurance policies, it is not surprising that most people do not even bother to read their policies.² What is surprising is that the court handling the litigation concerning the above-quoted policy found this language unambiguous as a matter of law.³

Given the generally accepted belief that insurance contracts hold hidden problems for the individual buyers,⁴ courts developed rules

¹ *Biebel Bros., Inc. v. United States Fidelity & Guar. Co.*, 522 F.2d 1207, 1209 (8th Cir. 1975) (omissions in original). The quoted language is from a commercial liability policy issued to the plaintiff in that case by the defendant insurer. This is typical of language found in commercial liability policies.

² See RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. b (1979) ("A party who makes regular use of a standardized form of agreement does not ordinarily expect his customers to understand or even to read the standard terms. . . . Customers do not in fact ordinarily understand or even read the standard terms.").

³ *Biebel Bros.*, 522 F.2d at 1211. Decisions such as this set the stage for the problem addressed in this Note: if a court requires a prerequisite showing of ambiguity for an application of the doctrine of reasonable expectations, then *Biebel Bros.* could effectively preclude its application to an insurance policy even if the language is at wide variance with the reasonable expectations of the insured party.

⁴ This Note will refer only to insurance contracts though much of the applicable law could be used with standardized contracts in general. Some jurisdictions have gone the added step of applying the doctrine of reasonable expectations to standardized contracts in general rather than limiting it to insurance contracts. See, e.g., *Broemmer v. Otto*, 821 P.2d 204, 208 (Ariz. Ct. App. 1991) (applying the doctrine to a contract between an abortion provider and a patient), *approved in part, vacated in part sub nom. Broemmer v. Abortion Servs. of Phoenix, Ltd.*, 840 P.2d 1013 (Ariz. 1992). To date, Kentucky has applied the doctrine only to insurance contracts. For a discussion of Kentucky cases applying the doctrine, see *infra* notes 94-122 and accompanying text. It is not clear if Kentucky courts will apply the doctrine to a wider range of adhesion contracts.

applicable to the interpretation of these policies.⁵ This occurred for two reasons. First, courts have accepted the fact that buyers of insurance do not read their contracts, while scholars promoted the theory that the buyer should not reasonably be expected to do so.⁶ Second, courts were concerned with overreaching by insurance companies and a lack of bargaining power on the part of the individual insurance buyer. By and large, insurance companies offer buyers standardized contracts on a "take-it-or-leave-it"⁷ basis. This may appear to afford the buyer bargaining power in the sense that he or she can simply go to another insurance agent and find a better offer, but there is little variation from policy to policy. This choice ultimately appears to be illusory.⁸

To address the problems prevalent with standardized contracts, courts have applied the doctrine of reasonable expectations. Over the past three decades courts have developed this doctrine as an alternative to the usual rules of contract interpretation.⁹ Unfortunately, the development of the

⁵ See RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. c (1979); E. ALLAN FARNSWORTH, CONTRACTS § 4.26 (2d ed. 1990).

⁶ Courts decided to develop an interpretive tool incorporating the prevalent belief that the "purchasing" party to a standardized contract does not read the terms. In so doing, they rejected the traditional rule that parties are bound to a contract regardless of whether or not they read the actual contract. This is prudent because it is more efficient for society generally, and for the parties in particular (especially insurance companies), to draft standardized policies and offer them to buyers on a "take-it-or-leave-it" basis. FARNSWORTH, *supra* note 5, § 4.26, at 312. The standardization and the absence of bargaining reduces transaction costs and lowers the overall cost of insurance. If courts imposed an obligation on the buyer to read what could be a 100-page commercial liability contract, the benefits of standardization would be obliterated. See RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. a (1979) and FARNSWORTH, *supra* note 5, § 4.26 for a discussion of the benefits of standardization and the danger of imposing increased transaction costs.

⁷ FARNSWORTH, *supra* note 5, at 312.

⁸ RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. c (1979).

⁹ The genesis of the doctrine has often been traced to the California Supreme Court decision in *Gray v. Zurich Ins. Co.*, 419 P.2d 168 (Cal. 1966) and to Professor Keeton's important early law review article on the subject. See Robert Keeton, *Insurance Law Rights at Variance With Policy Provisions*, 83 HARV. L. REV. 961 (1970) (Part I) and 83 HARV. L. REV. 1281 (1970) (Part II). For a good overview of the history behind the judicial institution of the doctrine, see generally Kenneth S. Abraham, *Judge-made Law and Judge-made Insurance:*

doctrine has not been relatively uniform from jurisdiction to jurisdiction. A split has developed in part over whether courts should impose the requirement of a finding of an ambiguity in the language before applying the doctrine. Some jurisdictions allow a party to a standardized insurance policy to invoke the protections of the doctrine whether or not the language is ambiguous; others require that the language be ambiguous before the doctrine can come into play.¹⁰

This Note will examine the development of the doctrine of reasonable expectations in Kentucky through a comparison to the Restatement's approach.¹¹ Part I will examine the doctrine of ambiguity, a related interpretational tool that in some instances is virtually indistinguishable from the doctrine of reasonable expectations.¹² Part II will detail the mechanics, judicial interpretations, and critiques of the Restatement (Second) version of the doctrine of reasonable expectations as well as its connection to the doctrine of ambiguity. The Restatement version dispenses with any requirement that a fact finder determine that the policy language is ambiguous before the doctrine can apply.¹³ Part III will look at and critique the development of the Kentucky formulation of the doctrine and its interaction with the doctrine of ambiguity. In contrast to the Restatement, Kentucky requires the party challenging the policy language to show that the policy is ambiguous before a court may apply the doctrine of reasonable expectations.¹⁴ Finally, this Note will conclude by comparing the relative strengths and weaknesses of the two approaches and advocating the Restatement approach, because it is more protective of policy holders' interests.¹⁵

Honoring the Reasonable Expectations of the Insured, 67 VA. L. REV. 1151 (1981).

¹⁰ There have been a number of law review articles and student notes on the general subject of this doctrine. For a thorough overview of the various interpretations given to the doctrine in different jurisdictions, see Laurie K. Fett, Note, *The Reasonable Expectations Doctrine: An Alternative to Bending and Stretching Traditional Tools of Contract Interpretation*, 18 WM. MITCHELL L. REV. 1113, 1123-24 nn.64-65 (1992).

¹¹ See RESTATEMENT (SECOND) OF CONTRACTS § 211 (1979).

¹² See *infra* notes 16-31 and accompanying text.

¹³ See *infra* notes 32-90 and accompanying text.

¹⁴ See *infra* notes 91-138 and accompanying text.

¹⁵ See *infra* notes 139-41 and accompanying text.

I. THE DOCTRINE OF AMBIGUITY

The doctrine of ambiguity¹⁶ is a general tool of contract interpretation, but it has been most notably applied in the context of adhesion contracts, which are especially common in the insurance industry.¹⁷ Most simply, the doctrine of ambiguity states that an ambiguous term will be construed against the drafter of the disputed language.¹⁸ In other words, if there is a term in a contract susceptible to more than one interpretation, a court, in interpreting the term, will choose the interpretation that works most to the benefit of the party that did not write the contract. The purpose behind this doctrine is to encourage the drafter to take care not to include ambiguous terms and to penalize the drafter in such circumstances.¹⁹

This doctrine has particular importance in the interpretation of insurance contracts. With a normal bargained-for contract, there are some questions about the need for the doctrine since both parties would have had some input into the terms.²⁰ This safeguard is not present with an insurance contract since the insured normally has no input into the contractual terms beyond a request that certain coverage be provided.²¹ The doctrine of ambiguity can protect against overreaching on the part of insurance companies by giving the insured the benefit of the terms over which the insured has no control.²²

¹⁶ This doctrine is also commonly known under the name *contra proferentum*, but this Note will refer to the doctrine by its English name. See FARNSWORTH, *supra* note 5, § 7.11, at 518-19.

