WHAT TO REASONABLY EXPECT IN THE COMING YEARS FROM THE REASONABLE EXPECTATIONS OF THE INSURED DOCTRINE

ARTHUR J. PARK*

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INTRODUCTION

The reasonable expectations of the insured (REI) doctrine is one of the most controversial legal theories of the twentieth and twenty-first centuries and has been a frequent topic among commentators, receiving both high praise,[1] and scathing criticism.[2] Despite the

* Associate Attorney at Mozley, Finlayson & Loggins LLP in Atlanta, Georgia. J.D., Univ. of Mississippi School of Law; B.A., Univ. of Georgia. The author practices primarily in civil litigation defense, aviation defense, subrogation, and insurance coverage, and may be contacted at apark@mfllaw.com. Special thanks to Professor Farish Percy for her insightful comments and feedback.

1. *See, e.g.*, Martin Kamarck, *Opening the Gate: The Steven Case and the Doctrine of Reasonable Expectations*, 29 HASTINGS L.J. 153 (1977); Robert E. Keeton, *Reasonable Expectations in the Second Decade*, 12 FORUM 275 (1976); Kelli Hanley Crabb, Note,

continued analysis, the REI doctrine continues to evade a universal understanding or clear definition—as the Utah Supreme Court said, "after more than twenty years of attention to the doctrine in various forms by different courts, there is still great uncertainty as to the theoretical underpinnings of the doctrine, its scope, and the details of its application."[3] A few recent cases have completely rejected the REI doctrine, casting doubt on the doctrine's continued existence.[4] Despite this criticism, the REI doctrine should continue to assist the courts in insurance coverage disputes, although perhaps in a somewhat altered nature.[5]

I. ORIGIN OF THE REI DOCTRINE

The modern REI doctrine can be traced back to the seminal law journal article *Insurance Law Rights at Variance with Policy Provisions* written by Professor Robert Keeton in 1970.[6] Professor Keeton began with the notion that "[i]nsurance contracts continue to be contracts of adhesion, under which the insured is left little choice beyond electing among standardized provisions offered to him."[7] The REI doctrine was originally formulated as follows: "[t]he objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated

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Interpreting the "Business Pursuits" Exclusion in Homeowner's Policies—Toward Honoring "Reasonable Expectations," 25 S.D. L. REV. 132 (1980); John Fielding Shreves, Comment, *Insurer Liability in the Asbestos Disease Context—Application of the Reasonable Expectations Doctrine*, 27 S.D. L. REV. 239 (1982).

2. *See, e.g.*, Arnold P. Anderson, *Life Insurance Conditional Receipts and Judicial Intervention*, 63 MARQ. L. REV. 593 (1980); Gary L. Birnbaum, Louis A. Stahl & Michael P. West, *Standardized Agreements and the Parol Evidence Rule: Defining and Applying the Expectations Principle*, 26 ARIZ. L. REV. 793 (1984); Frank E. Gardner, *Reasonable Expectations: Evolution Completed or Revolution Begun?*, 669 INS. L.J. 573 (1978); Conrad L. Squires, *A Skeptical Look at the Doctrine of Reasonable Expectation*, 6 FORUM 252 (1971).

3. Allen v. Prudential Prop. & Cas. Ins. Co., 839 P.2d 798, 803 (Utah 1992).

4. *See infra* Part V.

5. *See infra* Part VI.

6. Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions: Part One*, 83 HARV. L. REV. 961 (1970). Of course, Professor Keeton did not come up with the REI doctrine out of the blue; several cases had applied aspects of the REI doctrine before the Keeton article. *See* Robert H. Jerry, II, *Insurance, Contract, and the Doctrine of Reasonable Expectations*, 5 CONN. INS. L.J. 21, 50 (1998) (citing Klos v. Mobil Oil Co., 259 A.2d 889 (N.J. 1969) (insurance solicited by mail); Gray v. Zurich Ins. Co., 419 P.2d 168 (Cal. 1966) (duty to defend under liability insurance); Kievit v. Loyal Protection Life Ins. Co., 170 A.2d 22 (N.J. 1961)).

