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Great Expectations for the Reasonable Expectations Doctrine [Atwater Creamery Co. v. Western National Mutual Insurance Co., 366 N.W.2d 271 (Minn. 1985)]

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COMMENT

GREAT EXPECTATIONS FOR THE REASONABLE EXPECTATIONS DOCTRINE

[*Atwater Creamery Co. v. Western National Mutual Insurance Co.*, 366 N.W.2d 271 (Minn. 1985)]

INTRODUCTION

Of the many areas of law that present confusion, difficulty, and unpredictability to bench and bar alike, few, if any, rival insurance contract law.[1] More precisely, judicial decisions involving the interpretation and construction of insurance contracts are disturbingly unprincipled,[2] due in part to the inadequacy of traditional contract theories.[3] In an admirable attempt to cultivate principled, consistent decisions, the Minnesota Supreme Court adopted the "reasonable expectations" doctrine[4] in *Atwater Creamery Co. v. Western National Mutual Insurance Co.*[5] This doctrine is intended to provide Minnesota courts with principled, non-arbitrary guidelines for interpreting and constructing disputed policy provisions in insurance contracts.[6] An additional aim of this doctrine is to encourage or even force insurance companies to conspicuously and concisely communicate the parameters of policy coverage.[7]

This Comment will discuss the reasonable expectations doctrine from a perspective grounded in traditional contract principles. The Comment, however, will also address the underlying economic and

1. *See* Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 391, 682 P.2d 388, 396 (1984); *see generally* Abraham, *Judge-Made Law and Judge-Made Insurance: Honoring the Reasonable Expectations of the Insured*, 67 VA. L. REV. 1151 (1981); Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961 (1970); Note, *A Reasonable Approach to the Doctrine of Reasonable Expectations as Applied to Insurance Contracts*, 13 U. MICH J.L. REF. 603 (1980).

2. *See* Abraham, *supra* note 1, at 1151; Keeton, *supra* note 1, at 961.

3. *See* Note, *A Common Law Alternative to the Doctrine of Reasonable Expectations in the Construction of Insurance Contracts*, 57 N.Y.U. L. REV. 1175, 1176 (1982).

4. For a discussion of the reasonable expectations doctrine, see *infra* notes 37-49 and accompanying text.

5. 366 N.W.2d 271 (Minn. 1985).

6. *See id.* at 278; Keeton, *supra* note 1, at 968.

7. *See Atwater*, 366 N.W.2d at 278; *see also* MINN. STAT. §§ 70C.06-.09 (1984) (requiring insurance contracts to be readable and legible); *id.* § 325G.31 (requiring consumer contracts to be written in plain language).

social issues that are implicated by the doctrine.[8] Part I of this Comment will review the nature of the adhesion contract, the form in which insurance policies are written, and the customary theories used by courts to resolve the problems created by such contracts. Part II will examine the facts, as well as the supreme court's holding and analysis in *Atwater.* Part III will analyze and discuss the controversial aspects of the reasonable expectations doctrine as adopted by the Minnesota Supreme Court. A suggested modification for future cases is also included in Part III.

I. Adhesion Contracts and Traditional Contract Theories

In order to fully appreciate the insurance contract dilemma and the desperate need to develop responsive contract theories, a brief examination of adhesion contracts and traditional contract theories is warranted.[9]

A. Adhesion Contracts

A modern day insurance policy represents a prime example of a standard form contract or contract of adhesion.[10] The typical policy is often drafted by an attorney who endeavors to limit the overall scope of insurance coverage.[11] The insurance company then offers the policy on a "take it or leave it" basis.[12] The prospective insured may either reject the policy standard or accept it. He may not negotiate or alter the specific terms.[13] Furthermore, because this is the

8. The reasonable expectations doctrine encompasses more than the technical "niceties" of contract law. The doctrine extends to fundamental themes, concepts, and issues of social and economic importance. For instance, insurance in general is a "phenomenon of incalculable importance" in the distribution of risk both in and out of the commercial marketplace. *See* Abraham, *supra* note 1, at 1151. Moreover, our free enterprise system and its consequent division of labor depend upon the medium of contract to ensure a secure exchange of goods and services in the market. *See* Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract,* 43 Colum. L. Rev. 629, 640 (1943); *see also* Comment, *Unconscionable Business Contracts: A Doctrine Gone Awry,* 70 Yale L.J. 453, 455-56 (1961) (allocation of risk through business contracts can affect the price levels of a free market system).

9. Standard form (adhesion) contracts account for more than 99 percent of all contracts made. Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power,* 84 Harv. L. Rev. 529, 529 (1971). For an informative review of the history behind the adhesion contract, see Issacs, *The Standardizing of Contracts,* 27 Yale L.J. 34 (1917).

10. Note, *supra* note 3, at 1178; *see* Keeton, *supra* note 1, at 966; Note, *supra* note 1, at 604.

11. *See* 7 S. Williston, A Treatise on the Law of Contracts § 900, at 19 (3d ed. 1963); Note, *supra* note 3, at 1179.

12. *Atwater,* 366 N.W.2d at 277; 7 S. Williston, *supra* note 11, § 900, at 19; Note, *supra* note 1, at 604.

13. *See* 7 S. Williston, *supra* note 11, § 900, at 29; Note, *supra* note 1, at 604.

standard practice throughout the insurance industry, the prospective insured has no real bargaining power and is vulnerable to overreaching by the insurance company.[14]

Given the inherent complexity and confusion of many insurance contracts, the insured is deterred from inspecting the policy either before or after it is accepted.[15] Moreover, provisions excluding or limiting coverage are not openly discussed between the insured and the agent.[16] Consequently, the insured remains ignorant of the limiting provisions and relies on nonexistent or deficient coverage.[17]

B. Traditional Contract Theories

When confronted with issues regarding the existence or extent of insurance coverage, courts customarily turn to the language of the pertinent contract provisions in order to establish the intent of the parties.[18] A court interprets the provisions by reference to the language of the entire contract.[19] The provisions will ordinarily be dis-

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The absence of choice of policy or contract terms is a principal reason why insurance contracts are singled out as inherently oppressive. *See* Kessler, *supra* note 8, at 631.

14. *See* Keeton, *supra* note 1, at 963; Comment, *supra* note 8, at 453. The *Atwater* court specifically noted the following:

> Most courts recognize the great disparity in bargaining power between insurance companies and those who seek insurance. Further, they recognize that, in the majority of cases, a lay person lacks the necessary skills to read and understand insurance policies, which are typcially long, set out in very small type and written from a legalistic or insurance expert's perspective.

Atwater, 366 N.W.2d at 277.

15. Policies are drafted in legal terms of art. Note, *supra* note 3, at 1180. In addition, the insurer does not expect the insured to read the terms of the contract. *See* RESTATEMENT (SECOND) OF CONTRACTS § 211 comment b (1981) (hereinafter cited as RESTATEMENT). In an attempt to simplify the language contained in insurance contracts and contracts in general, the Minnesota Legislature has enacted the "Readability of Insurance Policies Act," MINN. STAT. §§ 72C.01-.13 (1984), and the "Plain Language Contract Act," MINN. STAT. §§ 325G.29-.37 (1984). The former aims at providing insurance policies that are readable and understandable to a person of average intelligence, experience, and education. *Id.* § 72C.02. It outlines specific tests and standards for readability, legibility, format, and for the coversheet. *Id.* §§ 72C.05-.09. The Plain Language Contract Act, on the other hand, requires that every *consumer* contract (involving a purchase of goods and services) "be written in a clear and coherent manner using words with common and everyday meanings and shall be appropriately divided and captioned by its various sections." *Id.* § 325G.32.

16. *See* Note, *supra* note 3, at 1181.

17. *See id. See also* Abraham, *supra* note 1, at 1169-75 (outlining the benefits of an informed insured).

