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THE DOCTRINE OF REASONABLE EXPECTATIONS IN INSURANCE LAW: WHAT TO EXPECT IN WISCONSIN

I. INTRODUCTION

One of the most controversial doctrines to emerge in insurance law over the last thirty years is the doctrine of reasonable expectations.¹ The doctrine of reasonable expectations is a principle that relies on the "reasonable expectations of the insured" as a guide for insurance contract interpretation.² Under the doctrine of "reasonable expectations," courts often grant coverage to an insured even when the express language of the policy does not provide coverage.³

In its strongest form, the doctrine of reasonable expectations goes beyond *contra proferentem*, a traditional rule of interpretation.⁴ *Contra proferentem* grants coverage to an insured by construing ambiguous policy language against the insurance company.⁵ In contrast, the doctrine of reasonable expectations grants coverage when the insured has an objectively reasonable expectation of coverage even in the absence of ambiguous insurance policy language.⁶

Different approaches to the doctrine have emerged, but the stronger approaches, willing to ignore clear insurance contract language and nonetheless honor the insured's reasonable expectations, have caused the most controversy.⁷ Further, confusion still exists in understanding and applying the doctrine even in those jurisdictions that have adopted it.⁸ Critical issues remain, such as whether a particular jurisdiction has

1. Mark C. Rahdert, *Reasonable Expectations Revisited*, 5 CONN. INS. L.J. 107, 108 (1998).

2. *Id.* (quoting Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 970 n.14 (1970)).

3. *Id.*

4. Eugene R. Anderson & James J. Fournier, *Why Courts Enforce Insurance Policyholders' Objectively Reasonable Expectations of Insurance Coverage*, 5 CONN. INS. L.J. 335, 342-45 (1998).

5. *Id.*

6. *Id.*

7. *Id.*

8. Roger C. Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L.J. 823, 824 (1990).

adopted the doctrine, and exactly what approach has been adopted.⁹

This Comment analyzes whether the Wisconsin Supreme Court has adopted the doctrine of reasonable expectations. To provide the necessary historical background, this Comment explores how other jurisdictions have approached the doctrine. Part II explains the genesis of the doctrine in American courts generally, while Part III describes the evolution of four different approaches to the doctrine. Part IV analyzes how the Wisconsin Supreme Court has applied this controversial doctrine. Part V briefly discusses some of the criticisms of the doctrine and determines which approach should be applied in Wisconsin courts. Lastly, Part VI concludes that the Wisconsin Supreme Court should continue to limit the doctrine of reasonable expectations to a rule of insurance policy construction used to resolve ambiguities.

II. GENESIS OF THE REASONABLE EXPECTATIONS DOCTRINE

A. *From Principle to Doctrine*

In 1970, Professor Robert E. Keeton formulated a new insurance law principle after reviewing numerous judicial opinions that he labeled as "product[s] of unprincipled prejudice against insurers."¹⁰ He stated the principle as follows: "The *objectively* reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored *even though painstaking study of the policy provisions would have negated those expectations.*"¹¹ Keeton supported this principle by relying on the adhesive nature of insurance contracts and the courts' willingness to look at the purchasers' expectations and assumptions regarding coverage.¹²

Keeton initially realized that this principle was too broad and unrefined to serve as a doctrine, or as a set of rules, in insurance policy interpretation.¹³ Keeton posited that the common law process would have to slowly work out the specific rules and boundaries of this broad principle.¹⁴ Keeton believed his principle reflected a valid trend in

9. *Id.*

10. *Id.* at 825.

11. *Id.* (emphasis added) (quoting Keeton, *supra* note 2, at 967).

12. Rahdert, *supra* note 1, at 108-09.

13. Henderson, *supra* note 8, at 825-26.

14. *Id.* Four different approaches to the doctrine eventually developed. See *infra* Part

insurance law¹⁵ and invited courts to adopt it.¹⁶ Indeed, many jurisdictions did adopt his principle and began the process of delineating the boundaries and application of his principle into a doctrine.¹⁷

However, different approaches to the principle¹⁸ emerged in the jurisdictions that adopted Keeton's broad principle.¹⁹ Although these developments caused considerable confusion,²⁰ Keeton's basic principle evolved into an important doctrine of insurance policy interpretation in these jurisdictions.

Iowa and Arizona have extensively developed the substantive boundaries of the doctrine.²¹ In 1973, Iowa adopted the doctrine in *Rodman v. State Farm Mutual Auto Insurance Co.*²² and continued to outline the doctrine's application and boundaries in *C & J Fertilizer, Inc. v. Allied Mutual Insurance Co.*²³ In *C & J Fertilizer, Inc.*, an insured brought an action seeking to collect under two burglary policies.²⁴ Both insurance policies *unambiguously* defined "burglary" as meaning:

[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. . . .²⁵

15. Henderson, *supra* note 8, at 825–26.

16. Rahdert, *supra* note 1, at 108–09.

17. *Id.*

18. See *infra* Part III; see also Jeffery W. Stempel, *Unmet Expectations: Undue Restriction of the Reasonable Expectations Approach and the Misleading Mythology of Judicial Role*, 5 CONN. INS. L.J. 181, 193–94 (1998).