¹⁷ See RESTATEMENT (SECOND) OF CONTRACTS § 206 cmt. a (1979); Joseph E. Minnock, Comment, *Protecting the Insured from an Adhesion Insurance Policy: The Doctrine of Reasonable Expectations in Utah*, 1991 UTAH L. REV. 837, 844.

¹⁸ See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 206 (1979); Wolford v. Wolford, 662 S.W.2d 835, 838 (Ky. 1984).

¹⁹ See FARNSWORTH, *supra* note 5, § 7.11.

²⁰ In this situation there is no party who would have gained the advantage from a favorable construction of a term. Since the premise underlying the doctrine of ambiguity is that the party drafting the language has a motive to draft in its favor, the doctrine should not apply in this situation. See RESTATEMENT (SECOND) OF CONTRACTS § 206 cmt. a (1979) (“[W]here one party chooses the terms of a contract, he is likely to provide more carefully for the protection of his own interests than for those of the other party.”).

²¹ See *supra* notes 6-8 and accompanying text.

²² See, e.g., Wolford, 662 S.W.2d at 838 (“If the contract has two construc-

Unfortunately, courts have not been consistent in applying the doctrine of ambiguity. Decisions range from a refusal to apply the doctrine unless there is a patent ambiguity²³ to a willingness to apply the doctrine even if there is no ambiguity in the language, either latent or patent.²⁴ Courts often find an ambiguity just to reach a more equitable result. Therefore, in a "narrow" jurisdiction, the doctrine of ambiguity is at best an unreliable protection for the insured since there is no guarantee that the insured will find a judge willing to protect her interests under the doctrine.²⁵ People with arguably valid claims against an insurance company, where there was some obvious overreaching on the part of the insurer, may not have any recourse if their jurisdiction adheres to the narrower interpretation of the doctrine of ambiguity.

One may gain a better understanding of the debate over the doctrine of ambiguity through a comparison to the debate concerning the parol evidence rule. The parol evidence rule states that extrinsic evidence, usually of prior negotiations, is not admissible in interpreting a fully integrated contract unless the language of the contract is ambiguous.²⁶ Though the rule seems clear and straightforward, it has triggered a debate over the meaning to be placed on the word "ambiguous." This conflict has led to the development of two prevailing views. The traditional view, most normally associated with Williston, is that the ambiguity must be patent. In other words, the ambiguity must appear on the face of the document for parol evidence to be admissible.²⁷ The competing view, associated with Corbin, is that an ambiguity may be latent for parol evidence to be admissible. Not only may parol evidence be introduced to interpret a clause that is ambiguous on its face, but parol evidence also may be admissible to show that a term that appears unambiguous is, in fact, not as clear as one would think from a reading of the document.²⁸

tions, the one most favorable to the insured must be adopted.").

²³ See FARNSWORTH, *supra* note 5, § 7.3, at 474. Kentucky takes this narrow approach and requires a patent ambiguity. See, e.g., *Wolford*, 662 S.W.2d at 835. See *infra* notes 26-31 and accompanying text for a more thorough discussion of patent and latent ambiguities.

²⁴ See Minnock, *supra* note 17, at 845 (explaining that courts have created ambiguity where none existed in an effort to circumvent the ambiguity requirement).

²⁵ *Id.*

²⁶ FARNSWORTH, *supra* note 5, § 7.3.

²⁷ *Id.*

²⁸ *Id.*

While the Restatement generally reflects the Corbin approach,²⁹ Kentucky adheres to the traditional Willistonian version of the parol evidence rule. In Kentucky, parol evidence is only admissible if the contractual language is patently ambiguous or if there are allegations of fraud or mutual mistake.³⁰ Logically, Kentucky has also adopted the restricted doctrine of ambiguity.³¹

II. THE RESTATEMENT DOCTRINE

A. *Mechanics of the Restatement Formulation*

The drafters of the Restatement (Second) of Contracts included what they considered to be a model version of the doctrine of reasonable expectations in section 211:

(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.³²

²⁹ *Id.*

³⁰ See *O.P. Link Handle Co. v. Wright*, 429 S.W.2d 842, 847 (Ky. 1968) (holding that, in deference to the "stability and a salutary confidence in the written word," the parol evidence rule precludes the introduction of parol evidence where mere mistake is claimed, but that an exception may apply in "true cases of fraud and deceit" and certain kinds of mistakes); *Woodward v. Calvert Fire Ins. Co.*, 239 S.W.2d 267, 269 (Ky. 1951) ("turning to the . . . policy . . . , we find that the language is clear and unequivocal . . .", therefore precluding parol evidence).

³¹ See, e.g., *Wolford v. Wolford*, 662 S.W.2d 835, 837-38 (Ky. 1984).

³² RESTATEMENT (SECOND) OF CONTRACTS § 211 (1979). The title of this section is "Standardized Agreements," indicating that it applies to standardized contracts in general, not just insurance contracts.

These three subsections work together to permit a fully integrated³³ agreement for purposes of the parol evidence rule³⁴ even if the non-drafting party did not actually assent³⁵ to all the terms in the agreement. At the same time, section 211 places substantial limitations on the scope of the agreement. Each subsection plays a distinct role in fulfilling these purposes. Subsection 1 provides the general rule that standardized contracts are permissible and enforceable notwithstanding the fact that they typically contain terms that are not bargained-for and to which there has been no affirmative assent.³⁶ This rule implicitly assumes that there are form contracts, such as insurance contracts, that parties may not read. Subsection 2 sets out the rule that an enforceable standardized contract must be exactly that — standardized. Terms are interpreted the same for every buyer of insurance regardless of his or her knowledge of the presence of the terms or their implication.³⁷

Subsection 3 forms the heart of the doctrine of reasonable expectations. Within the broader scheme of section 211, it limits subsection 1 terms that are not bargained-for and circumscribes the overall enforceability of standardized contracts. Subsection 3 excludes from the enforceable scope of the standardized document contractual terms that “are beyond the range of reasonable expectations.”³⁸ Terms “beyond the range of reasonable expectations” are those that “the other party has reason to believe that the adhering party would not have accepted . . . had [the party] known that the agreement contained the particular term.”³⁹

³³ An integrated agreement is one in which the parties intend the written document to be a final or complete version of the agreement. An integrated agreement may be either partially or completely integrated. *See* FARNSWORTH, *supra* note 5, § 7.3.

³⁴ *See supra* notes 26-28 and accompanying text.

³⁵ Assent is a vital part of the contractual process. Normally, one must agree to the terms of a contract for there to be the requisite offer and acceptance leading to an enforceable contract. For a good discussion of assent, see generally FARNSWORTH, *supra* note 5, §§ 3.6-3.15.

³⁶ RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. b (1979).

³⁷ *Id.* § 211 cmt. e (“One who assents to standard contract terms normally assumes that others are doing likewise and that all who do so are on equal footing.”).

³⁸ *Id.* § 211 cmt. f.