18. *See* 3 A. CORBIN, CORBIN ON CONTRACTS § 538, at 55 (1960); 2 G. COUCH, CYCLOPEDIA OF INSURANCE LAW 15:8, at 136-44 (2d ed. 1984). As a general rule, the matter of interpretation and construction is a matter of law, as opposed to a question of fact. 3 A. CORBIN, *supra*, § 554, at 225; 2 G. COUCH, *supra*, § 15:3, at 116.

19. *See* RESTATEMENT, *supra* note 15, § 202(2) (1981); 13 J. APPLEMAN, INSURANCE LAW AND PRACTICE § 7383, at 30-49 (1976); 3 A. CORBIN, *supra* note 20, § 549, at 183-93; 2 G. COUCH, *supra* note 18, § 15:29, at 216.

positive of the coverage issue if they are determined by the court to be clear and unambiguous.[20] If, however, the provisions are found to be ambiguous, either inherently or in context of the entire contract, they are construed in "favor of the insured" or "against the insurer" who is the drafting party.[21] This traditional theory is known as the contract of adhesion doctrine[22] and is still recognized by a significant number of jurisdictions.[23] The doctrine has been severely criticized, however, because courts often fabricate ambiguity in order to avoid rendering an unfair and unjust decision.[24] The fabricated finding of ambiguity makes judicial decisions interpreting insurance

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20. *See* 13 J. APPLEMAN, *supra* note 19, § 7384, at 50-55; 2 G. COUCH, *supra* note 18, § 15:4, at 122-23. *But cf.* 3 A. CORBIN, *supra* note 18, § 535, at 15-16. Professor Corbin seriously questions whether words are ever "plain and clear" and capable of only one true meaning:

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

Id. (citations omitted).

> [S]ome of the surrounding circumstances always must be known before the meaning of the words can be plain and clear; and proof of the circumstances may make a meaning plain and clear when in the absence of such proof some other meaning may also have seemed plain and clear.

Id. § 542, at 100-03 (citations omitted).

21. RESTATEMENT, *supra* note 15, § 206; 13 J. APPLEMAN, *supra* note 19, § 7401; 3 A. CORBIN, *supra* note 19, § 559; 2 G. COUCH, *supra* note 18, § 15:74; 7 S. WILLISTON, *supra* note 11, § 900 at 18.

22. *See Atwater,* 366 N.W.2d at 277; Mills v. Agrichemical Aviation, Inc., 250 N.W.2d 663, 670 (N.D. 1977); Perlet, *The Insurance Contract and the Doctrine of Reasonable Expectation,* 6 F. 116, 117-118 (1970). In North Dakota, the contract of adhesion doctrine has been codified into statutory law. *See* N.D. CENT. CODE § 9-07-19 (1975).

23. Eight states still recognize the contract of adhesion doctrine. *See* Connecticut Gen. Life Ins. Co. v. Aguilar, 579 F. Supp. 1201, 1205 (N.D. Ill. 1983); Kates v. St. Paul Fire and Marine Ins. Co., 509 F. Supp. 477, 490-91 (D. Mass. 1981) (ironically, this decision was written by Judge, formerly Professor, Keeton); Wright v. Newman, 598 F. Supp. 1178, 1205 (W.D. Mo. 1984); American Home Prod. Corp. v. Liberty Mut. Ins. Co., 565 F. Supp. 1485, 1492 (S.D.N.Y. 1983); Urtado v. Shupe, 33 Colo. App. 162, 167, 517 P.2d 1357, 1359-60 (1973) (both courts noted that Colorado had not adopted the reasonable expectations doctrine); Meckert v. Transamerica Ins. Co., 701 P.2d 217, 221 (Idaho 1985); Insurance Co. of N. Am. v. Adkisson, 121 Ill. App. 3d 224, 229, 459 N.E.2d 310, 312-13 (1984); Markline Co. v. Travelers Ins. Co., 384 Mass. 139, 141-42, 424 N.E.2d 464, 465-66 (1981); Thompson v. Occidental Life Ins. Co. of Cal., 90 N.M. 620, 621, 567 P.2d 62, 63 (1977); Larson v. Transamerica Life & Annuity Ins. Co., 41 Or. App. 311, 319, 597 P.2d 1292, 1297 (1979); Ryan v. Harrison, 699 P.2d 230, 233 (Wash. 1985).

24. *See* 7 S. WILLISTON, *supra* note 11, § 900, at 17.

contracts arbitrary and unprincipled.[25]

Even if contract terms are clear and unambiguous, courts commonly refuse to enforce the terms, relying on other traditional contract theories such as public policy,[26] unconscionability,[27] or equitable estoppel.[28] The theories of public policy and unconsciona-

25. *See* 13 J. APPLEMAN, *supra* note 19, § 7402, at 289-91 (stating rule against fictitious ambiguity); 2 G. COUCH, *supra* note 20, § 15:86 (condemning simulated ambiguity).

26. *See, e.g.*, Nygaard v. State Farm Mut. Auto. Ins. Co., 301 Minn. 10, 14-15, 221 N.W.2d 151, 154 (1974)(court awarded coverage even though automobile insurance provisions would have precluded coverage because provisions contravened intent of state statute). *See* RESTATEMENT, *supra* note 15, § 207; 3 A. CORBIN, *supra* note 18, § 550, at 194-96; *see also* In re Peterson's Estate, 230 Minn. 478, 483, 42 N.W.2d 59, 63 (1950); *see generally* Allum v. MedCenter Health Care, Inc., 371 N.W.2d 557, 560 (Minn. Ct. App. 1985)(indemnification agreement that violates public policy is void); Rector v. State Farm Mut. Auto. Ins. Co., 369 N.W.2d 589, 592-93 (Minn. Ct. App. 1985).

27. *See* American Fidelity Fire Ins. Co. v. Williams, 80 Mich. App. 125, 132, 263 N.W.2d 311, 315 (1977) (Kaufman, J., dissenting) (despite majority's failure to find ambiguity, minority argued that the policy provisions were unenforceable for reasons of unconscionability); Foursquare Properties Joint Venture I v. Johnny's Loaf & Stein, Ltd., 116 Wis. 2d 679, 681, 343 N.W.2d 126, 128 (1983) (Wisconsin Supreme Court concluded that any error made by the trial court regarding ambiguity of contract clause is harmless because of unconscionability of the clause); RESTATEMENT, *supra* note 15, § 208; 6A A. CORBIN, *supra* note 18, § 1376, at 21. *See also* U.C.C. § 2-302(l) (1978); *see generally* Dorso Trailer Sales, Inc. v. American Body and Trailer, Inc., 372 N.W.2d 412, 415 (Minn. Ct. App. 1985)(finding of unconscionability requires inequality in bargaining power); Murray, *Unconscionability: Unconscionability*, 31 U. PITT. L. REV. 1-80 (1969)(commenting on U.C.C. § 2-302).

28. *See* 16B J. APPLEMAN, *supra* note 19, § 9088, at 554-61; 2 G. COUCH, *supra* note 18, § 71:1; Note, *supra* note 3, at 1182. Professor Keeton includes the doctrines of estoppel and waiver under the general principle of "detrimental reliance." *See* Keeton, *supra* note 1, at 977-85. Professor Keeton, however, makes a concerted effort to distinguish the two doctrines. According to Professor Keeton, a waiver involves a voluntary relinquishment of a known right by the insurer; whereas estoppel entails an insured's detrimental reliance on some representation for which the insurer is accountable. *Id.* at 964. In Minnesota, the doctrine of equitable estoppel cannot be invoked to enlarge policy coverage. *See* Shannon v. Great American Ins. Co., 276 N.W.2d 77, 78 (Minn. 1979) (equitable estoppel will not expand coverage of policy even if insurer offers to settle for more than policy limits); Twin City Hide v. Transamerica Ins. Co., 358 N.W.2d 90, 93 (Minn. Ct. App. 1984) (estoppel not used to expand policy coverage even though insurance agent had represented to insured that insured was covered); Minnesota Mut. Fire and Cas. Co. v. Rudzinski, 347 N.W.2d 848, 851 (Minn. Ct. App. 1984) (automobile insurer not estopped from reimbursement of payments made by mistake). The doctrine of equitable estoppel, however, can be invoked to prevent forfeiture. *See* Seavey v. Erickson, 244 Minn. 232, 242, 69 N.W.2d 889, 896 (1955)(insurer estopped from asserting the forfeiture provisions of the policy were insurer failed to notify insured of forfeiture of rights due to nonpayment of premiums). *See generally* Northern Petrochemical Co. v. U.S. Fire Ins. Co., 277 N.W.2d 408, 410 (Minn. 1979) (evidence sufficient to support application of equitable estoppel); Transamerica Ins. Group v. Paul, 267 N.W.2d 180, 183 (Minn. 1978) (outlining the five prerequisites of estoppel); Bethesda Lutheran Church v.

bility, however, have the same shortcoming as the contract of adhesion doctrine. Neither theory has specific standards or rules governing its application.[29] Thus, courts can arbitrarily apply these

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Twin City Const. Co., 356 N.W.2d 344, 349 (Minn. Ct. App. 1984) (whether elements of equitable estoppel are present is a question of fact).