19. Compare *C & J Fertilizer, Inc. v. Allied Mut. Ins. Co.*, 227 N.W.2d 169, 177 (Iowa 1975) (finding coverage based on the doctrine of reasonable expectations despite unambiguous policy language defining "burglary"), with *Farm Bureau Mut. Ins. Co. v. Sandbulte*, 302 N.W.2d 104, 112 (Iowa 1981) (requiring ambiguous, bizarre, or oppressive policy language to apply the doctrine of reasonable expectations).

20. See *infra* Part III.

21. Henderson, *supra* note 8, at 842.

22. 208 N.W.2d 903, 906 (Iowa 1973) ("The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations.") (quoting ROBERT E. KEETON, *INSURANCE LAW—BASIC TEXT* § 6.3(a), at 751 (1971)). By directly quoting Keeton's interpretation of his doctrine, Iowa appeared to adopt his stronger version of the doctrine. But see *supra* note 20 and accompanying text.

23. 227 N.W.2d 169 (Iowa 1975).

24. *Id.* at 171.

25. *Id.* (emphasis added) (quoting the insurance policy definition of burglary).

The court determined that the evidence showed no visible marks or damages on the *exterior* of the insured's property, but found visible marks *inside* the premises.²⁶ The court believed the insured would not have "reasonably anticipate[d]" this definition of burglary from the negotiations and communications with the insurance company's agent.²⁷ The court also found that the burglary definition was inconsistent with either a layman's definition or a legal definition.²⁸ Accordingly, the court held that the doctrine of reasonable expectations applied and demanded reversal and judgment for the insured.²⁹

The Supreme Court of Arizona adopted the doctrine in *Darner Motor Sales, Inc. v. Universal Underwriters Insurance Co.*,³⁰ but significantly clarified the applicability of the doctrine in *Gordinier v. Aetna Casualty & Surety Co.*³¹ In *Gordinier*, an insured brought an action to recover uninsured motorist benefits after she was injured while riding as a passenger on an uninsured motorcycle.³² At the time of the accident, the plaintiff and her husband, the named insured, had separated and were living at different locations.³³ The insurer denied payment to the plaintiff because she was an "additional driver" and not a "resident of the same household."³⁴ The court of appeals found the limiting language of the policy unambiguous and held that the doctrine of reasonable expectations, as adopted in *Darner*, did not apply to unambiguous language.³⁵

The Supreme Court of Arizona, however, stated that the doctrine of reasonable expectations could be applied to unambiguous language in standardized insurance contracts in four situations:³⁶

26. *Id.*

27. *Id.* at 177. The court also quoted extensively from the RESTATEMENT (SECOND) OF CONTRACTS § 237 (1981) (now § 211): "[A] party who adheres to the other party's standard terms does not assent to a term if the other party has reason to believe that the adhering party would not have accepted the agreement if he had known that the agreement contained the particular term." *Id.* at 176. "This rule is closely related to the policy against unconscionable terms and the rule of interpretation against the draftsman." *Id.*

28. *Id.* at 177.

29. *Id.*

30. 682 P.2d 388, 397 (Ariz. 1984) (adopting RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981) as a "sensible rationale for interpretation of . . . usual type[s] of insuring agreement[s]").

31. 742 P.2d 277 (Ariz. 1987).

32. *Id.* at 279.

33. *Id.* at 278.

34. *Id.* at 279, 284 (quoting the insurance policy language).

35. *Id.* at 283.

36. *Id.*

1. Where the contract terms, although not ambiguous to the court, cannot be understood by the reasonably intelligent consumer who might check on his or her rights, the court will interpret them in light of the objective, reasonable expectations of the average insured . . . ,
2. Where the insured did not receive full and adequate notice of the term in question, and the provision is either unusual or unexpected, or one that emasculates apparent coverage . . . ,
3. Where some activity which can be reasonably attributed to the insurer would create an objective impression of coverage in the mind of a reasonable insured . . . ,
4. Where some activity reasonably attributable to the insurer has induced a particular insured reasonably to believe that he has coverage, although such coverage is expressly and unambiguously denied by the policy³⁷

The court held that the policy language, which limited the plaintiff's coverage, became unenforceable as a matter of law under Arizona's version of the doctrine of reasonable expectations.³⁸