³⁹ *Id.* Comment f goes on to flesh out indicators of a term beyond the reasonable expectations of the adhering party. Some of these include “the fact that the term is bizarre or oppressive, from the fact that it eviscerates the non-standard terms explicitly agreed to, or from the fact that it eliminates the

Illustration 6 in the commentary to section 211 is a good example of the application of the doctrine of reasonable expectations to the insurance context.⁴⁰ This hypothetical situation is set up as follows:

A ships goods via B, a carrier. B carries an insurance policy with C, an insurance company, and with C's authority [B] issues to A a certificate that A's shipment is insured under the policy [between B and C and apparently subject to the terms of that agreement]. The policy contains a clause excluding coverage of trips on the Great Lakes unless approved by D, an individual, but this clause is not referred to in the certificate or known to A. It is not part of the contract between A and C.⁴¹

If not for the exception created by subsection 3, this contract term would normally be enforceable against A even though A had no way of knowing about the term. Note that this contract term was completely unambiguous and that C, the insurer, is in no way at fault for the failure to inform A of the term since B drafted the certificate.⁴²

Through this framework, a court may invalidate any term of a standardized agreement that falls under subsection 3 while leaving intact under subsection 1 an otherwise fully enforceable agreement that is not subject to parol evidence (assuming the terms are unambiguous). The entire framework of section 211 allows for the enforcement of what are very common, useful agreements while at the same time protecting the non-drafting party from unreasonable terms.

There is little interaction between the Restatement formulation of the doctrine of reasonable expectations and the doctrine of ambiguity.⁴³ Though they may both apply in a given situation, there is no requirement that contractual language be ambiguous for the doctrine of reasonable expectations to apply. A disputed term only needs to be one that falls

dominant purpose of the transaction." *Id.*

⁴⁰ *See id.* § 211 cmt. f, illus. 6.

⁴¹ *Id.*

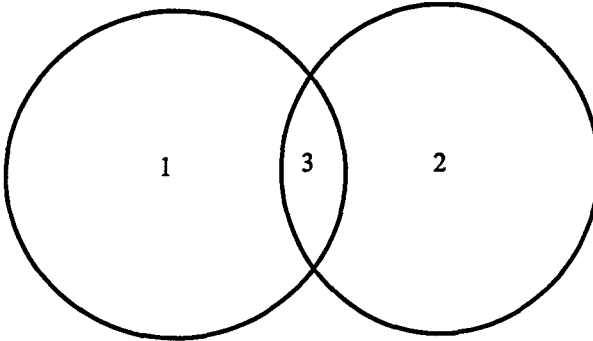
⁴² *See id.*

⁴³ *See id.* § 206. This Restatement formulation of the doctrine of ambiguity states that "[i]n choosing among the reasonable meanings of a promise or agreement or a term thereof, that meaning is generally preferred which operates against the party who supplies the words or from whom a writing otherwise proceeds." *Id.* *See supra* notes 16-31 and accompanying text for a fuller discussion of the doctrine of ambiguity.

outside of reasonable expectations for the protections of subsection 3 to come into play.

The interaction of the two doctrines can be represented graphically.

Figure 1



1. Contractual terms to which only the doctrine of reasonable expectations applies.
2. Contractual terms to which only the doctrine of ambiguity applies.
3. Contractual terms to which both doctrines apply.

For example, a contractual term could be (1) unambiguous and outside the realm of reasonable expectations, (2) ambiguous but any reasonable interpretation of the term would comport with reasonable expectations, or (3) ambiguous but the most preferential interpretation for the insured would still fall outside of reasonable expectations. Terms in the first category would be subject only to the doctrine of reasonable expectations, and any unreasonable terms would be excised from the document. Terms in the second category would be affected by the doctrine of ambiguity, and the ambiguous term would be construed to the benefit of the insured. Both doctrines would apply to terms in the third category, presumably with the doctrine of ambiguity determining the true meaning of the term, and the doctrine of reasonable expectations determining whether the term may stand as a part of the policy.

B. Judicial Interpretations

Few jurisdictions have jumped on the Restatement bandwagon. Only Arizona has explicitly adopted the Restatement version of the doctrine of

reasonable expectations,⁴⁴ though the Restatement formulation has had some success in other jurisdictions, such as Utah⁴⁵ and Iowa.⁴⁶ The Arizona, Utah, and Iowa interpretations help to explain the scope and application of the Restatement formulation.

1. *Arizona*

The Arizona Supreme Court formally adopted the Restatement formulation in its decision in *Darner Motor Sales, Inc. v. Universal Underwriters Insurance Co.*⁴⁷ In so doing, the Arizona Supreme Court accepted the policy foundations and judgments of the Restatement formulation.⁴⁸ In *Darner*, the insured, Darner Motor Sales and its owner, Joel Darner, bought automobile liability coverage from Universal Underwriters through its agent, Doxsee. This policy had limits of \$100,000 per injury/\$300,000 per accident for Darner and \$15,000/\$30,000 limits for lessees.⁴⁹

Though there was a factual dispute on this matter, Darner apparently attempted to raise the lessee coverage to the \$100,000/\$300,000 level. In reliance on what Darner thought was a successful policy change, he

⁴⁴ See *infra* notes 47-68 and accompanying text. See Fett, *supra* note 10, for an overview of the state of the doctrine of reasonable expectations in a number of jurisdictions across the country. Fett breaks the various jurisdictions into three categories: (a) those that accept the Keeton Approach (a liberal approach comparable to the Restatement approach), (b) jurisdictions that take a more restrictive approach, and (c) jurisdictions that reject the doctrine outright. Fett places Kentucky in the category of the more liberal approach, but Kentucky is better categorized as a jurisdiction that places strict limitations on the applicability of the doctrine. See *infra* notes 91-141.

⁴⁵ See *infra* notes 69-74 and accompanying text.

⁴⁶ See *infra* notes 75-80 and accompanying text.

⁴⁷ *Darner Motor Sales, Inc. v. Universal Underwriters Ins.*, 682 P.2d 388 (Ariz. 1984). This case also had implications for the parol evidence rule in Arizona. The state had previously begun a move toward the more liberal Corbin formulation of the parol evidence rule and the *Darner* court solidified the doctrine's hold over the contract law of the state. See Robert L. Gottsfield, *Darner Motor Sales v. Universal Underwriters: Corbin, Williston and the Continued Viability of the Parol Evidence Rule in Arizona*, 25 ARIZ. ST. L.J. 377 (1993).

⁴⁸ See *supra* notes 6-8 and accompanying text for a discussion of some of the policy justifications for the doctrine of reasonable expectations; see also RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. c-f (1979).

⁴⁹ *Darner*, 682 P.2d at 390.

placed a clause in his rental agreement stating that Darner had insurance coverage for lessees at the higher limits. However, when he received the renewal policy, the limits were still at the \$15,000/\$30,000 level.⁵⁰ When he complained, Doxide told him that his umbrella policy with Underwriters would make up the difference in coverage.⁵¹

A little less than two years later, one of Darner's lessees negligently injured a pedestrian. The lessee's rental agreement stated the policy limits as \$100,000/\$300,000, but Underwriters claimed that the policy limits were fixed at the \$15,000/\$30,000 level and that the umbrella policy did not cover this injury. The injured party sued Darner under the limits stated in the rental agreement. Darner filed a third-party complaint against Underwriters and Doxide.⁵² In the litigation, the trial court granted summary judgment for Universal and Doxide.⁵³ The Arizona Court of Appeals affirmed, stating that Darner had made no showing that the policy was ambiguous in its denial of coverage, thus foreclosing any alternative interpretations of the policy.⁵⁴

The Arizona Supreme Court reversed and adopted the Restatement version of the doctrine of reasonable expectations.⁵⁵ That court relied on the policy considerations found in the Restatement's commentary section to justify incorporating the rule into state law.⁵⁶ The *Darner* court was concerned with balancing the interests in creating binding, enforceable contracts with controlling the discretion of standardized agreements' drafters:

The rule . . . recognizes reality and the needs of commerce; it allows businesses that use such forms to write their own contract. It charges the

⁵⁰ *Id.* Neither Darner nor his office manager actually read the terms of the policies involved in this case. The policies were quite large and consisted of loose-leaf pages in a three-ring binder. Doxide would even come to Darner's place of business and remove and add pages to the binder. *Id.* at 391.