7. Keeton, *supra* note 6, at 966.

> unambiguous, because insurers know that ordinarily policyholders will not in fact read their policies.[12]

While the REI doctrine could apply to unambiguous language, it "does not deny the insurer the opportunity to make an explicit qualification effective by calling it to the attention of a policyholder at the time of contracting, thereby negating surprise to him."[13]

II. How the States Have Interpreted and Applied the REI Doctrine

When it comes to interpreting and applying the REI doctrine, the states are far from agreement: "[f]rom the beginning, there has been a striking lack of agreement among the courts and commentators as to what the reasonable expectations doctrine is, how it should be applied, or when it should be invoked."[14]

The state courts have essentially developed four variations on the REI doctrine: (1) the unqualified version, (2) the prominence-based version, (3) the ambiguity-based version, and (4) the hybrid version.[15]

12. Keeton, *supra* note 6, at 968.

13. *Id.*

14. Susan M. Popik & Carol D. Quackenbos, *Reasonable Expectations After Thirty Years: A Failed Doctrine*, 5 CONN. INS. L.J. 425, 427 (1998). "Despite thirty years of effor

doctrine as a rule of substantive law altogether, treating it instead as a rule of construction analogous to—indee

> [I]nsurance contracts are standardized, are contracts of adhesion, are complex, are of nec

> [T]he insurance policy has become overloaded with warranties, representations, conditions and exceptions, and other restrictive provisions, besides which tend to take on highly technical and treacherous characteristics. . . . It has been often said that if all the provisions of the modern insurance policy were literally enforced no policyholder could recover a penny. This is an overstatement, but suggestive.[39]

The insurance companies' inability to craft understandable policy language has also been criticized by the courts. "Although insurers have had over a hundred years to hone their policies into forms that would not ferry the unwary reader on a trip through Wonderland, they regrettably have not seen fit to do so."[40] It has also been said that insurance policies

> are a virtually impenetrable thicket of incomprehensible verbosity. It seems that insurers generally are attempting to convince the customer when selling the policy that everything is covered and convince the court when a claim is made that nothing is covered. The miracle of it all is that the English language can be subjected to such abuse and still remain an instrument of communication.

general practices."[43] For example:

> Allstate's slogan "You're in Good Hands," Travelers' motto of protection "Under the Umbrella," and Fireman's Fund symbolic protection beneath the "Fireman's Hat," exemplify the industry's

protect."[51] This idea is important because "insurers must be able to predict *in advance and with reasonable certainty* how the policy terms will be interpreted."[52] It is "imperative that the provisions of insurance policies which are clearly and definitely set forth in appropriate language, and upon which the calculations of the company are based, should be maintained unimpaired by loose and ill-considered judicial interpretation" under the REI doctrine.[53] When it comes to the REI doctrine, "the insurer confronts a variable in its

litigation expenses. Determining the insured's reasonable expectations can be a fact-specific inquiry, especially when the REI doctrine can be applied to unambiguous provisions, i.e., to every single provision in every single insurance policy.[58] For example, "[b]y focusing on what was and was not said at the time of contract formation rather than on the parties' writing, [the reasonable expectations doctrine] makes the question of the scope of insurance coverage in any given case depend upon how a fact-finder resolves questions of credibility," thus creating both uncertain results, unnecessary delays in litigation, and unwanted costs.[59]

Perhaps the most furious criticism of the REI doctrine is the possibility for judicial lawmaking. The REI doctrine "turns every court into a mini-legislature, with the power to fashion public policy by invalidating contract terms it believes to be unfair or inappropriate."[60] In this way, "courts unable to find any other means of providing insurance coverage will turn to the reasonable expectations doctrine to ensure a source of funding for victims of tragic circumstances who might otherwise find themselves without financial resources."[61] In one commentator's example of judicial lawmaking, the Kentucky Supreme Court ruled that the household exclusion in automobile insurance policy was void as against public policy simply because the injured party was a nine-year-old child with a brain injury.[62] In other words, hard facts often make bad law,[63] and

58. Popik, *supra* note 14, at 432.

59. *Id.* at 432 n.25 (quoting Standard Venetian Blind Co. v. Am. Empire Ins. Co., 469 A.2d 563, 567 (Pa. 1983)).