Despite the proliferation of the doctrine in some jurisdictions, the controversy surrounding the doctrine clearly prevents other jurisdictions from accepting it.³⁹ For example, Florida's highest court rejected the doctrine in *Deni Associates of Florida, Inc., v. State Farm Fire & Casualty Insurance Co.*⁴⁰ In *Deni*, the Florida Supreme Court examined Keeton's principle and stated that:

We decline to adopt the doctrine of reasonable expectations. There is no need for it if the policy provisions are ambiguous because in Florida ambiguities are construed against the insurer. To apply the doctrine to an unambiguous provision would be to rewrite the contract and the basis upon which the premiums are charged.⁴¹

37. *Id.* at 283-84 (citing William A. Mayhew, *Reasonable Expectations: Seeking a Principled Application*, 13 PEPP. L. REV. 267, 287-89 (1986)).

38. *Id.* at 285. The case was remanded to determine if the plaintiff or the husband had knowledge of the limitations. *Id.*

39. Rahdert, *supra* note 1, at 109.

40. 711 So. 2d 1135, 1140 (Fla. 1998).

41. *Id.* (citing *Sterling Merch. Co. v. Hartford Ins. Co.*, 506 N.E.2d 1192, 1197 (Ohio Ct. App. 1986)). However, one commentator suggests that the Florida Supreme Court misunderstood the doctrine. Anderson & Fournier, *supra* note 4, at 357.

Likewise, Utah has refused to accept the doctrine. In *Allen v. Prudential Property & Casualty Insurance Co.*,⁴² the Utah Supreme Court discussed the doctrine and held that "[a]doption of the reasonable expectations doctrine poses a much greater risk of broadly undermining [freedom of contract] than our continued use of existing equitable doctrines applied on a case-by-case basis."⁴³ Thus, as these cases illustrate, many courts still view the doctrine as a vehicle for judicial rewriting of unambiguous policy language and therefore have refused to accept the doctrine.⁴⁴

Other jurisdictions have flirted with the idea, but have not yet truly accepted or rejected it.⁴⁵ For example, the Wisconsin Supreme Court has applied the doctrine of reasonable expectations, but has not explicitly adopted it.⁴⁶ The reluctance of some jurisdictions to adopt the doctrine may be caused by the general confusion surrounding it.⁴⁷ Different approaches to the doctrine have fueled this confusion.⁴⁸ Indeed, the doctrine may be best described as a "bundle of related ideas" rather than "a single concept."⁴⁹

III. THE DIFFERENT APPROACHES TO THE DOCTRINE: WHY THE DOCTRINE IS CONTROVERSIAL AND MISUNDERSTOOD

Commentators have outlined four different approaches to the doctrine of reasonable expectations.⁵⁰ These four approaches range

42. 839 P.2d 798 (Utah 1992).

43. *Id.* at 807.

44. Rahdert, *supra* note 1, at 109.

45. *Id.*

46. *See infra* Part IV.

47. Rahdert, *supra* note 1, at 111.

48. *See id.* at 111-12.

49. *Id.* at 111.

50. *Id.* Other commentators outline different variations of the doctrine of reasonable expectations. *See, e.g.,* Stephen J. Ware, *A Critique of the Reasonable Expectations Doctrine*, 56 U. CHI. L. REV. 1461, 1467-75 (1989) (outlining the "ambiguity," "fine print," and "whole transaction" approaches to the doctrine of reasonable expectations). One commentator suggests that the doctrine of reasonable expectations has two variations: "objective reasonable expectations" and "subjective expectations." ARNOLD P. ANDERSON, WISCONSIN INSURANCE LAW § 1.1 (4th ed. 1988). Objective reasonable expectations "is a conventional use . . . that construes the meaning of a specific word or phrase in an insurance policy. This test of construction is: What a reasonable person in the position of the insured would understand specific words to mean." *Id.* In contrast, "[i]n applying subjective reasonable expectations, a court bases an interpretation on whether an insured would *reasonably* expect to be covered because of the general nature of [insurance] coverage purchased, in other words, 'theft,' 'liability,' and the like." *Id.*

along a continuum from traditional policy interpretation rules to "downright dangerous" judicial manipulation of insurance policy language.⁵¹ Further, these four approaches are "interrelated [and] often overlap."⁵² As such, commentators have suggested that courts often apply more than one of these approaches to justify their decisions.⁵³ Thus, how one jurisdiction construes a policy according to the insured's "reasonable expectations" may differ markedly from another jurisdiction's approach.⁵⁴

A. Ambiguity and Traditional Insurance Policy Rules of Construction

Some courts apply the doctrine of reasonable expectations only when policy language is ambiguous.⁵⁵ Policy language is ambiguous if it is reasonably or fairly susceptible to more than one meaning and the different meanings have opposite effects on coverage.⁵⁶ This approach holds that if a policy is ambiguous, the court construes the language against the insurer and in favor of the insured.⁵⁷ This approach parallels *contra proferentem*, a traditional contract interpretation canon that construes ambiguity against the drafter.⁵⁸

Under the ambiguity approach, courts apply the basic premise of *contra proferentem* in the context of insurance contracts.⁵⁹ In the overwhelming majority of insurance contracts, the insurer unilaterally drafts the terms of coverage.⁶⁰ Further, modern contract theory holds

51. Rahdert, *supra* note 1, at 111.

52. *Id.* at 144.