29. *See In re* Peterson's Estate, 230 Minn. 478, 483, 42 N.W.2d 59, 63 (1950) (regarding public policy); Murray, *supra* note 27, at 1-3 (concerning unconscionability).

In the case of *Peterson's Estate,* the Minnesota Supreme Court outlined a general description of the types of cases that contravene public policy:

> Generally speaking, a contract is not void as against public policy unless it is injurious to the interests of the public or contravenes some established interest of society. On the other hand, contracts are contrary to public policy if they clearly tend to injure public health or morals, the fundamental rights of the individual, or if they undermine confidence in the impartiality of the administration of justice.

Peterson's Estate, 230 Minn. at 483, 42 N.W.2d at 63. The *Restatement,* proposes a "balancing" approach in determining when a contract, in violation of "public policy," is unenforceable.

> § 178. When a Term is Unenforceable on Grounds of Public Policy
> (1) A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms.
> (2) In weighing the interest in the enforcement of a term, account is taken of
> (a) the parties' justified expectations,
> (b) any forfeiture that would result if enforcement were denied, and
> (c) any special public interest in the enforcement of the particular term.
> (3) In weighing a public policy against enforcement of a term, account is taken of
> (a) the strength of that policy as manifested by legislation or judicial decisions,
> (b) the likelihood that a refusal to enforce the term will further that policy,
> (c) the seriousness of any misconduct involved and the extent to which it was deliberate, and
> (d) the directness of the connection between that misconduct and the term.

RESTATEMENT, *supra* note 15, § 178. *See also id.* comment b. The rules or standards for applying the doctrine of unconscionability are equally indefinite. The basic test is "whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one sided as to be unconscionable under the circumstances existing at the time of the making of the contract." U.C.C. § 2-302, comment one (1978).

In Minnesota, the courts examine the procedural and substantive aspects of the contract and determine: (1) whether the party asserting unconscionability had no "meaningful choice" but to enter the agreement; and (2) whether the contract or specific term is "unreasonably favorable to the other party." *See Dorso Trailer Sales,* 372 N.W.2d at 415 (citing RJM Sales & Marketing, Inc. v. Banfi Prod. Corp., 546 F. Supp. 1368, 1375 (D.Minn. 1982)); *see also* Note, *supra* note 3, at 1181. The *Restatement* suggests that courts use two factors—inadequacy of consideration and absence of bargaining power—in determining whether a contract or specific term is unconscionable. *See* RESTATEMENT, *supra* note 15, § 208, comments c, d, & e.

theories, thereby producing unprincipled and inconsistent decisions.[30] Equitable estoppel, on the other hand, has a specific standard for application.[31] The scope of equitable estoppel, however, is limited to an examination of the parties' *conduct* as opposed to the *contract language* itself.[32] Given the shortcomings of these previous theories of contract interpretation, judges and attorneys needed an objective, principled contract theory to apply when construing the language of a disputed insurance policy provision.[33]

The Minnesota Supreme Court previously recognized the contract of adhesion doctrine.[34] In *Atwater*, the court acknowledged the dire need for a responsive theory of insurance contract interpretation[35] and joined the progressive trend toward the recognition of the reasonable expectations doctrine[36]

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30. *Cf.* Murray, *supra* note 27, at 4-5 (commenting on the gross absence of principled judicial decisions and the resulting inconsistency with respect to unconscionability cases); Trakman, *The Effect of Illegality in the Law of Contract: Suggestions for Reform*, 55 CAN. B. REV. 625, 625-30 (1977) (commenting on the significant judicial confusion surrounding the contract theories of illegality and public policy).

31. The doctrine of equitable estoppel may be invoked if the following five requirements are satisfied:

(1) There must be a misrepresentation of *material* fact;
(2) The party to be estopped must be shown to have known that the representation was false;
(3) The party to be estopped must have intended that the representation be acted upon;
(4) The party asserting estoppel must not have had knowledge of the true facts; and
(5) The party asserting estoppel must have relied on the misrepresentation to his detriment.

Transamerica, 267 N.W.2d at 183.

32. *See* Abraham, *supra* note 1, at 1178-80; Keeton, *supra* note 1, at 973; Note, *supra* note 3, at 1182. The doctrine of equitable estoppel is often entangled with issues of agency law. Specifically, the issue may center on whether the agent had the requisite authority to act as he did. *See* Keeton, *supra* note 1, at 979-81. *See generally*, RESTATEMENT (SECOND) OF AGENCY §§ 7, 8, 26, 27, 33 & 34 (1958) (concerning authority, apparent authority, and interpreted or "implied" authority).

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

34. *See, e.g.*, Simon v. Milwaukee Auto. Mut. Ins. Co., 262 Minn. 378, 385, 115 N.W.2d 40, 45 (1962) (court will not redraft insurance contracts absent ambiguous language); *Transamerica*, 358 N.W.2d at 93 (interpretation of insurance contract not allowed if the contractual language is not ambiguous); *see also supra* notes 10-18 and accompanying text.

35. *Atwater*, 366 N.W.2d at 275-79.

36. A number of state and federal courts have adopted the reasonable expectations doctrine. *See, e.g.*, Berne v. Aetna Ins. Co., 604 F. Supp. 958, 960 (D.C.V.I. 1985) (requiring ambiguity); Owens-Illinois, Inc. v. Aetna Cas. and Sur. Co., 597 F. Supp. 1515, 1523-24 (D.D.C. 1984); Progressive Cas. Ins. Co. v. Marnel, 587 F. Supp. 622, 624 (D. Conn. 1983) (requiring ambiguity before applying reasonable expectations doctrine); Fritz v. Old Am. Ins. Co., 354 F. Supp. 514, 516-17 (S.D. Tex. 1973) (requiring ambiguity); Guin v. Ha, 591 P.2d 1281, 1284-85 (Alaska 1979)(ambiguity not required); Lambert v. Liberty Mut. Ins. Co., 331 So.2d 260, 263-64 (Ala.