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.* Since the trial court disposed of the case on summary judgment, there were insufficient factual findings for the Supreme Court to directly apply the doctrine to the facts. The Supreme Court had to remand for an application of the doctrine after there were factual findings but it gave an outline of possible theories of recovery and outcomes. *Id.* at 399-405.

⁵⁴ *Id.* at 391-92.

⁵⁵ *Id.* at 396-99.

⁵⁶ *Id.* at 396. The court took judicial notice of the belief that standardized contracts foster efficiency and are subject to abuse by insurance companies.

customer with knowledge that the contract being “purchased” is or contains a form applied to a vast number of transactions and includes terms which are unknown (or even unknowable); it binds the customer to such terms. However, the rule stops short of granting the drafter of the contract license to accomplish any result [I]t does not give effect to boilerplate terms which are contrary to either the expressed agreement or the purpose of the transaction as known to the contracting parties.⁵⁷

Implicit in the *Darner* court’s analysis was the premise that there is no requirement of ambiguity in the Restatement formulation. The Arizona Court of Appeals held that, for purposes of the appeals process, the policy at issue was not ambiguous.⁵⁸ Since the Arizona Supreme Court could not consider the policy ambiguous given earlier findings, the *Darner* court, in accepting the Restatement doctrine, rejected the idea that ambiguity is required as a threshold consideration in its application.⁵⁹

The Arizona Supreme Court later explicitly ruled that ambiguity is not a prerequisite to an application of the doctrine in *Gordinier v. Aetna Casualty & Surety Co.*⁶⁰ The Arizona Court of Appeals had refused to apply the doctrine to an unambiguous definition in an underinsured motorist policy extending coverage only to family members that were “resident[s] of the same household.”⁶¹ The family member of the named insured was his estranged wife.⁶² The Arizona Supreme Court reversed on the issue of ambiguity. Relying on a line of cases beginning with *Darner*, the *Gordinier* court listed four situations in which the Restatement formulation may come into play whether or not the language is ambiguous: where the terms could not be understood by the average insured;⁶³ where the terms eviscerated reasonably expected coverage and there was no notice that those terms were present;⁶⁴ where the actions of the insurer created a reasonable belief of coverage in the insured;⁶⁵ where the insurer leads the insured to believe that coverage is present in

⁵⁷ *Id.* at 398-99.

⁵⁸ *Id.* at 391.

⁵⁹ Note that the court did not specifically reject a requirement of ambiguity in all cases. *See id.* at 392, 396-99.

⁶⁰ *Gordinier v. Aetna Cas. & Sur. Co.*, 742 P.2d 277 (Ariz. 1987).

⁶¹ *Id.* at 280.

⁶² *Id.*

⁶³ *Id.* at 283-84.

⁶⁴ *Id.* at 284.

⁶⁵ *Id.*

the policy that is excluded.⁶⁶ These situations are consistent with the examples listed in the Restatement as terms that would trigger the doctrine.⁶⁷

Arizona has continued to develop the Restatement formulation of the doctrine of reasonable expectations since the decision in *Darner*. There is currently a large body of case law in Arizona applying the doctrine to a broad spectrum of standardized contracts even though the doctrine originated in the insurance context.⁶⁸ In Arizona, the doctrine of reasonable expectations is clearly a general contract principle as opposed to a specialized insurance rule.

2. Utah

Utah explicitly rejected the doctrine of reasonable expectations in *Allen v. Prudential Property and Casualty Insurance Co.*⁶⁹ after some earlier rulings had essentially adopted the main elements of the Restatement formulation of the doctrine.⁷⁰ The *Allen* majority⁷¹ rejected three

⁶⁶ *Id.*

⁶⁷ See RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. f (1979).

⁶⁸ See *Angus Medical Co. v. Digital Equip. Corp.*, 840 P.2d 1024, 1030 (Ariz. Ct. App. 1992).

⁶⁹ *Allen v. Prudential Property and Cas. Ins. Co.*, 839 P.2d 798 (Utah 1992). The decision in this case came after a student-written law journal work advocated the adoption of the Restatement formulation of the doctrine. See Minnock, *supra* note 17. The *Allen* court specifically addressed the arguments made by Minnock. For an overview and analysis of the events leading up to the decision in *Allen*, see Douglas K. Fadel, Comment, *Utah Rejects the Reasonable Expectations Doctrine in Insurance Contract Interpretation*, 1993 UTAH L. REV. 275.

⁷⁰ See, e.g., *Farmers Ins. Exch. v. Call*, 712 P.2d 231 (Utah 1985) ("We therefore hold that where the insurer fails to disclose material exclusions in an automobile insurance policy and the purchaser is not informed of them in writing, . . . the exclusion clause fails to 'honor the reasonable expectations' of the purchaser. . . ." *Id.* at 236-37); *Wagner v. Farmers Ins. Exch.*, 786 P.2d 763 (Utah Ct. App. 1990). The *Wagner* court instituted a three-pronged analysis of applicability of the doctrine in an individual case: first, the insurer had to have actual knowledge or it reasonably should have known of the insured's expectations of coverage; second, the insurer had to be the source of the expectation; and third, the expectation had to be reasonable. *Id.* at 766. Compare this statement of the applicability of the doctrine to that in *Gordinier v. Aetna Cas. & Sur. Co.*, 742 P.2d 277 (Ariz. 1987). See *supra* notes 60-67 and accompanying text for a discussion of the *Gordinier* case.

⁷¹ The *Allen* majority consisted of three justices. *Allen*, 839 P.2d at 798.

separate formulations of the doctrine, including one formulation that dispensed with a showing of ambiguity as a prerequisite.⁷² One justice, concurring in the result, refused to join the majority because of their outright rejection of the doctrine of reasonable expectations.⁷³ One justice dissented and would have adopted the Restatement formulation.⁷⁴ The fact that two of the five justices on the Utah Supreme Court appeared willing to accept the doctrine suggests that the doctrine has support in Utah.

3. Iowa

Iowa courts have adopted a form of the doctrine of reasonable expectations that is like the Restatement formulation, though its scope may not be quite as broad. The court adopted the doctrine as early as 1973 in *Rodman v. State Farm Mutual Automobile Insurance Co.*⁷⁵ There, the Iowa Supreme Court stated that “[t]he objectively reasonable expectations of applicants and intended beneficiaries regarding insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations.”⁷⁶ This language implies that, like the Restatement formulation, there is no requirement of ambiguity as a prerequisite for the application of the doctrine in Iowa.