53. *Id.* at 144-46.

54. Anderson & Fournier, *supra* note 4, at 356.

55. See, e.g., Lutsky v. Blue Cross Hosp. Serv. Inc., 695 S.W.2d 870, 875 (Mo. 1985) (applying the doctrine of reasonable expectations where the policy language was ambiguous); Waylett v. United Servs. Auto. Assoc., 401 N.W.2d 160, 163 (Neb. 1987) (stating that "[i]n view of the language used [in the policy,] the plaintiff could have no reasonable expectation that the policy did not mean exactly what it said") (quoting Pettit v. Edwards, 240 N.W.2d 344, 346-47 (Neb. 1976)).

56. Rahdert, *supra* note 1, at 116. In Wisconsin, "Words or phrases in a contract are ambiguous when they are reasonably or fairly susceptible to more than one construction." Katze v. Randolph & Scott Mut. Fire Ins. Co., 330 N.W.2d 232 (Wis. Ct. App. 1983), *rev'd*, 341 N.W.2d 689, 692 (Wis. 1984). In addition, the Supreme Court of Wisconsin has "held consistently . . . that the construction of the words and clauses in an insurance policy is a question of law for the court." *Id.* at 691.

57. Rahdert, *supra* note 1, at 116.

58. *Id.*

59. *Id.*

60. *Id.* Most insurance policies are standard-form policies. KENNETH S. ABRAHAM, INSURANCE LAW AND REGULATION 32 (3d ed. 2000).

that the insurer must effectively and clearly communicate these terms to the insured.⁶¹ Essentially, this approach puts the insurer on notice as follows: "'Cover what you want. Exclude what you want. But make sure you do it clearly. Sloppy drafting could cost you something.'"⁶²

The Nevada Supreme Court decision of *National Union Fire Insurance Co. v. Reno's Executive Air Inc.*⁶³ illustrates the ambiguity approach to the doctrine of reasonable expectations.⁶⁴ In *National Union*, an air taxi operator purchased aviation liability insurance for his helicopter.⁶⁵ The liability policy excluded property "carried in or on any aircraft with respect to which . . . this policy applies."⁶⁶ After hitting power lines, the operator crashed his helicopter and damaged a passenger's photography equipment.⁶⁷ The insurer denied coverage because the passenger's photography equipment was "carried in or on" the helicopter.⁶⁸

The court believed the exclusion to be ambiguous because the policy did "not specify in whose possession property 'carried in or on [the] aircraft' must be before the exclusion applies."⁶⁹ The court noted that an insured "reasonably expects that the policy will cover . . . property of others carried on board the aircraft."⁷⁰ The court held that the exclusion did not apply, and therefore the liability policy provided coverage for the passenger's equipment.⁷¹

Most commentators view this approach as the least controversial because it is based upon traditional contract interpretation canons of "noble common law pedigree."⁷² However, the threshold issue of whether insurance contract language is ambiguous continues to cause

61. Rahdert, *supra* note 1, at 116.

62. *Id.* at 117.

63. 682 P.2d 1380 (Nev. 1984).

64. See also *Grinnell Mut. Reinsurance Co. v. Wasmuth*, 432 N.W.2d 495, 500 (Minn. Ct. App. 1988) (resolving ambiguity in favor of the insured's "reasonable" understanding).

65. *National Union*, 682 P.2d at 1381. Liability insurance covers claims "against the insured for such damages as injury or death to other drivers or passengers, property damage, and the like." BLACK'S LAW DICTIONARY 805 (6th ed. 1990) (emphasis added).

66. *National Union*, 682 P.2d at 1382 (quoting insurance policy language).

67. *Id.* The owner of the photography equipment brought suit against the air taxi operator to recover the value of his equipment and eventually obtained judgment against the operator for \$41,000. *Id.*

68. *Id.*

69. *Id.* at 1382-83 (alteration in original) (quoting insurance policy language).

70. *Id.* at 1383-84.

71. *Id.* at 1384.

72. Rahdert, *supra* note 1, at 116.

dissension among courts.⁷³ Thus, judicial disagreement over the issue of ambiguity impacts the application of this approach to the doctrine of reasonable expectations.