C. *Reasonable Expectations Doctrine*

The doctrine's immediate function is to accomplish what its name implies, effectuating the insured's reasonable expectations with respect to his insurance contract.[37] When a court construes a disputed policy provision, it will look to the reasonable expectations of the insured.[38] More importantly, the doctrine represents an objective and principled means of construing insurance contract language.[39] The doctrine allows the court to interpret contract language without fabricating ambiguity and without resorting to arbitrary application of public policy or unconscionability doctrines in order to avoid un-

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1976); Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 389, 682 P.2d 388, 394-95 (1984)(other factors considered as well as ambiguity); Smith v. Westland Life Ins. Co., 15 Cal. 3d 111, 121-26, 539 P.2d 433, 441-43, 123 Cal. Rptr. 649, 657-58 (1975) (requiring ambiguity before applying the reasonable expectations doctrine); State Farm Mut. Auto Ins. Co. v. Ball, 127 Cal. App. 3d 568, 572, 179 Cal. Rptr. 644, 646-47 (1981); Hallowell v. State Farm Mut. Auto Ins. Co., 443 A.2d 925, 926-27 (Del. 1982) (requiring ambiguity); Hawaiian Ins. and Guar. Co. v. Brooks, 686 P.2d 23, 27 (Hawaii 1984); American Economy Ins. Co. v. Liggett, 426 N.E.2d 136, 141, 144 (Ind. 1981) (requiring that exclusion be explicit); Chipokas v. Travelers Indem. Co., 267 N.W.2d 393, 396 (Iowa 1978) (requiring the ordinary layman to be "misguided" after reading the policy); C & J Fertilizer, Inc. v. Allied Mut. Ins. Co., 227 N.W.2d 169, 176-77 (Iowa 1975); Estrin Const. Co. v. Aetna Cas. and Sur. Co., 612 S.W.2d 413, 420-25 (Mo. Ct. App. 1981) (ambiguity not required); Transamerica Ins. Co. v. Royle, 656 P.2d 820, 824 (Mont. 1983) (implying that ambiguity is not required); Grimes v. Concord Gen. Mut. Ins. Co., 120 N.H. 718, 722-23, 422 A.2d 1312, 1315 (1980) (interpretation of policy terms is only a factor to be considered in formulating reasonable expectations); Magulas v. Travelers Ins. Co., 114 N.H. 704, 706-07, 327 A.2d 608, 609-10 (1974); DiOrio v. New Jersey Mfrs. Ins. Co., 79 N.J. 257, 269, 398 A.2d 1274, 1280 (1979) (requiring ambiguity); Historic Smithville Dev. Co. v. Chelsea Title & Guar. Co., 184 N.J. Super. 282, 288, 445 A.2d 1174, 1177-78 (N.J. Super. Ct. Ch. Div. 1981) *aff'd.* 190 N.J. Super. 567, 464 A.2d 1177 (N.J. Super. Ct. App. Div. 1983); Great Am. Ins. Co. v. C.G. Tate Const. Co., 303 N.C. 387, 395, 279 S.E.2d 769, 773-74 (1981); Bierer v. Nationwide Ins. Co., 314 Pa. Super. 397, 461 A.2d 216, 220-21, (Pa. Super. Ct. 1983)(ambiguity not required); Collister v. Nationwide Life Ins. Co., 479 Pa. 579, 588-89, 388 A.2d 1346, 1353 (1978), *cert. denied,* Nationwide Life Ins. Co. v. Collister, 439 U.S. 1089 (1979); Brown v. Maxey, 124 Wis. 2d 426, 442, 369 N.W.2d 677, 686 (1985) (requiring ambiguity); Gross v. Lloyds of London Ins. Co., 121 Wis. 2d 78, 87, 358 N.W.2d 266, 271 (1984) (requiring ambiguity). Kentucky and Michigan may adopt the reasonable expectations doctrine in the future. *See* Ohio Cas. Ins. Co. v. Stanfield, 581 S.W.2d 555, 558-59 (Ky. 1979)(citing numerous cases in which the doctrine was either adopted or applied); Bradley v. Mid-Century Ins. Co., 409 Mich. 1, 60-61, n.69, 294 N.W.2d 141, 162-63, n.69, (1980) (citing Professor Keeton's article advocating the doctrine).

37. *See Atwater,* 366 N.W.2d at 277 (citing Keeton, *supra* note 1, at 967); Note, *supra* note 1, at 608-09; Note, *supra* note 3, at 1186.

38. *See Atwater,* 366 N.W.2d at 278. Despite the element of "reasonableness", the doctrine provides a much needed standard. Keeton, *supra* note 1, at 966-74.

39. *Cf. Atwater,* 366 N.W.2d at 278 (stating that the reasonable expectations doctrine eliminates the inclination to stretch and arbitrarily apply existing contract theories).

just decisions.[40]

There are two forms of the reasonable expectations doctrine. The traditional or interpretive form resembles the contract of adhesion doctrine by requiring ambiguity as a condition precedent to application.[41] Conversely, the extended or "Keeton" form is applied regardless of ambiguity.[42]

The reasonable expectations doctrine is a relatively recent contract theory.[43] Judge Learned Hand is credited with creating the concept of reasonable expectations in 1947.[44] It was not until the 1960's, however, that the concept of reasonable expectations developed into an efficacious judicial doctrine.[45] The California[46] and New Jersey Supreme Courts[47] have been instrumental in the development of the doctrine. Both of these courts initially adhered to the

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40. *See id.* at 277; Note, *supra* note 3, at 1183-85; Note, *supra* note 1, at 608-11.

41. *Atwater*, 366 N.W.2d at 277; *see* Keeton, *supra* note 1, at 967; Note, *supra* note 3, at 1186-87; Note, *supra* note 1, at 611-19. In his treatise, Professor Corbin makes a concerted effort to distinguish "interpretation" from "construction." 3 A. CORBIN, *supra* note 18, § 534, at 492-95.

> By 'interpretation of language' we determine what ideas that language induces in other persons. By 'construction of the contract,' as that term will be used here, we determine its legal operation — its effect upon the action of courts and administrative officials. If we make this distincton, then the construction of a contract starts with the interpretation of its language but does not end with it; while the process of interpretation stops wholly short of a determination of the legal relations of the parties. When a court gives a construction to the contract as that is affected by events subsequent to its making and not foreseen by the parties, it is departing very far from mere interpretation of their symbols of expression, although even then it may claim somewhat erroneously to be giving effect to the 'intention' of the parties.

Id. at 492-93. Thus, the "interpretive" form of the reasonable expectations doctrine obligates the court to first ascertain the meaning of the words and determine whether ambiguity exists. The court may only indulge in contract construction if ambiguity exists. Conversely, the extended form of the reasonable expectations doctrine allows the court to exercise contract construction from the outset. *Id.*

42. Keeton, *supra* note 1, at 968.

43. *Atwater*, 366 N.W.2d at 277; *see also infra* note 46 and accompanying text.

44. Judge Learned Hand is credited with the creation of the expectations principle:

> An underwriter might so understand the phrase, when read in its context, but the application was not to be submitted to underwriters; it was to go to persons utterly unacquainted with the niceties of life insurance, who would read it colloquially. It is the understanding of such persons that counts.

Gaunt v. John Hancock Mut. Life Ins. Co., 160 F.2d 599, 601 (2d Cir.), *cert. denied*, 331 U.S. 849 (1947). *See* Keeton, *supra* note 1, at 969; Note, *supra* note 3, at 1184.

45. *See* Abraham, *supra* note 1, at 1158, 1164; Note, *supra* note 3, at 1185; Note, *The Doctrine of Reasonable Expectations in Massachusetts and New Hampshire: A Comparative Analysis*, 17 NEW ENG. L. REV. 891, 893-900 (1982).

46. *See* Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966).

47. *See* Kievit v. Loyal Protective Life Ins. Co., 34 N.J. 475, 170 A.2d 22 (1961).

extended form of the doctrine.[48] Ironically, they have since joined the majority of jurisdictions recognizing the traditional form.[49] The following section reviews the *Atwater* decision and examines the Minnesota Supreme Court's adoption of the extended form of the reasonable expectations doctrine.

II. THE *ATWATER* DECISION

A. Facts

The Atwater Creamery Company, in addition to being a creamery, is a supplier of farm chemicals in Atwater, Minnesota.[50] Included in the Atwater complex is a warehouse used for the storage of fertilizer and farm chemicals.[51] The warehouse was burglarized without evidence of forceable entry between Saturday, April 9, 1977 and the following Monday.[52] Chemicals valued at $15,000 were stolen using a company truck that had been parked inside the warehouse building.[53] The ensuing investigation determined that none of the company's past or present employees were involved with the burglary.[54]

At the time of the burglary, the company was insured by the Western National Mutual Insurance Company under a "Mercantile-Open-Stock" burglary policy.[55] The policy, however, contained a definition of burglary which essentially required visible signs of forceable entry as a condition precedent to coverage.[56] The insurance agent

48. *See* Perlet, *The Insurance Contract and the Doctrine of Reasonable Expectations*, 6 F. 116, 118-22 (1971).