Notwithstanding the court’s statement, the scope of the doctrine is not quite as broad as the language from *Rodman* might suggest. The Iowa Supreme Court narrowed the application of the doctrine to policy exclusions that “(1) [are] bizarre or oppressive, (2) eviscerate[] terms of the explicitly agreed to, or (3) eliminate[] the dominant purpose of the transaction.”⁷⁷ Though this does mimic the Restatement indicators of terms beyond the reasonable expectations of the parties,⁷⁸ the Restate-

⁷² *Id.* at 803. In *Allen*, the Court of Appeals had applied the *Wagner* version of the doctrine.

⁷³ *Id.* at 807 (Stewart, J., concurring).

⁷⁴ *Id.* at 1047-49 (Durham, J., dissenting) (stating that “the reasonable expectations doctrine would operate as a ‘balancing test,’ requiring equilibrium between the risk of insurer overreaching and the advantages . . . of standardization and form contracting”).

⁷⁵ *Rodman v. State Farm Mut. Auto. Ins. Co.*, 208 N.W.2d 903, 906 (Iowa 1973).

⁷⁶ *Id.*

⁷⁷ *West Trucking Line, Inc. v. Northland Ins. Co.*, 459 N.W.2d 262, 264-65 (Iowa 1990) (citing *Farm Bureau Mut. Ins. v. Sandbulte*, 302 N.W.2d 104, 112 (Iowa 1981)).

⁷⁸ RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. f (1979).

ment list is not an exhaustive list of terms. It is only a starting place for the analysis.⁷⁹ The language of Restatement section 211(3) would allow for any term beyond any reasonable expectation to be read out of the agreement.⁸⁰ Therefore, Iowa provides for a form of the Restatement formulation that will apply to an insurance contract regardless of the ambiguity of the language, but not to all terms that are patently unreasonable.

C. Critique

There are a number of problems with the Restatement approach. Primarily, the Restatement approach is focused on excluding language that is already in the policy. As section 211 states, it focuses on "particular term[s]" contained in the writing.⁸¹ This means that the Restatement is focused on expectations or terms explicitly embodied in the insurance contract. Unfortunately, an insured may have a reasonable expectation of coverage that is frustrated not because of a "bizarre or oppressive" term or a term that "eliminates the dominant purpose of the transaction,"⁸² but rather because the requested coverage (figured into the premium according to the policy declarations) is not included at all. For example, one could request that a policy contain coverage for completed operations damages up to \$100,000, but the policy may not contain the coverage even if the agent promised that it did. The Restatement approach presumably would not include coverage even if the insured relied on an erroneous belief that she was already covered by passing up an opportunity to obtain the requested coverage from another company.

From a loss allocation perspective, it would be reasonable to make the insurer bear the risk of loss because it created the expectation on the part of the insured that was not fulfilled.⁸³ Furthermore, the insurer is in a better position to bear and spread the risk. Unfortunately, the Restatement approach will not necessarily bring about this result since the Restatement literally applies only to language in the policy.⁸⁴

⁷⁹ See *id.*

⁸⁰ See *id.* § 211(3).

⁸¹ *Id.*

⁸² *Id.* § 211 cmt. f.

⁸³ When comparing the relative fault of the company which, through the actions of its agent, promised coverage that it did not provide in the actual contract, and of the insured individual, who reasonably did not read the contract and relied on the representations of the agent, the insurance company is arguably more at fault since it created the expectation on the part of the individual insured.

⁸⁴ See RESTATEMENT (SECOND) OF CONTRACTS § 211(3) (1979).

On the other hand, the Restatement approach of addressing terms in the policy itself would cut down on judicial drafting. If there is a goal in the law of encouraging written agreements,⁸⁵ evidenced by such contractual rules as the parol evidence rule⁸⁶ and the statute of frauds,⁸⁷ a special rule that would allow a litigant to circumvent the certainty of a written agreement by introducing new terms would undermine that goal. The Restatement strikes an effective balance between protection of insureds' interests and encouragement of written agreements.

Furthermore, the Restatement is not clear whether the reasonable expectations of the insured are to be measured by a subjective standard, an objective standard, or both. The very title "reasonable expectations" would seem to imply an objective standard based on a reasonable prudent person (akin to a tort negligence standard), but the language of section 211 ties the expectations to the beliefs of the individual parties to the contract.⁸⁸ If the section contemplates a completely subjective standard, the insured could claim to have any kind of belief whatsoever without any controls on the claim, and in turn, the insurer could always claim that it had no reason to believe that the particular party would not have assented to the term at issue. If there is a completely objective standard that does not inquire into the mental states of the parties, insurers may be forced to provide coverage if the term is acceptable on an objective level, even if the individual insured would have accepted the term if she would have known of its presence. A combination approach where the belief must be objectively reasonable and subjectively held would help to cure these problems, but it is not clear how the Restatement drafters meant to resolve this problem.⁸⁹

⁸⁵ See FARNSWORTH, *supra* note 5, § 7.2.

⁸⁶ See *supra* notes 26-28 and accompanying text.

⁸⁷ See FARNSWORTH, *supra* note 5, § 6.1. Most generally, the statute of frauds states that certain types of contracts must be in writing to be enforceable. *See id.*

⁸⁸ This section states: "(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." RESTATEMENT (SECOND) OF CONTRACTS § 211(3) (1979) (emphasis added).

⁸⁹ The Restatement commentary gives little guidance on this subject. Comment f to section 211 lists a number of objective tests, such as whether the term is "bizarre or oppressive," but these are only listed as indicators where the reasonableness of the insured's belief may be "inferred." Furthermore, the commentary gives subjective factors, such as a lack of an opportunity to read the policy, as further support for an application of the doctrine. *Id.* § 211, cmt. f.

Notwithstanding these problems, the Restatement approach adequately addresses the issues that originally drove the creation of the doctrine. This formulation protects the insured from terms that are vastly unfair and beyond the scope of any expectation, regardless if the insured read the contract and regardless if the terms are ambiguous. The Restatement approach basically fulfills the purpose, underlying the need for a doctrine of reasonable expectations. There is no detrimental overlap with the doctrine of ambiguity since the doctrine of ambiguity and the doctrine of reasonable expectations were created to serve different purposes.⁹⁰ The Restatement doctrine can take up where the doctrine of ambiguity leaves off, or both doctrines can apply to the same language, at the same time, to serve different purposes.

III. THE KENTUCKY FORMULATION

Although Kentucky has adopted a version of the doctrine of reasonable expectations,⁹¹ its formulation is fundamentally different than that promulgated by the Restatement drafters. Kentucky varies most prominently from the Restatement by requiring a showing of ambiguity as a predicate to invocation of the doctrine.⁹² Rather than protecting a different set of terms for different underlying purposes than the doctrine of ambiguity, the Kentucky doctrine of reasonable expectations protects insureds from only a subset of terms already covered by the doctrine of ambiguity.⁹³

A. *Mechanics of the Kentucky Formulation*

1. *Genesis of the Kentucky Formulation:* *Simon v. Continental Insurance Co.*

The Kentucky formulation of the doctrine can be traced back to Justice Leibson's majority opinion for the Kentucky Supreme Court in

⁹⁰ See *id.* § 211 cmt. c-f for a discussion of the purposes of the doctrine of reasonable expectations, and *supra* note 19 and accompanying text for a discussion of the purpose behind the doctrine of ambiguity.

⁹¹ See *Simon v. Continental Ins. Co.*, 724 S.W.2d 210 (Ky. 1986).