B. Avoiding Unfair Results

Some courts utilize the doctrine of reasonable expectations to avoid an unfair or "unconscionable" result.⁷⁴ These courts are willing to ignore *clear policy language* in order to ensure the "basic fairness of policy terms and procedures."⁷⁵ Proponents of this approach argue that insurance policies are "examples *par excellence* of adhesion contracts."⁷⁶ Proponents argue that the insurer obtains "extraordinary control" over the terms of coverage by knowing critical industry practice and detailed risk determinations.⁷⁷ In addition, supporters of this approach note that insurers realize that most insureds do not read, let alone understand, their insurance policies.⁷⁸ As a result, these proponents argue that courts must "police" the fairness of the insurance policy.⁷⁹

The "fairness" approach protects against three inequitable circumstances: 1) "procedural unfairness," where insurance marketing causes the insured to expect coverage even though the policy explicitly excludes coverage; 2) "structural unfairness," where the layout and organization of the insurance policy can cause an insured to become confused and wary; and 3) "situational unfairness," where standard-

73. See, e.g., *Peace v. N.W. Nat. Ins. Co.*, 596 N.W.2d 429, 449 (Wis. 1999) (Crooks, J., dissenting) (disagreeing with the majority's holding that the insurance policy was unambiguous).

74. Rahdert, *supra* note 1, at 126.

75. *Id.* at 127.

76. *Id.* However, the Wisconsin Supreme Court does not believe that insurance policies are adhesion contracts. *Katze v. Randolph & Scott Mut. Fire Ins. Co.*, 341 N.W.2d 689, 691 (Wis. 1984). In *Katze*, the court opined that "[t]he court of appeals identified this insurance policy as a contract of adhesion. We disavow that categorization of the policy. This court has not labeled insurance policies as contracts of adhesion which have been defined as form contracts submitted on a 'take it or leave it' basis." *Id.* In addition, the court stated:

To sweep out in a single labeling of adhesion contract the well-established case law used in the interpretation of insurance contracts would not be of service to the public. We do not superimpose the case law of other jurisdictions regarding contracts of adhesion on this insurance policy. There are sufficient rules of interpretation of the policy and its meaning available.

Id. at 692.

77. Rahdert, *supra* note 1, at 127.

78. *Id.* at 128.

79. *Id.* at 127.

form insurance policies result in unfair coverage restrictions when applied to a unique policyholder.⁸⁰

The New Hampshire Supreme Court decision of *Atwood v. Hartford Accident Indemnity Co.*,⁸¹ exemplifies the "fairness" approach to the doctrine.⁸² In *Atwood*, a self-employed electrician repaired a thermostat in an apartment building.⁸³ After the electrician's repair, a child died from heat-related complications.⁸⁴ The electrician's insurer refused to defend the electrician and would not indemnify him for any damages assessed against him.⁸⁵ The insurer claimed that a "completed operations" exclusion applied and negated coverage for the electrician.⁸⁶

The trial court noted that "[a] reasonable person in the position of the [electrician] would have believed that he was covered by the policy for any claims against him for negligence in his work as an electrician."⁸⁷ Further, the trial court critically analyzed the language and structure of the policy and believed that "[t]here is little in the language and arrangement of this policy which would lead the ordinary person to believe that he had no coverage for injury or property damage which arose after he completed a job."⁸⁸

The Supreme Court of New Hampshire agreed with the trial court's analysis.⁸⁹ In addition, the court relied on the insurance agent's beliefs.⁹⁰

80. *Id.* at 128.

81. 365 A.2d 744 (N.H. 1976).

82. *See also* *Gordinier v. Aetna Cas. & Sur. Co.*, 742 P.2d 277, 289 (Ariz. 1987) (holding that a limitation on coverage was unenforceable because of inadequate notice); *Bromfeld v. Harleysville Ins. Cos.*, 688 A.2d 1114, 1123 (N.J. Super. Ct. App. Div. 1997) (directing the lower court to "look at the reasonable expectations of the average home owner" where the structure of the policy is complicated).

83. *Atwood*, 365 A.2d at 745.

84. *Id.*

85. *Id.* The child's estate brought suit against the electrician, and a third party also sought indemnity from the electrician. *Id.*

86. *Id.*

87. *Id.* at 746 (quoting the trial court's findings).