49. For the states which have adopted the reasonable expectations doctrine, see *supra* note 36.

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

51. *Id.* at 274. *See also* Brief for Appellant at 6 & Appendix at 23-24, Atwater Creamery Co. v. Western Nat'l. Mut. Ins. Co., 366 N.W.2d 271 (Minn. 1985).

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

53. *Id.*

54. *Id.* An investigation was also performed by the Kandiyohi County Sheriff's Department. *Id.*

55. *Id.*

56. *Id.* Also at issue in this case was whether the policy's definition of burglary must conform to the statutory definition outlined in MINN. STAT. § 609.58, subd. 2 (1982). The statute defined burglary as:

> Whoever enters a building without the consent of the person in lawful possession . . . with intent to commit a crime in it, or whoever remains within a building without the consent of the person in lawful authority, with intent to commit a crime in it, commits burglary.

Atwater, 366 N.W.2d at 275 (citing MINN. STAT. § 609.58, subd. 2). The insurance policy, on the other hand, defined burglary as:

> [T]he 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 felonious exit therefrom by actual force and violence as evi-

who issued the policy testified that he had mentioned this particular provision to either the Board of Directors or the plant manager.[57] No one at the company, however, read the insurance policy. Even though the plant manager attempted to read the policy, he failed to read it completely because he could not understand the language contained in the text.[58] The company filed a claim with its insurer, but was denied coverage because the condition precedent had not been satisfied; specifically, there were no visible signs of forceable entry.[59]

B. Holding and Analysis

The Minnesota Supreme Court ruled that the definition of burglary contained in the insurance contract was not ambiguous.[60] Nonetheless, the court concluded that the insurer should cover the loss because Atwater reasonably expected that its burglary insurance would cover a burglary.[61] The court consequently reversed the trial

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denced 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.

Atwater, 366 N.W.2d at 275.

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

58. *Id.*

59. *Id.*

60. *Id.* at 276.

61. *Id.* at 278-79. Of incidental interest is the effect of the reasonable expectations doctrine on the parol evidence rule. The parol evidence rule is a rule of substantive law that preserves the integrity of a written contract by precluding evidence of contradictory or varying terms. *See* 3 A. CORBIN, CORBIN ON CONTRACTS § 573 (1960); J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 2-9 (2d ed. 1980); 9 J. WIGMORE, WIGMORE ON EVIDENCE §§ 2400, 2425 (Chadbourn rev. 1981). Thus, it encourages parties to put their agreements in writing. *See* Hield v. Thyberg, 347 N.W.2d 503, 507 (Minn. 1984). Most extrinsic evidence of agreements contemporaneous to the written contract is excluded or inadmissible. *See* Material Movers, Inc. v. Hill, 316 N.W.2d 13, 17 (Minn. 1982). *See generally* MINN. STAT. §§ 366.2-.202 (1984).

The rule does not apply if the writing is inherently ambiguous, incomplete, or silent on a term reasonably expected to be included in the writing. *See Hield*, 347 N.W.2d at 507. Moreover, evidence regarding a subsequent modification or condition precedent of the written agreement is exempt from the parol evidence rule. *See* Nord v. Herreid, 305 N.W.2d 337, 339-40 (Minn. 1981).

A potential conflict exists between the parol evidence rule and the extended form of the reasonable expectations doctrine, which is applied regardless of unambiguous language. If, for instance, the claimant alleged terms that varied from those contained in an unambiguous, complete, and integrated standardized contract, there would be a direct conflict between the parol evidence rule (preserving the integrity of the terms) and the extended form of the reasonable expectations doctrine (construing the terms in accordance with the objective expectations of the insured). Section 211(l) of the *Restatement* attempts to unify these difficult concepts. RESTATEMENT, *supra* note 15, § 211(l). *See* Murray, *The Parol Evidence Process and Standardized Agreements under the Restatement (Second) of Contracts*, 123 U. PA. L. REV. 1342, 1374 (1975)

court's decision,[62] which had upheld the policy provision in a directed verdict.[63] Thus, the supreme court joined the minority of jurisdictions recognizing the extended form of the reasonable expectations doctrine.[64] The majority opinion had the support of five of the nine justices.[65] Four justices concurred specially, disapproving of the extended form of the doctrine. This minority advocated the traditional form of the doctrine, but nevertheless, agreed with the result.[66] Consequently, the holding in *Atwater* is somewhat tenuous with respect to the extended form of the reasonable expectations doctrine.

The supreme court also examined and then dismissed the various doctrines and theories utilized by other courts in the interpretation and construction of similar burglary definitions.[67] It implicitly rejected the traditional contract of adhesion doctrine, whereby if the definition is found ambiguous, it is construed in favor of the insured, permitting coverage.[68] Moreover, the contract of adhesion doctrine provides that if the definition is clear and concise, it must be honored by a court.[69] The supreme court was unwilling to fabricate ambiguity because the language was clear and unambiguous.[70] Yet the court also refused to enforce the condition precedent contained in the burglary definition and awarded coverage.[71]

(commenting on § 237 which is currently embodied in § 211). According to § 211(l), if the party assenting to a standardized contract signs the 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. RESTATEMENT, *supra* note 15, § 211(l). Presumably the assenting party must demonstrate that he or she reasonably believed the form agreement to be the kind typically used in similar transactions. *See* Murray, *supra*, at 1375. Hence, the reasonable belief of the assenting party dictates the application of the parol evidence rule. As to consumers, it might be difficult to demonstrate that the requisite reasonable belief existed. If, however, this reasonable belief is established, the parol evidence rule would preclude alleged terms, based on reasonable expectations, that deviate from written policy provisions. RESTATEMENT, *supra* note 15, § 211(l) (1979); Murray, *supra* note 61, at 1374-75.

62. *Atwater*, 366 N.W.2d at 279.

63. The policy provision in question required signs of forceable entry as a prerequisite to coverage. *Id.* at 274.

64. *See supra* note 36. Approximately one-third of all the jurisdictions listed in note 36 recognize the extended form of the reasonable expectations doctrine. *See supra* note 36.

65. This case was heard and decided *en banc*. *Atwater*, 366 N.W.2d at 273. The majority consisted of five justices (Amdahl, Wahl, Yetka, Todd, and Scott). Four justices (Simonett, Peterson, Kelley, and Coyne) concurred specially. *Id.* at 279-80.

66. *Atwater*, 366 N.W.2d at 279-80.

67. *Id.* at 275-76.

68. *Id.; see also id.* at 278 (the supreme court inferred that in the past courts had to "bend" traditional contract principles to achieve equity and justice).

69. *See supra* note 20.

70. *Atwater*, 366 N.W.2d at 276.

71. *Id.* at 278-79.

Moreover, the supreme court declined to apply the "purpose" doctrine.[72] According to this doctrine, if the underlying purpose of the provision is satisfied, the condition precedent would be disregarded and coverage would be awarded.[73] Thus, in *Atwater*, if the court were assured that the burglary was not an "inside job", the provision requiring signs of forced entry would be ignored and the company would be covered. The court, however, felt uncomfortable with this approach because it believed that insurance companies have the right to literally limit the "risk against which it will indemnify insureds."[74]

Finally, the court refused to adopt the "evidential" theory, whereby courts have determined that despite the restrictive language, the burglary definitions merely suggest one form of evidence which may be used to demonstrate a burglary.[75] Again, the court acknowledged the insurer's right to literally limit its liability and voiced its disapproval of any doctrine, including the evidential theory that circumscribes this right.[76] Through the process of elimination, the court arrived at the reasonable expectations doctrine.

The incorporation of the reasonable expectations doctrine represents the true significance of the supreme court's decision. As previously stated, the doctrine's immediate function is to effectuate the insured's reasonable expectations with respect to his insurance contract.[77] Therefore, when a court must construe a disputed provision in an insurance policy or contract, it will look to the reasonable expectations of the insured.[78]

The supreme court enumerated three justifications for adopting

72. *Id.* at 276.