⁹² See, e.g., *Hendrix v. Fireman's Fund Ins. Co.*, 823 S.W.2d 937, 938 (Ky. Ct. App. 1991) (holding that "in the absence of ambiguities or of a statute to the contrary, the terms of an insurance policy will be enforced as drawn"), *review denied* (Ky. Mar. 4, 1992).

⁹³ See *infra* notes 123-26 and accompanying text.

*Simon v. Continental Insurance Co.*⁹⁴ *Simon* involved litigation over an underinsured motorist policy. The insured, Michael Simon, and his daughter were killed in an automobile accident. His wife, Janet, recovered a judgment against the other driver in a wrongful death action, but the tortfeasor was judgment-proof and only carried the statutory minimum for liability insurance.⁹⁵

Janet Simon filed an underinsured motorist claim with her own insurer, Continental Insurance Co., but the insurer disputed the extent of its liability under the policy.⁹⁶ Simon's policy stated that it included underinsured motorist coverage, but the policy itself did not specify the limits of the insurer's liability under the underinsured coverage. The policy stated a limit on "occurrence[s]" generally of \$100,000, but there was a separate limit on uninsured coverage of \$10,000/\$20,000.⁹⁷ Simon claimed that she was entitled to the higher limit on underinsured motorist coverage since the policy did not state a specific limitation, but the insurer claimed that the policy limits on the uninsured motorist coverage should apply to the underinsured portion of the policy since they are analogous coverages.⁹⁸ The trial court agreed with Simon and awarded her the \$100,000 limit offset by the \$20,000 already paid by the tortfeasor's insurer.⁹⁹ The Kentucky Court of Appeals reversed, holding that the underinsured motorist statute¹⁰⁰ did not require that this type of insurance provide coverage limits coextensive with the outer policy limits for an "occurrence."¹⁰¹

The Supreme Court saw this case as involving two issues: interpretation of the statute and interpretation of the policy.¹⁰² The court disposed of the entire case by interpreting the policy and avoided construing the

⁹⁴ *Simon v. Continental Ins. Co.*, 724 S.W.2d 210 (Ky. 1986).

⁹⁵ Janet Simon won a judgment of \$104,023 as administrator of her husband's estate and \$40,000 as guardian for her daughter. The other driver's liability insurance limits were \$10,000 per person/\$20,000 per accident, and his insurer paid the limits of the policy. This left a shortfall of \$134,023 combined owed to the Simon family. *Id.* at 210.

⁹⁶ *Id.* at 210-11.

⁹⁷ *Id.*

⁹⁸ *Id.* at 211.

⁹⁹ *Id.*

¹⁰⁰ KY. REV. STAT. ANN. § 304.39-320 (Michie/Bobbs-Merrill 1996). This statute requires every insurer operating in Kentucky to offer underinsured motorist insurance if it is requested by an insured.

¹⁰¹ *Simon*, 724 S.W.2d at 211.

¹⁰² *Id.*

statute.¹⁰³ In interpreting the policy, Justice Leibson made the first reference in a Kentucky case to the doctrine of reasonable expectations.¹⁰⁴ Leibson described the doctrine as applicable in “deciding whether an insurance policy is *ambiguous*, and consequently should be interpreted in favor of the insured”¹⁰⁵ Leibson based his version of the doctrine in part on a proposal by Professor Keeton¹⁰⁶ and stated that “[o]nly an unequivocally conspicuous, plain and clear manifestation of the company’s intent to exclude coverage will defeat [the insured’s reasonable] expectation.”¹⁰⁷ Leibson further explained that “[t]he doctrine of reasonable expectations *is used in conjunction with the principle that ambiguities should be resolved against the drafter* in order to circumvent the technical, legalistic and complex contract terms which limit benefits to the insured.”¹⁰⁸

Beyond this statement of abstract principles, the opinion otherwise gives little guidance. The court found the policy ambiguous because the policy did not state a limit directly on the underinsured motorist policy statement, and, therefore, construed the policy to maximize Simon’s coverage. The only discussion of reasonable expectations in reference to these facts was the observation that a reasonable purchaser of underinsured motorist insurance would expect full coverage “absent ‘an unequivocally conspicuous, plain and clear manifestation of the company’s intent to exclude coverage.’”¹⁰⁹

2. *Subsequent Developments*

A series of cases after *Simon* applied the Kentucky formulation to a number of different factual situations, all involving insurance disputes.

¹⁰³ *Id.* at 212.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* (emphasis added).

¹⁰⁶ *Id.* (citing ROBERT E. KEETON, BASIC TEXT OF INSURANCE LAW § 6.3(a) (1971)). Oddly enough, Keeton actually supported a doctrine which applied when the language is not ambiguous. See generally Keeton, *supra* note 9.

¹⁰⁷ *Id.* (quoting R.H. LONG, THE LAW OF LIABILITY INSURANCE § 5.10B).

¹⁰⁸ *Id.* (quoting R.H. LONG, THE LAW OF LIABILITY INSURANCE § 5.10B) (emphasis added). The language from the Long treatise may be the key to Kentucky’s insistence on an ambiguity before an application of the doctrine. If only a “plain and clear manifestation of the company’s intent to exclude . . . will defeat [the insured’s] expectation,” *id.*, it would stand to reason that an unambiguous policy would be enforceable under this rationale regardless of the insured’s reasonable expectations.

¹⁰⁹ *Id.* at 213 (quoting LONG, *supra* note 108).

Each of the cases emphasize the necessity for a finding of ambiguity before the doctrine can apply.¹¹⁰ In *Home Folks Mobile Homes, Inc. v. Meridian Mutual Insurance Co.*,¹¹¹ the plaintiff was an incorporated business solely owned by Richard Berry. The corporation had a business auto policy with the defendant. Berry's daughter was involved in an automobile accident while driving in a car not owned by a family member or the business.¹¹² The Kentucky Court of Appeals applied the doctrine of reasonable expectations to a "drive other car" provision which stated "[a]ny auto you don't own is a covered auto while being used by you or by any family member"¹¹³

The trial court had held that this policy unambiguously "provided [drive other car] coverage only if the insured was an individual,"¹¹⁴ and the insured here was a corporation.¹¹⁵ When the insured initially bought the policy he had told the agent that he wanted "full coverage" for both his business and family.¹¹⁶ The Court of Appeals reversed, stating that the mere insertion of a policy endorsement which, on its face, applied only to individuals, into a policy nominally for a corporation, creates an ambiguity.¹¹⁷ This ambiguity opened the door for the court to apply the

¹¹⁰ Note that the requirement of a finding of ambiguity is consistent with the Kentucky version of the parol evidence rule. Similarly, in Arizona the acceptance of the Restatement version heralded a change in that state's version of the parol evidence rule. See *supra* note 47 for a discussion of Arizona's version. In contrast to the Corbin approach accepted by Arizona, Kentucky adheres to the Willistonian version of the rule, which requires that language be clearly ambiguous on its face (i.e., a patent ambiguity) for extrinsic evidence to be admissible. This has clearly and detrimentally controlled the development of the doctrine of reasonable expectations. If there is no facial ambiguity, then an insured cannot introduce evidence to explain her reasonable expectation. For a statement of Kentucky's parol evidence rule, see, for example, *Woodward v. Calvert Fire Ins. Co.*, 239 S.W.2d 267, 269 (Ky. 1951).

¹¹¹ *Home Folks Mobile Homes, Inc. v. Meridian Mut. Ins. Co.*, 744 S.W.2d 749 (Ky. Ct. App. 1987).