60. *Id.* at 433. *But see*, Stempel, *supra* note 15, at 256 (arguing in response: "Armed with the notion that a textual focus limits unwarranted judicial activism and keeps the judiciary properly balanced against other government branches and market forces, courts strive to render textualist contract constructions. Faced with the counter-theory of reasonable expectations creating rights at variance with text, some elements of the profession have recoiled and resisted this antithesis or opposing paradigm. This explains a good deal of the opposition to the Keeton article."); *id.* at 268 (The judicial activism argument often "fail[s] to go beyond the surface of this shibboleth, the utterance of which alone is expected to convince the reader that expectations analysis must be bad if it entails judges doing anything more complex than reading an insurance policy and a dictionary in tandem.").

61. Popik, *supra* note 14, at 433. This same argument has been applied to the *contra proferentum* doctrine as well in that ambiguity can differ from person to person. Stempel, *supra* note 15, at 265 (citing Agfa

the REI doctrine can be used as a tool to reach a desired result.

Finally, it has been postulated that "the existing rules of contract interpretation, such as waiver, estoppel, unconscionability, and *contra proferentem,* are all that is necessary to interpret the contract—and even to protect insureds from overreaching insurers."[64] In other words:

> [W]aiver and estoppel rely for their application on the actual dealings between the insured and the insurer. Thus, courts cannot invoke these doctrines to create coverage unless the insurer hast

doctrine overlaps with unconscionability,[68] the unconscionability standard is "more specific, more exacting, and more demanding than an 'unreasonableness' standard."[69] In addition, insurer's rarely meet the legal requirements of fraud or negligent misrepresentation.[70] In short, "Keeton described the [REI] principle as one that synthesized many 'doctrinal theories,' including waiver, estoppel, *contra proferentem,* reformation, rescission, modification rules in contract, and agency."[71]

V. WHERE WE'RE HEADED—RECENT TRENDS IN STATES APPLYING THE REI DOCTRINE

Recent cases have expressly rejected the REI doctrine, finding

expectations should be abolished.[80]

Florida's *Deni* decision was criticized for referring to both objective and subjective expectations and for stating that the REI doctrine requires ambiguous policy language.[81] This criticism would apply with equal force to Michigan's *Wilkie* decision. It is clear that the REI doctrine should apply to objective expectations, not subjective.[82] In his seminal article, Professor Keeton asserted that "[a]n objective standard produces an essential degree of certainty and predictability about legal rights, as well as a method of achieving equity not only between insurer and insured but also among different insureds whose contributions through premiums create the funds that are tapped to pay judgments against insurers."[83] However, the courts appear to remain confused on this point. Some courts, applying the unqualified or pure version of the REI doctrine, "simply divine what coverage 'the average person' or theoretical group of 'consumers' would expect the policy to provide without the benefit of any extrinsic evidence on the subject."[84] Other courts, applying the prominence-based version of the REI doctrine, "tend to determine the insured's reasonable expectations as to coverage primarily from an examination of the overall format of the policy."[85]

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80. *Id.* at 787.

81. Anderson, *supra* note 29, at 357–58.

82. *See* Stempel, *supra* note 15, at 257 ("Mere policyholder hope and whim is not enough to gain coverage. There must be an objectively reasonable expectation of coverage before the policyholder may prevail."); Henderson, *supra* note 11, at 839 (REI "seems to require that there be some evidentiary basis beyond naked belief on the part of the person seeking coverage, i.e., that it be objectively determinable."); Popik, *supra* note 14, at 441 ("[M]ost insureds develop a 'reasonable expectation' that every loss will be covered by their policy. Therefore, the reasonable expectation concept must be limited by something more than the fervent hope usually engendered by loss.").

83. Keeton, *supra* note 6, at 968.

84. Popik, *supra* note 14, at 441–42 (citing Lewis v. W. Am. Ins. Co., 927 S.W.2d 829, 833 (Ky. 1996) (refusing to enforce unambiguous household exclusion because buyers of automobile insurance "expect their family members to receive comparable protection to that afforded to unknown third persons . . . .") (quotation marks in original); Sparks v. St. Paul Ins. Co., 495 A.2d 406, 414 (N.J. 1985) (unambiguous provision will be enforced only if it conforms to "public expectations" about insurance coverage)).