73. *Id.* The purposes of the condition precedent, requirement of visible signs of forced entry are to protect insurance companies from fraud by way of "inside jobs" and to encourage insureds to reasonably secure the premises. *Id.* Arguably, because the investigators determined that the burglary was not an "inside job," and because the trial court found the premises to be secure, neither purpose is advanced by requiring the condition precedent to be satisfied. *Id. See* Kretschmer's House of Appliances, Inc. v. United States Fidelity & Guar. Co., 410 S.W.2d 617, 618-19 (Ky. 1966).

74. *See Atwater*, 366 N.W.2d at 276.

75. *Id.* In Ferguson v. Phoenix Assurance Co. of New York, 189 Kan. 459, 370 P.2d 379 (1962), the Kansas Supreme Court ruled that where a requirement of evidence is included in an insurance contract and the purpose of the requirement is not advanced by enforcing it, judicial enforcement of such a requirement violates public policy, unless the rule is found under the provision labeled EXCLUSIONS. *Id.* at 470-71, 370 P.2d at 387. The court further stated that such a rule is not comprehensive with respect to the particular types of evidence needed to establish a burglary. *Id.* Hence, the evidential theory entails the examination of the provision's underlying purpose. *See id.*

76. *Atwater*, 366 N.W.2d at 275-76.

77. *See id.* at 277; Keeton, *supra* note 1, at 967-68.

78. *See Atwater*, 366 N.W.2d at 278; Note, *supra* note 3, at 1184.

the doctrine. First, the doctrine affords protection to the insured who lacks the bargaining power and the technical knowledge to understand insurance policies.[79] Second, the doctrine gives courts guidelines by which to construe insurance contracts.[80] As a result, the courts will not have to depend on antiquated principles or strain the application of these principles to achieve justice.[81] Third, the doctrine will encourage insurers and their agents to communicate coverage and exclusions in a clear and concise manner.[82]

When determining what constitutes "reasonable expectations," the supreme court prescribed a case-by-case analysis[83] and recommended the following relevant criteria: (1) whether the language of the insurance contract is ambiguous; (2) whether the insurer or its agent disclosed any obscure conditions or exclusions; and (3) whether a particular provision involves a matter of general public knowledge.[84] The court did not specifically state that the list of factors was to be comprehensive, but rather, implied a totality-of-the-circumstances analysis for determining reasonableness.[85]

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79. *See Atwater*, 366 N.W.2d at 277; Keeton, *supra* note 1, at 966-68. *See also* Note, *supra* note 1, at 608 (regarding the doctrine as a neutralizing force to the disparity in bargaining position). There is widespread debate on whether there exists a disparity in bargaining power between commercial parties. *See generally* Ostrager & Ichel, *Should the Business Insurance Policy Be Constructed Against the Insurer? Another Look At the Reasonable Expectations Doctrine*, 33 FED'N. INS. COUNS. Q. 273 (1983). One author states that bargaining power stems from knowledge, acumen, and market status. *See* Comment, *supra* note 8, at 455. The insurance contract in *Atwater* is between an insurance company and a commercial business. *See Atwater*, 366 N.W.2d at 274. Arguably, the reasonable expectations doctrine should not apply when the insured is a commercial business, as in this case. Many small businesses, however, lack bargaining power when dealing with larger, powerful commercial businesses, and merit protection from overreaching. *See* Comment, *supra* note 8, at 455.

80. *See Atwater*, 366 N.W.2d at 278; Keeton, *supra* note 1, at 966-74 (discussing the emergence of reasonable expectations as a legal principle).

81. *See Atwater*, 366 N.W.2d at 278.

82. *See id.* The *Atwater* case involved a "hidden exclusion." This is defined as exclusionary language couched in contract provisions which are not conspicuously labeled as exclusionary provisions, but rather as definition sections. *See Atwater*, 366 N.W.2d at 277-78 (citing C&J Fertilizer, Inc. v. Allied Mutual Insurance Co., 227 N.W.2d 169 (Iowa 1975)). Conceivably, the problem of the hidden exclusion should be alleviated, if not eliminated, by the Readability of Insurance Act, MINN. STAT. §§ 72C.05-.08 (1984).

83. *Atwater*, 366 N.W.2d at 278 (court directs the fact-finder to consider the surrounding circumstances of a particular case when determining reasonable expectations).

84. *Id.* at 278. Professor Keeton states that an insurer can effectively avoid liability for coverage despite the reasonable expectations doctrine, if the insurer makes an explicit, conspicuous qualification or limitation effective by calling it to the attention of the potential policyholder at the time of contracting. Keeton, *supra* note 1, at 968.

85. *See supra* note 83; Note, *supra* note 1, at 610 (stating that reasonable expectations depend upon the present circumstances). *See also* 3 A. CORBIN, *supra* note 18, § 536, at 28 (recognizing the importance of considering the "surrounding circum-

Of paramount importance is the supreme court's refusal to adopt the common version of the reasonable expectations doctrine.[86] In adopting the extended or "Keeton" version,[87] the court recognized several practical constraints imposed on consumers purchasing insurance that justified the more liberal approach.[88] First, purchasers have no bargaining power and cannot negotiate the terms. Second, most purchasers do not see the policy until after the first premium is paid. Third, even if they attempt to read it, they often cannot fully understand it.[89] As noted above, however, ambiguity or the lack of it remains a relevant factor in determining reasonable expectations.[90]

Even in attempting to protect the purchaser, the supreme court emphasized that the extended version of the doctrine does not excuse the insured from reading the contract.[91] The insured will be held to a "reasonable knowledge" of the literal terms and conditions of the contract, which will dictate the reasonableness of expectations.[92] The court offered a final caveat: "Properly used, the doctrine will result in coverage in some cases and *in no coverage in*

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stances"). Whether the extended form of the reasonable expectations doctrine is a question of fact or law is of immense significance. The interpretation and construction of contracts is traditionally a question of law. *See* 2 G. COUCH, *supra* note 18, § 15:3, at 116; 3 A. CORBIN, *supra* note 18, § 554, at 225. The Minnesota Supreme Court, however, stated that the "fact-finder should determine whether [the] expectations were reasonable under the circumstances," inferring that perhaps the doctrine is a question of fact. *See Atwater*, 366 N.W.2d at 278. Moreover, section 212 of the *Restatement* states that there are certain instances where interpretation is a question of fact. Section 212 offers a compromise for the above dilemma by stating that issues of interpretation, involving extrinsic evidence (i.e. surrounding circumstances), are only left to the judge "where the evidence is so clear that no reasonable person would determine the issue in any way but one." RESTATEMENT, *supra* note 15, § 212 comment e. *See also C & J Fertilizer*, 227 N.W.2d at 172-73 (Iowa 1975)(determination by court unless dependent on extrinsic evidence or "choice among reasonable inferences").

86. *Atwater*, 366 N.W.2d at 278-79 (despite finding the contract language unambiguous, the court effectuated the insured's reasonable expectations).

87. *Id.* at 277 (citing "Keeton's view" of ambiguity); *see* Keeton, *supra* note 1, at 966-77; Note, *supra* note 1, at 611.

88. *See Atwater*, 366 N.W.2d at 277; Note, *supra* note 1, at 612 (commenting on how the protection of the insured's reasonable expectations becomes essential when the realities of the insurance sales transaction are examined). Hence, the extended form of the reasonable expectations doctrine is responsive to the practical aspects of an insurance policy transaction.

89. *See Atwater*, 366 N.W.2d at 277; Abraham, *supra* note 1, at 1181; Keeton, *supra* note 1, at 966-68. *See also* 7 S. WILLISTON, *supra* note 11, § 900, at 29-30 (describing the typical insurance sales transaction).

90. *See Atwater*, 366 N.W.2d at 278.