¹¹² *Id.* at 749.

¹¹³ *Id.* at 750.

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ *Id.* at 749-50.

¹¹⁷ The Court of Appeals' interpretation of ambiguity is indicative of the problem of courts bending the doctrine to fit the ends the court is trying to achieve. Kentucky holds to a strict Willistonian definition of ambiguity and the parol evidence rule, which means that the policy language itself would have to be patently ambiguous in order for a court to invoke the doctrine of ambiguity.

doctrine of reasonable expectations. The court stated that “the insured could reasonably expect the endorsement was meant to extend such coverage to members of the [insured’s] family. The ‘doctrine of reasonable expectations’ is one, as explained in *Simon*, appropriate for resolving such ambiguities.”¹¹⁸

Later that same year the Kentucky Supreme Court explicitly discussed the doctrine’s relation to the doctrine of ambiguity in *Woodson v. Manhattan Life Insurance Co.*¹¹⁹ The court referred to the doctrine of reasonable expectations as a “corollary to the rule for construing ambiguities”¹²⁰ and reiterated the holding of *Simon*.¹²¹ The trend of requiring ambiguity continues throughout the remainder of the reported Kentucky cases interpreting run-of-the-mill insurance contracts. All of these cases either explicitly or implicitly require a showing of ambiguity before the doctrine can be invoked in a particular case.¹²²

This court seemed willing to go out of its way in order to find an ambiguity that would support what it saw as the “correct” result. For a discussion of the Kentucky version of the doctrine of ambiguity, see *supra* note 30 and accompanying text.

¹¹⁸ *Home Folks*, 744 S.W.2d at 750.

¹¹⁹ *Woodson v. Manhattan Life Ins. Co.*, 743 S.W.2d 835 (Ky. 1987). The main dispute in this case was not over an interpretation of the policy; rather, it was over whether, as a matter of fact, the insured’s conduct came within the leave of absence exception to the termination clause of the insured’s life insurance. *Id.* at 836-38.

¹²⁰ *Id.* at 839.

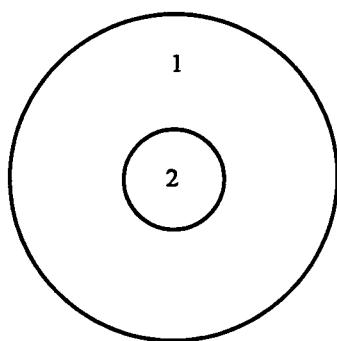
¹²¹ *Id.* The court quoted the language that the *Simon* court relied on from *LONG*, *supra* note 108. See *supra* notes 94-109 and accompanying text for a discussion of the *Simon* case.

¹²² See *James Graham Brown Found., Inc. v. St. Paul Fire & Marine Ins. Co.*, 814 S.W.2d 273, 279 (Ky. 1991) (stating in the context of the doctrine of ambiguity that “it cannot be accepted as a fact that parties in good faith intended to bargain for insurance that paid no benefits”); *Hendrix v. Fireman’s Fund Ins. Co.*, 823 S.W.2d 937, 941 (Ky. Ct. App. 1991) (refusing to apply the doctrine of reasonable expectations to create a duty on behalf of blanket excess liability insurers to check the insured’s other policies to see the extent of coverage offered under their policies since the parties bargained to allocate the risk of loss; no allegations were made of ambiguity in that allocation); *Moore v. Commonwealth Life Ins. Co.*, 759 S.W.2d 598, 599 (Ky. Ct. App. 1988) (stating that courts “must define an insurer’s liability according to the terms and conditions of the policy” but that under the doctrine of reasonable expectations, the insured “is entitled to all the coverage he may reasonably expect to be provided under the policy”). *But see* *Lewis v. West Am. Ins. Co.*, 927 S.W.2d 829, 833-34 (Ky. 1996) (plurality opinion) (invalidating household exclusions on public policy grounds); *Hamilton v. Allstate Ins. Co.*, 789 S.W.2d 751, 753 (Ky. 1990) and *Chaffin v. Kentucky Farm Bureau Ins. Co.*, 789 S.W.2d 754, 757 (Ky. 1990)

3. *The Current Kentucky Formulation*

Under the rules set out in the foregoing cases, the application of the Kentucky doctrine can be boiled down to a two-question test: (1) is there an ambiguity? and (2) is the insured's interpretation one that can be reasonably attributed to the language of the policy?¹²³ This second analysis may involve many of the same questions involved in the Restatement analysis.¹²⁴ Like the Restatement version, the Kentucky formulation may best be understood graphically.

Figure 2



1. Contractual terms to which the doctrine of ambiguity applies.
2. Contractual terms to which both the doctrine of ambiguity and the doctrine of reasonable expectations apply.

(companion cases holding unambiguous policy exclusions void as a matter of public policy because they violated the uninsured motorist statute). Though these cases explicitly apply the doctrine of reasonable expectations to unambiguous contract language, the analysis in each case focuses more on broad public policy implications than on the nature of the policy language. In fact, *Hamilton* and *Chaffin* only nominally mention *Simon*, and *Lewis* cites only to *Hamilton* and *Chaffin* for the doctrine of reasonable expectations. In the average interpretative case that does not implicate broad public policy concerns, the normal requirement of a showing of ambiguity would apply.

¹²³ See, e.g., *Simon v. Continental Ins. Co.*, 724 S.W.2d 210, 211-12 (Ky. 1986).

¹²⁴ See *supra* notes 4-8 and accompanying text for a list of typical considerations under the Restatement formulation of the doctrine. See also *Brown*, 814 S.W.2d at 273 (applying as an indicator of an unreasonable term as one that gives the insured none of the bargained-for benefits).

The Kentucky formulation of the doctrine works as a subset of the doctrine of ambiguity. In order for the doctrine to apply, the court must first find that the language is ambiguous; this means that necessarily the doctrine of ambiguity applies to any term Kentucky would analyze under the doctrine of reasonable expectations. Beyond that, it is not clear whether Kentucky would then treat the ambiguous term any different from one to which the doctrine of reasonable expectations would not apply (since the doctrine of reasonable expectations only applies to insurance agreements). Unlike the Restatement, Kentucky has never stricken a term from a policy document. Courts have merely given the terms the best interpretation possible in conjunction with the rest of the policy.¹²⁵

The Kentucky version is even more restrictive when viewed in conjunction with the Kentucky form of the parol evidence rule. The definition of ambiguity is governed by the parol evidence rule, and Kentucky adheres to the restrictive Willistonian interpretation of ambiguity. Therefore, Kentucky will only construe a term against the drafter if it is patently ambiguous.¹²⁶

B. Critique

The Kentucky doctrine is supported by the policy that courts are not in the business of rewriting contracts. A court may try to interpret the terms so as to benefit one of the parties, but it should not draft a new document.¹²⁷ The Kentucky version of the doctrine clearly does not violate this rule of judicial restraint. This is the only real argument in favor of the Kentucky formulation, and the Restatement version does not truly violate the rule that the Kentucky formulation upholds. A court cannot add terms under the Restatement; it can only cross them out.¹²⁸

¹²⁵ See, e.g., *Hendrix*, 823 S.W.2d at 938 ("Under the 'doctrine of reasonable expectations,' an insured is entitled to all the coverage he may reasonably expect to be provided *according to the terms of the policy.*") (emphasis added).