88. *Id.*

89. *Id.* The Supreme Court of New Hampshire commented on the liability policy's layout as follows:

The critical heading [of the policy], which is located between two other headings, reads as follows: "Coverage for Premises and for the Named Insured's Operations in Progress." It is possible to look through the document several times before noticing this heading. Yet this is the only affirmative statement of the coverage of the policy. The defendant also relies on [the completed operations exclusion]. . . . This exclusion clause is buried amidst thirteen others, which are either irrelevant to the plaintiff or expected, as for example the exclusion of obligations imposed by

The court opined that "[i]f an insurance agent with twenty years of experience thought that [the electrician] was covered for completed operations, it is unreasonable to expect [the electrician], who had no experience with reading insurance policies, to know that he was not so covered."⁹¹ As a result, the court held that the policy covered the electrician's negligent repair.⁹²

Not surprising, this approach to the doctrine of reasonable expectations is controversial.⁹³ The major criticisms of this approach include judicial manipulation of clear policy language, disregarded insurance contract language, and increased premium costs.⁹⁴

C. Promoting the Purpose of Insurance

In very rare instances, courts apply the doctrine of reasonable expectations to promote the purpose of insurance.⁹⁵ Here, courts are primarily concerned with "mak[ing] an insurance policy perform its intended function."⁹⁶ In some circumstances, courts realize that strict enforcement of written policy language would eviscerate the underlying purpose of the insurance transaction.⁹⁷ As a result, some courts invoke the doctrine of reasonable expectations to justify their actions when they refuse to enforce written policy language.⁹⁸

The Wisconsin Supreme Court decision of *Wood v. American Family Insurance Co.*⁹⁹ illustrates the "purpose" approach to the doctrine.¹⁰⁰ In *Wood*, an insured's wife was killed in a head-on collision with an underinsured motorist.¹⁰¹ The insured sought to recover damages for his

workmen's compensation and unemployment compensation laws. Neither the quoted heading nor the quoted exclusion clause constitutes fair notice to the insured that the policy does not cover the risks defined as the completed operations hazard, which the front page would lead him to believe were covered.

Id. at 746-47 (quoting insurance policy language).

90. *Id.* at 747.

91. *Id.*

92. *Id.*

93. Rahdert, *supra* note 1, at 131.

94. *Id.* See *infra* Part V for a discussion of these criticisms.

95. Rahdert, *supra* note 1, at 136.

96. *Id.* Courts also use this approach to protect not only the insured before the court, but also other insureds who purchase similar insurance. *Id.*

97. *Id.*

98. *Id.*

99. 436 N.W.2d 594 (Wis. 1989).

100. Rahdert, *supra* note 1, at 137.

101. *Wood*, 436 N.W.2d at 595-96. The same insurance company insured the vehicle driven by the insured's wife and also another vehicle owned by the insured. *Id.* Thus, the

wife's death under the underinsured motorist provisions in each of his insurance policies.¹⁰² However, the insurance company claimed that the "reducing clause" in each of the insured's policies reduced the amount the insured could recover.¹⁰³

After finding the phrase "amounts payable" within the reducing clause ambiguous, the court construed the phrase according to the insured's reasonable expectations.¹⁰⁴ The court found that a reasonable insured would understand "amounts payable" to mean the total amount of damages sustained because:

[A] reasonable insured expects to be protected against a loss caused by another that is not covered by the underinsured driver's liability coverage.

Furthermore, this interpretation is consistent with the purpose of UIM coverage as announced by this court. The purpose of UIM coverage is to compensate the victim of an underinsured motorist's negligence where the third party's liability limits are not adequate to fully compensate the victim for his or her injuries.¹⁰⁵

Based on these arguments, the court held that the "reducing clause" did not reduce the amount payable under the policy "by the amount received by the insured from the underinsured driver's liability policy."¹⁰⁶

This approach to the doctrine of reasonable expectations is also controversial.¹⁰⁷ Under this approach, courts no longer umpire the

insured had two insurance policies. *Id.*

102. *Id.* at 596. The insured sought to "stack" or combine the coverage afforded by both policies. *Id.* Specifically, the insured wanted to collect the \$100,000 limit afforded under one policy and \$100,000 under the other insurance policy. *Id.* The insured had total damages of more than \$225,000. *Id.*

103. *Id.* The insurer argued that the "amounts payable" to the insured totaled only \$75,000 because the insured received \$25,000 from the underinsured motorist's liability policy. *Id.* at 600. According to the insurer, the \$25,000 had to be subtracted from the \$100,000 underinsured motorist limits per the terms of the reducing clause. *Id.* However, the court held that the insured was entitled to stack coverage, but it had to determine how to apply the reducing clause in order to determine the "amounts payable" to the insured. *Id.* at 598-99.

104. *Id.* at 599.

105. *Id.* (citing *Schwochert v. Am. Family Ins. Co.*, 407 N.W.2d 525 (Wis. 1987)).

106. *Id.* at 601.