91. *Id.*

92. *Id. See* Note, *supra* note 1, at 621. *But see* Keeton, *supra* note 1, at 974-77 (Professor Keeton indicates that the insured's reasonable expectations should be honored notwithstanding the insured's knowledge of the limiting provisions).

others."[93]

III. Discussion

A. Ambiguity

Those dissatisfied with the extended form of the reasonable expectations doctrine, and the *Atwater* decision, cite the absence of the customary ambiguity prerequisite as the chief shortcoming.[94] Opponents contend that such an absence encourages insureds to forego reading their policies[95] and exaggerates expectations, which invites inflated coverage.[96] The following discussion responds to these criticisms.

1. The Role of Ambiguity

The Minnesota Supreme Court does not eliminate ambiguity as a pivotal consideration.[97] The difference between the court's analysis and critics' position is the function of ambiguity. Critics propose that ambiguity should serve as a *threshold* to the application of the doctrine.[98] Accordingly, unless the language of the contract provision is found to be ambiguous, the insured is subject to the terms and precluded from establishing his reasonable expectations.[99] Conversely, the supreme court prescribes ambiguity as a *factor* to be considered in determining the insured's reasonable expectations.[100]

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93. *Atwater,* 366 N.W.2d at 278 (emphasis added).

94. *See* Kelso, *Idaho and the Doctrine of Reasonable Expectations: A Springboard for an Analysis of a New Approach to a Valuable but Often Misunderstood Doctrine,* 47 Ins. Couns. J. 325, 333 (1980); Note, *supra* note 3, at 1189-92; Note, *supra* note 1, at 617; *see also* Squires, *A Skeptical Look at the Doctrine of Reasonable Expectation,* 6 F. 252, 256 (1971).

95. *Cf.* Kelso, *supra* note 93, at 326-27; Note, *supra* note 1, at 619, 621 (stating that the traditional form of the reasonable expectations doctrine would not eliminate nor reward the failure of the insured to read the policy).

96. Kelso, *supra* note 94, at 333 (implying that the Keeton form of the reasonable expectations doctrine results in "forced charity"). *Cf.* Note, *supra* note 3, at 1191 (retreat from extended version due to excesses possible under this approach); Note, *supra* note 1, at 617-19.

97. *See Atwater,* 366 N.W.2d at 278.

98. *See* Kelso, *supra* note 94, at 331; Squires, *supra* note 94, at 256; Note, *supra* note 1, at 620-21.

99. *See* Kelso, *supra* note 94, at 331; Squires, *supra* note 94, at 256; Note, *supra* note 1, at 620-21.

100. *Atwater,* 366 N.W.2d at 278. Recognizing the insured's reasonable expectations serves two fundamental purposes. *See* Abraham, *supra* note 1, at 1169-75. First, because the reasonable expectations doctrine encourages insurers to clearly and conspicuously communicate policy information, economic efficiency is promoted. *Id.* at 1170. This is theoretically true since an informed person can make quicker, more accurate decisions in the marketplace and can consequently better allocate his resources while pursuing self-interests. *Id.* Second, clear, conspicuous disclosure results in genuine assent or informed choice which is an end in itself. *Id.* at 1174. Genuine assent is consistent with such legal doctrines as informed consent, duty to

In view of the typically biased insurance policy transaction,[101] it is both fair and appropriate for the supreme court to consider ambiguity as a factor rather than a prerequisite. By considering it as a factor, the trial court gives the insured the opportunity to establish that his alleged expectations were reasonable.

2. *The Difficulty in Discerning Ambiguity*

The analysis used by courts to identify ambiguity in a contract is often abstract and vague.[102] Part of the difficulty may be the absence of a uniform, pragmatic definition of ambiguity.[103] The intrinsic difficulty and inconsistency of identifying ambiguity is evidenced by the supreme court's decision in *Atwater.* The court was almost equally divided as to the existence of ambiguity.[104] The difficulty in identifying ambiguity underscores the unfairness of using ambiguity as a threshold.[105] Furthermore, requiring ambiguity as a prerequisite would lead to dubious rulings.[106] The court will need to find ambiguity in order to avoid enforcement of adhesion contracts,[107] and thus may be inclined to fabricate ambiguity in order to avoid rendering an unjust decision.[108] The supreme court specifically adopted

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warn about potential dangers of consumer products, and waiver of rights. *Id.* Professor Abraham states that the expectations doctrine should promote economic efficiency and informed consent. He proposes, however, that the doctrine may, in practice, be limited in serving these ends. *Id.* at 1171-75.

101. The insured has little bargaining power during the insurance sales transaction. *See supra* notes 12-16 and accompanying text.

102. *See, e.g.,* Bond Bros., Inc. v. Robinson, 471 N.E.2d 1332, 1335 (1984).

103. *See* Note, *supra* note 1, at 606-08.

104. Four of the nine justices concurring specially, believed the burglary definitions to be ambiguous. *Atwater,* 366 N.W.2d at 279-80. *See supra* notes 65, 66 and accompanying text.

105. This unfairness can be alleviated with ambiguity serving as a factor instead of a threshold prerequisite. Hence, the questionable determination would only inhibit, as opposed to preclude, the establishment of reasonable expectations.

106. 7 S. WILLISTON, *supra* note 11, § 900, at 17. Professor Williston states that "[i]n order to prevent forfeiture of the policy or other types of overreaching by the insurer, courts purport to find ambiguities whose existence is dubious, to say the least." *Id.*

107. *See* Keeton, *supra* note 1, at 970-72; Note, *supra* note 1, at 604-06. Professor Keeton, in explaining the dubious results, states:

> 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. To extend the principle of resolving ambiguities against the draftsman in this fictional way not only causes confusion and uncertainty about the effective scope of judicial regulation of contract terms but also creates an impression of unprincipled judicial prejudice against insurers. If results in such cases are supportable at all, generally it is because the principle of honoring policyholders' reasonable expectations applies.

Keeton, *supra* note 1, at 972.

108. *See supra* note 25 and accompanying text.

the reasonable expectations doctrine to eliminate the arbitrary results that arise when traditional contract principles are manipulated to achieve fairness.[109]

3. *The Responsibility for Reading the Policy*

Both Professor Keeton and the Minnesota Supreme Court agree that the reasonable expectations doctrine does not remove the insured's responsibility to read the insurance policy.[110] The doctrine, however, excuses the insured from possessing a thorough understanding of a contract that is excessively confusing and complex.[111] The insured will merely be held to a "reasonable knowledge" of the conditions and terms given the surrounding circumstances.[112]

B. *A Proposal for Narrowing the Void*

Opponents claim that the absence of the ambiguity prerequisite exaggerates an insured's expectations, resulting in inflated coverage.[113] A corollary contention is the court's inability to accurately assess the insured's reasonable expectations.[114] More precisely, opponents are troubled by the absence of specific, established inquiries or factors with which to determine reasonable expectations.[115]

Although the Minnesota Supreme Court espouses three factors, the court does not imply that these factors are conclusive.[116] The court implies that the surrounding circumstances must be consid-

109. *See Atwater*, 366 N.W.2d at 278.

110. *Id.* at 278; Keeton, *supra* note 1, at 968.

111. *Cf. Atwater*, 366 N.W.2d at 278 (the court merely requires the insured to have a reasonable knowledge of the policy's conditions and exclusions).

112. *See id.* at 278. Although the precise wording varies among the jurisdictions recognizing either form of the reasonable expectations doctrine, the rudimentary definition of reasonable knowledge is the understanding an ordinary layman would have after a deliberate, but less than scrutinous, reading of the contract. *See Grimes*, 120 N.H. at 722, 422 A.2d at 1315 (examining the knowledge of a reasonably intelligent person after a more than casual reading of the policy); *Chipokas*, 267 N.W.2d at 396 (examining whether an ordinary layman would be misguided after reading the policy).

113. *See supra* note 96 and accompanying text.

114. *See* Note, *supra* note 1, at 617 (stating that the bargain protected by the courts may not be indicated by the surrounding facts). *Cf.* Kelso, *supra* note 94, at 331 (suggesting that the application of the Keeton form of the doctrine leads to unsupportable and haphazard results).