¹²⁶ See, e.g., *Moore v. Commonwealth Life Ins. Co.*, 759 S.W.2d 598, 599 (Ky. Ct. App. 1988). For a more detailed discussion of the parol evidence rule and its interaction with the doctrine of ambiguity, see *supra* notes 26-28 and accompanying text.

¹²⁷ See, e.g., *Moore*, 759 S.W.2d at 599 ("[T]he courts cannot make a new contract for the parties to an insurance contract. However, restrictive interpretation in a standardized adhesion contract . . . is not favored.") (citations omitted).

¹²⁸ See RESTATEMENT (SECOND) OF CONTRACTS § 211(3) (1979).

Therefore, under the Restatement, there is no unfettered judicial discretion and no substantial judicial drafting.

Plainly stated, the Kentucky formulation completely fails to fulfill the reasons behind the institution of the doctrine of reasonable expectations due to Kentucky's insistence on a prerequisite showing of ambiguity. A prerequisite showing of ambiguity would completely undermine one of the very purposes behind the doctrine — the failure of the doctrine of ambiguity to adequately address the problems of inability of insureds to read the policy. Professor Robert Keeton, in one of the first major articles outlining the reasons for the doctrine, stated the reasons for the doctrine in terms of the failure of the doctrine of ambiguity to address problems in the insurance context:

This ought not be allowed even though the insurer's form is very explicit and unambiguous, because insurers know that ordinarily policyholders will not in fact read their policies. Policy forms are long and complicated and cannot be fully understood without detailed study; few policyholders ever read their policies as carefully as would be required for moderately detailed understanding.¹²⁹

The requirement of ambiguity presupposes that the insured read the contract and would have been so confused by the term that he would not have known the meaning of term. Only then would the penalty of construing the language against the drafter make sense. But as Professor Keeton points out, many purchasers of insurance never even have an opportunity to read the policy before they buy it: "the normal processes for marketing most kinds of insurance do not ordinarily place the detailed policy terms in the hands of the policyholder *until the contract has already been made.*"¹³⁰ It would be manifestly unfair to require a policyholder to make a showing of ambiguity in a contractual term before it may be challenged when the policyholder most likely never had a chance to read the term before the policy was purchased.

In fact, many courts tried to use the doctrine of ambiguity to fulfill this perceived need in insurance law, but that attempt was unsuccessful. In Professor Keeton's research, he summarized the attempts of several jurisdictions to use the doctrine of ambiguity to address the need: "Opinions proceeding generally on the theory of resolving ambiguities against the insurer have often included passages stretching toward but not

¹²⁹ Keeton, *supra* note 9, at 968.

¹³⁰ *Id.* (emphasis added).

reaching the broader principle of honoring reasonable expectations."¹³¹ Professor Keeton goes on to state: "[T]he principle of resolving ambiguities against the draftsman is simply an inadequate explanation of the results of some cases. The conclusion is inescapable that courts have sometimes invented ambiguity where none existed, then resolving the invented ambiguity contrary to the plainly expressed terms of the contract document."¹³² For these reasons, Professor Keeton proposed a form of the doctrine that should not be dependent on ambiguity in the language.¹³³

Policyholders need additional protection from insurers, and the doctrine of reasonable expectations was intended to supply that protection, regardless of the clarity of the language. The only protection available to the insured in the Commonwealth of Kentucky is the chance a court will also find the term ambiguous and then will construe it in favor of the insured. The Restatement version of the doctrine of reasonable expectations, along with adhesion contract theory in general, assumes that the insured does not read the contract and, even if she did, she would not be able to bargain for any changes in the terms.¹³⁴ The requirement of ambiguity completely undermines the underpinnings of the doctrine so that it is of little use in affording any extra protections to parties to an adhesion contract.

Kentucky's version is no more than the old doctrine of ambiguity repackaged under a new name. There is no substantial difference in application between the two. The doctrine of ambiguity requires a prerequisite showing of ambiguity, and if this is shown, the court will give the most reasonable interpretation in favor of the insured to the language.¹³⁵ The Kentucky formulation of the doctrine is applied in an identical fashion. It just carries a different name in the insurance context.

Since the Kentucky formulation is coextensive with the doctrine of ambiguity, it will fail to address the problem of insurance companies who

¹³¹ *Id.* at 969.

¹³² *Id.* at 972.

¹³³ "Thus, not only should a policyholder's reasonable expectations be honored in the face of difficult and technical language, but those expectations should prevail as well when the language of an unusual provision is clearly understandable, unless the insurer can show the policyholder's failure to read such language was unreasonable." *Id.* at 968.

¹³⁴ See RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. f (1979).

¹³⁵ See *Wolford v. Wolford*, 662 S.W.2d 835, 838 (Ky. 1984) (holding that "[i]f the contract language is ambiguous, it must be liberally construed to resolve any doubts in favor of the insured").

overreach in their policies but are clever enough to draft the language clearly. For example, if the language quoted in the introduction to this Note¹³⁶ worked to the detriment of the reasonable expectations of an insured in Kentucky, that insured may find no protection from a Kentucky court since there is a precedent on the books holding that this language is not ambiguous.¹³⁷ If Kentucky means to use the doctrine of ambiguity only, it should do so. If Kentucky means to give purchasers of insurance an additional protection, as the very use of an interpretive doctrine other than the doctrine of ambiguity in the *Simon* decision¹³⁸ implies, then it should formulate a version of the doctrine that gives these parties a true additional protection. The Restatement formulation effectively fulfills the justifications for the doctrine of reasonable expectations which are separate from those for the doctrine of ambiguity.

CONCLUSION

Kentucky should adopt the formulation of the doctrine of reasonable expectations embodied in the Restatement. At the very least, Kentucky needs to drop the requirement that the insured must make a prerequisite showing of ambiguity since it undermines the very reasons courts initially decided to develop the doctrine. It is well established that insurance customers do not read their policies, and contrary to usual contract law, they are not legally expected to do so.¹³⁹ Given the disparate bargaining power between insurance companies and their customers,¹⁴⁰ it is not unreasonable that courts have developed a tool to keep insurance companies in line. The Restatement version balances the need for binding, enforceable agreements with the need to fulfill the reasonable expectations of insurance customers when buying the policies at issue. Notwithstanding the judicial promise in *Simon v. Continental Insurance*

¹³⁶ See *supra* note 1 and accompanying text. The author does not mean to imply that this typical contractual language would necessarily be contrary to the reasonable expectations of an individual insured. The author does think, however, that this language is sufficiently vague and convoluted to give a typical insurance customer difficulty in determining what coverage she actually has.

¹³⁷ See *Biebel Bros., Inc. v. United States Fidelity & Guar. Co.*, 522 F.2d 1207, 1209, 1211 (8th Cir. 1975).

¹³⁸ *Simon v. Continental Ins. Co.*, 724 S.W.2d 210, 212-13 (Ky. 1986) (holding that "the insured is entitled to all coverage he may reasonably expect to be provided under the policy").

¹³⁹ See *supra* note 6 and accompanying text.

¹⁴⁰ See *supra* notes 7-8 and accompanying text.

*Co.*¹⁴¹ that Kentucky Courts will protect the reasonable expectations of the insured, Kentucky's version of the doctrine provides little or no additional protections for insurance buyers in the Commonwealth of Kentucky beyond the doctrine of ambiguity. Kentucky should now fulfill what has turned out to be an empty promise of an additional tool for protecting the interests of the insured and drop the prerequisite requirement of a showing of ambiguity.

¹⁴¹ *Simon*, 724 S.W.2d at 212-13.