107. *Rahdert, supra* note 1, at 139.

bargain struck between the insurer and insured.¹⁰⁸ Thus, by analyzing the purpose of the insurance transaction and then determining what should be covered, courts assume the role of a legislative body and therefore stray from their traditional judicial role.¹⁰⁹

D. Protection of Third-Party Interests

In extremely rare cases, courts apply the doctrine of reasonable expectations to protect the interests of third parties.¹¹⁰ Because insurance coverage impacts third parties such as family members, employees, and innocent victims of the insured, third parties have an "interest in how insurance policies are interpreted" and construed.¹¹¹ In turn, courts protect this interest by invoking the doctrine of reasonable expectations.¹¹²

In *Harvester Chemical Corp. v. Aetna Casualty & Surety Co.*,¹¹³ the Superior Court of New Jersey applied the "third-party protection" approach of the doctrine of reasonable expectations.¹¹⁴ In *Harvester*, a liability insurer terminated an insured's policy mid-term for "underwriting considerations."¹¹⁵ Immediately after the termination date, the insured tried to find new insurance but was unable to obtain coverage.¹¹⁶ Approximately four months after the policy was terminated, a third party was severely burned by one of the insured's products.¹¹⁷ The injured third party brought a personal injury claim against the insured.¹¹⁸

108. *Id.* at 140.

109. *Id.*

110. *See id.* at 140-41.

111. *Id.* at 141. This application of the doctrine most often arises in liability insurance cases. *Id.*

112. *Id.*

113. 649 A.2d 1296 (N.J. Super. Ct. App. Div. 1994).

114. *Id.* at 1301; *see also* *Keene Corp. v. Ins. Co. of N. Am.*, 667 F.2d 1034, 1041 (D.C. Cir. 1981) (applying the reasonable expectations of an insured in order to determine what triggers coverage for asbestos-related diseases of third-parties).

115. *Harvester*, 649 A.2d at 1298 (quoting the insurer's reason for termination). The policy read as follows: "With respect to the cancellation for any reason other than nonpayment of premium, this policy may be canceled by mailing to the named insured . . . written notice stating when not less than thirty days thereafter, such cancellation shall be effective." *Id.* The insurer claimed that "underwriting reason[s]" constituted "'any' reason" to cancel. *Id.* (quoting insurance policy language).

116. *Id.* The insured manufactured dangerous chemicals. *Id.*

117. *Id.* at 1299.

118. *Id.* The insurer denied coverage for this claim based on the assertion that the policy was terminated. *Id.*

After discussing prevailing public policy and precedent,¹¹⁹ the court asserted that a thirty-day cancellation clause did not "fulfill" the reasonable expectation of the insured because the insured had bargained for one year of coverage.¹²⁰ The court felt "[b]oth the insured . . . and *innocent third-party beneficiaries* . . . depend upon insurers to keep their promises of coverage without resorting to a 'catch-all' safety valve that permits the insurer to arbitrarily withdraw from its promise before the end of the policy term."¹²¹

Further, the court believed that "[n]otice requirements are designed to prevent a lapse in coverage not only for insureds, *but also to protect innocent third parties since lapse of coverage could translate into uncompensated injury that ought rightfully be remunerated.*"¹²² The court remanded the case to determine if the insured had received proper cancellation notice and if so, whether the insurer had an objective and reasonable reason to cancel the policy mid-term.¹²³ Finally, the court noted that if the insured did not receive notice or if no valid reason existed for the cancellation, the insurer would be required to cover the third-party claim.¹²⁴

IV. HOW WISCONSIN APPROACHES THE DOCTRINE OF REASONABLE EXPECTATIONS

Unlike some jurisdictions,¹²⁵ the Wisconsin Supreme Court has not explicitly adopted the doctrine of reasonable expectations. Nevertheless, the following case law illustrates how the court applies the doctrine of reasonable expectations.

119. *Id.* at 1299–1302. The court stated that "[t]he ability to arbitrarily terminate an insurance policy mid-term violates the tenets of good faith . . . required of insurers." *Id.* at 1301.

120. *Id.*

121. *Id.* (emphasis added).

122. *Id.* at 1302 n.8 (emphasis added). The insured's broker had notice of cancellation, but it was unclear whether the insured actually received notice. *Id.* at 1302.

123. *Id.*

124. *Id.*

125. See, e.g., *Max True Plastering Co. v. U.S. Fid. & Guar. Co.*, 912 P.2d 861, 870 (Okla. 1996) (holding "that the doctrine of reasonable expectations may be applicable to the interpretation of insurance contracts in Oklahoma, and that the doctrine may apply to ambiguous contract language or to exclusions which are masked by technical or obscure language or which are hidden in a policy's provisions"). Thirty-eight states "have recognized some variation of the reasonable expectations doctrine." Stempel, *supra* note 19, at 191 (quoting BARRY R. OSTRAGER & THOMAS P. NEWMAN, *HANDBOOK ON INSURANCE COVERAGE* § 1.03(b), at 22 (9th ed. 1998)).