115. *See* Note, *supra* note 1, at 618; *see also* Note, *Reasonable Expectations Approach to Insurance Contract Interpretation Modified in Missouri*, 47 MO. L. REV. 577, 584-85 (1982). Even the principal proponent of reasonable expectations, Professor Keeton, recognizes that the doctrine is "too general to serve as a guide from which particularized decisions can be derived through an exercise of logic, and too broad to be universally true . . . ." Keeton, *supra* note 1, at 967.

116. *See Atwater*, 366 N.W.2d at 278-79.

ered when determining reasonable expectations.[117]

In order to enhance the objectivity and predictability of the doctrine, a more discrete and refined approach must be established for ascertaining the reasonableness of an expectation.[118] Such an approach has not been fully established because the doctrine is in the early stages of development.[119] Therefore, courts and legal scholars should focus their efforts on formulating inquiries or factors which can ascertain the reasonableness of an alleged expectation.[120] The Minnesota Supreme Court has already begun this process.[121]

In future cases, the supreme court should supplement its suggested criteria with the addition of a fourth factor. The proposed factor pertains to "reasonable knowledge" as mentioned by the court[122] and as adopted by the New Hampshire Supreme Court.[123]

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117. "The insured may show what actual expectations he or she had, but the factfinder should determine whether those expectations were reasonable under the circumstances." *Id.* The totality-of-circumstances approach was recently adopted by the United States Supreme Court for the purpose of resolving the ever-distressing issue of probable cause. *See* Illinois v. Gates, 462 U.S. 213, 238 (1983). The Court stated that the totality approach would yield a more honest and accurate assessment than a rigid standard or formula in areas involving diverse fact settings. *Id.* at 232-35. The Court concluded that "[r]igid legal rules are ill-suited to . . . area[s] of such diversity." *Id.* at 232.

Professor Corbin strongly recommends that the surrounding circumstances be examined when interpreting the meaning of a contract. 3 A. CORBIN, *supra* note 18, § 536, at 28. Requiring courts to ascertain the reasonable expectations of a person has precedent in the area of criminal procedure—specifically, fourth amendment privacy issues. The United States Supreme Court has stated that in order to be protected from an unwarranted (and thus unreasonable) search and subsequent seizure, a person must have a *reasonable expectation* of privacy regarding the area or item searched. *See* Smith v. Maryland, 442 U.S. 735, 740-41 (1979) (elaborating on the fourth amendment right of privacy as outlined in Katz v. United States, 389 U.S. 347 (1967)); *see also* United States v. Knotts, 460 U.S. 276, 280-83 (1983). The reasonable expectations test as stated in *Smith* consists of two parts. *Smith,* 442 U.S. at 740. The first part is an examination of the surrounding circumstances to determine whether the suspect's conduct exhibited an actual, subjective expectation of privacy. *Id.* Conversely, the second part, which is objective in nature, determines whether the individual's genuine expectation is one that society is prepared to recognize as reasonable. *Id.*

118. *See* Abraham, *supra* note 1, at 1197-98.

119. *Id.*

120. *See, e.g., id.* Perhaps in time, the courts will have established a list of "traditional" reasonable expectations with respect to insurance policies, resembling traditional reasonable expectations as to privacy. *See Knotts,* 460 U.S. at 281-82 (addressing traditional and non-traditional reasonable expectations).

121. *See Atwater,* 366 N.W.2d at 278 (outlining three recommended factors for ascertaining reasonable expectations of insureds).

122. *See id.* The court stated that the insured should be held only to a "reasonable knowledge of the literal terms and conditions" of the contract. The court, however, did not define "reasonable knowledge." It stated only that the "insured may show what actual expectations he had, but the factfinder should determine whether those

The reasonableness of an expectation could be determined, in part, by discerning the knowledge of "an ordinarily intelligent insured" after a "more than casual reading" of the policy provision in question.[124] Inexplicably, the court seems to have overlooked language in the Readability of Insurance Policies Act that suggests this very factor.[125] The Act requires that insurance provisions be "readable and understandable to a person of average intelligence, expericence, and education."[126] This statutory language implies that if an insurance contract is readable to an ordinarily intelligent insured, his reasonable expectations will be influenced by the language of the contract. The court ought to recognize that any determination of reasonable expectations should reflect this statutory requirement.

Although this suggested factor would appear to overlap the ambiguity and public knowledge factors, it nevertheless refines the court's approach. Conceivably, the policy language of a disputed provision may be found unambiguous, but may still mislead an insured because the provision pertains to a substantive matter which is not generally understood by the public. The proposed factor could be used under these circumstances to determine whether the expectations of the insured were reasonable even though the language was unambiguous. The usefulness of this proposed factor is significantly greater in situations where the language of the disputed provision is found to be ambiguous. Thus, this factor could help to ascertain the reasonableness of *any* alleged expectation, whether based upon ambiguous language or not. In either scenario, the proposed factor could protect against exaggerated expectations and could thus minimize the threat of inflated coverage.[127]

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expectations were reasonable under the circumstances." *See infra* text accompanying note 126 (defining "reasonable knowledge").

123. *See Grimes*, 120 N.H. at 722, 422 A.2d at 1315. Professor Llewellyn has offered a second alternative to the contract of adhesion doctrine. *See* Note, *supra* note 3, at 1196-98 (citing K. LLEWELLYN, COMMON LAW TRADITION—DECIDING APPEALS 362-63, 370-71 (1960)). According to Llewellyn, a standard form contract results in two separate contracts: the *dickered* deal; and the collateral one of *supplementary* boiler plate. *Id.* at 1196. His theory is predicated on the presumption that the insurer and consumer are aware that the latter will not read the contract in its entirety. *Id.* at 1197. The terms of the *supplementary* contract, which has been given general assent, are honored to the extent that they do not undermine or thwart the dickered deal, which has been given specific assent, and are not manifestly unconscionable or unfair. *Id.*

124. *See Grimes*, 120 N.H. at 723, 422 A.2d at 1315 (quoting Hanover Ins. Co. v. Grondin, 119 N.H. 394, 397, 402 A.2d 174, 176 (1979)).

125. MINN. STAT. § 72C.02 (1984).

126. *Id.*

127. In the first scenario (where the disputed policy provision is found to be unambiguous), the provision would be enforced if *an ordinarily intelligent person* after a *more than casual reading* of the policy provision would have known the meaning and ramifications of the provision in question. In the second scenario (where the dis-

CONCLUSION

In *Atwater,* the Minnesota Supreme Court adopted the reasonable expectations doctrine. The court adopted the extended version of the doctrine which does not require ambiguity before the doctrine is applied. In doing so, the court has abandoned traditional theories of contract interpretation which have often led to unfair results or which have been stretched beyond their limits to achieve justice. The court's action represents a step forward in balancing the interests of the insured against the traditionally more powerful insurance company.

Hopefully, the court has only begun to develop the doctrine. It must continue formulating specific factors by which reasonable expectations can be determined. Failure to accomplish this will necessarily result in a retreat to either the traditional contract of adhesion doctrine or the common form of the reasonable expectations doctrine.[128] Although the Minnesota Supreme Court's efforts in *Atwater* are commendable, the process of developing the reasonable expectations doctrine into a more principled, manageable contract theory must continue.

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puted policy provision is determined to be ambiguous), the alleged expectation of the insured would be recognized if it were consistent with the knowledge or understanding of an ordinarily intelligent person after a more than casual reading of the provision. Recognition of the alleged expectation, in the second scenario, would be especially appropriate if the insured's expectation regarding a certain term was also consistent with the understanding of the general public's knowledge regarding that matter. In both scenarios, however, a concerted, conspicuous disclosure by the insurer or its agent, of the exclusions or limitations, would defeat any alleged expectation. *See supra* note 84.

128. *See* Abraham, *supra* note 1, at 1196; Note, *The Doctrine of Reasonable Expectations in Massachusetts and New Hampshire: A Comparative Analysis,* 17 NEW ENG. L. REV. 891, 923-24 (1982).