85. *Id.* at 442 (citing State Farm v. Falness, 39 F.3d 966, 968 (9th Cir. 1994) (inquiry into insured's reasonable expectations "involves an analysis of the format and clarity of the policy, as well as the circumstances of its acquisition and issuance"); Gray v. Zurich Ins. Co., 419 P.2d 168, 174 (Cal. 1966) (en banc) (refusing to enforce limitation on duty to defend that "is not 'conspicuous' since it appears only after a long and complicated page of fine print, and is itself in fine print"); Lehroff v. Aetna Cas. & Sur. Co., 638 A.2d 889, 892 (N.J. 1994)

It should also be noted that Iowa and Pennsylvania have "disapproved the pure reasonable expectations doctrine and instead appear to use expectations analysis only when contested policy language is ambiguous or otherwise problematic."[86] Professor Stempel went on to predict that "the Keeton formula alone will probably never enjoy majority status nor can it ever comprise the entire role of reasonable expectations analysis in construing insurance policies and resolving insurance coverage disputes."[87] It appears that this prediction was accurate.

VI. WHERE WE SHOULD BE HEADED—REI DOCTRINE AS A LIMIT ON *CONTRA PROFERENTEM*

The key to moving the REI doctrine forward is in the ambiguity-based version and in understanding how it should be applied. As it is currently applied, the ambiguity-based version of the REI doctrine has received a good deal of criticism. The *contra proferentem* doctrine states that ambiguities are to be construed against the drafter; in the insurance context, this means that ambiguous policy provisions will be construed against the insurer and in favor of the insured.[88] The decisions that use the REI doctrine "solely to construe [ambiguous] policy language do not support a new principle at all, but fall within the time-honored canon of construing ambiguities against the drafter of the contract—*contra proferentem*."[89] Applying the REI doctrine

("Reasonable expectations of coverage raised by the declaration page cannot be contradicted by the policy's boilerplate unless the declaration page itself clearly so warns the insured.")).

86. Stempel, *supra* note 15, at 194–95 (citing C & J Fertilizer, Inc. v. Allied Mut. Ins. Co. -(t)-2

only after first determining that the disputed policy language is ambiguous "adds nothing to the policyholder's quiver of arguments for coverage beyond that already existing through the *contra proferentem* principle, although it perhaps provides insurers with a chance to avoid liability even when guilty of drafting ambiguous language."[90] Also, "the presence of an ambiguity is not essential to invocation of the principle articulated by Professor Keeton."[91] Furthermore, "[t]he 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."[92]

However, some continue to argue in favor of the ambiguity approach. At least one commentator has opined that the ambiguity approach "represents the best approach because it confines the court to its traditional role of interpreting the bargain struck between the insured and insurer," and therefore "the court should continue to limit its application of the doctrine of reasonable expectations to a rule of construction to resolve ambiguity."[93]

Under the ambiguity-based version of the REI doctrine, the courts have taken three different views to determine the insured's reasonable expectations when faced with an ambiguous policy.[94] The first ambiguity approach provides that "the only question is whether the challenged provision is ambiguous; once that determination is made, the inquiry ends and coverage follows more or less automatically."[95] This approach can be especially troubling when applied to hypothetical situations.[96] The first ambiguity approach has even been referred to as the "penalty standard" because the insurance company, as the drafter of the policy, is penalized for employing unclear language, regardless of whether it is objectively reasonable to

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90. Stempel, *supra* note 15, at 206.

91. Henderson, *supra* note 11, at 827.

92. Keeton, *supra* note 6, at 972.

93. David J. Seno, Comment, *The Doctrine of Reasonable Expectations in Insurance Law: What to Expect in Wisconsin*, 85 MARQ. L. REV. 859, 885–86 (2002).

94. Popik, *supra* note 14, at 444.

95. *Id.*

96. *Id.* (citing Am. States Ins. Co. v. Koloms, 687 N.E.2d 72, 77 (Ill. 1977) (commercial landlord insured under CGL policy sued by tenants injured by carbon monoxide fumes emitted by defective furnace; absolute pollution exclusion not enforced because definition of pollutant as "any solid, liquid, gaseous . . . irritant or contaminant" was overbroad and could apply to any normally harmless substance to which someone had an allergic reaction)).

expect coverage under the specific circumstances.[97]

The second ambiguity approach will "find coverage only if a reasonable insured would have expected the policy to provide coverage under those specific circumstances."[98] In other words, "[i]f

expectations.[120]

CONCLUSION