A. Supreme Court of Wisconsin Case Law

1. *Katze v. Randolph & Scott Mutual Fire Insurance Co.*¹²⁶

In the majority of insurance policy interpretation cases, the Wisconsin Supreme Court applies the doctrine of reasonable expectations as a tool of construction to resolve ambiguity.¹²⁷ For example, in *Katze v. Randolph & Scott Mutual Fire Insurance Co.*, the court applied the doctrine as a tool of construction to resolve ambiguity. In *Katze*, a farmer brought an action to recover under the theft provisions of his insurance policy.¹²⁸ The farmer was not paid after he delivered sixty-three cattle to a fraudulent buyer.¹²⁹

The court needed to determine whether the farmer's failed transaction with the fraudulent buyer was a "theft" under the policy and whether the transaction resulted in a direct loss of cattle.¹³⁰ First, the court held that the term "theft" was ambiguous in the policy.¹³¹ After further analysis of the policy's provisions, the court remarked that "[t]here is no plain meaning to the word 'theft.'"¹³² Next, the court

126. 341 N.W.2d 689 (Wis. 1984).

127. See generally *Dowhower v. W. Bend Mut. Ins. Co.*, 613 N.W.2d 557, 565 (2000) (remanding the case to the lower court to determine whether a clause in an underinsured motorist provision was ambiguous, and if so, whether a reasonable person in the position of the insured would have understood the policy to mean that the coverage limit of policy was the maximum recovery allowed); *Peace v. N.W. Nat. Ins. Co.*, 596 N.W.2d 429, 448 (Wis. 1999) (holding that a reasonable insured property owner would believe, based on the terms of the policy, that lead present in paint was a pollutant); *Sprangers v. Greatway Ins. Co.*, 514 N.W.2d 1, 7 (Wis. 1994) (holding that a "reasonable person in the position of the insured would have understood [a store] was in the business of . . . selling . . . [and] serving . . . alcoholic beverages and therefore excluded from coverage") (internal quotations omitted); *Guenther v. City of Onalaska*, 588 N.W.2d 375, 379-80 (Wis. Ct. App. 1998) (holding that a reasonable insured would expect coverage under his insurance policy when sewage backed up into his basement); *Shea v. Haas*, Nos. 99-3330 & 00-0295, 2000 WL 1863568, at *3 (Wis. Ct. App. Dec. 21, 2000) (holding that the "policy is not ambiguous because a reasonable person in the position of the insured would not have understood the terms 'bodily injury arising out of the . . . use [or] occupancy . . . of any motorized land vehicle' to be limited to an insured's use or occupancy" of his vehicle) (alteration in original).

128. *Katze*, 341 N.W.2d at 689. The policy defined "theft" as "any act of stealing . . ." *Id.* at 691.

129. *Id.* at 690. As part of a fraudulent plan, the buyer immediately sold the farmer's cattle upon delivery. *Id.* The buyer was later prosecuted for issuing a worthless check to the farmer. *Id.*

130. *Id.* at 689.

131. *Id.* at 691. The policy's exclusions to the theft provision did not help define the term "theft." *Id.*

132. *Id.* at 692 (quoting insurance policy language). The court believed "theft" was a broad term that included many different acts. *Id.* at 691.

outlined "the rule in resolving ambiguity in insurance contracts"¹³³ as follows:

"In the case of an insurance contract, the words are to be construed in accordance with the principle that the test is not what the insurer intended the words to mean but what a *reasonable person in the position of an insured would have understood the words to mean*. Whatever ambiguity exists in a contract of insurance is resolved in favor of the insured."¹³⁴

After applying this rule, the court held that it was reasonable to believe that "theft" as used in the policy included the farmer's failed transaction with the fraudulent buyer.¹³⁵

However, the court stated that the homeowner's policy insures "against direct loss to the property covered" and believed that the insured's "direct loss" was money, not cattle.¹³⁶ The court noted that "[i]t is not reasonable nor would a reasonable insured contemplate that the theft coverage provided by this farmowner's policy extended to the very substantial credit and business loss risks."¹³⁷ Further, the court opined that "[a] reasonable insured would not have assumed that the policy covered unsuccessful credit transactions in the cattle dealer business."¹³⁸ As such, the court held that the farmer's direct loss was in money, not cattle, and therefore denied coverage.¹³⁹

2. *Gross v. Lloyds of London Insurance Co.*¹⁴⁰

In *Gross v. Lloyds of London Insurance Co.*, the Wisconsin Supreme Court moved beyond using the doctrine of reasonable expectations as a

133. *Id.* at 692.

134. *Id.* (emphasis added) (quoting *Garriguenc v. Love*, 226 N.W.2d 414, 417 (Wis. 1974)). The *Garriguenc* court stated that this test "is a restatement of the general rule that ambiguous contracts are to be construed most strongly against the maker or drafter." *Garriguenc*, 226 N.W.2d at 417.

135. *Katze*, 341 N.W.2d at 692. The court focused on the policy's listed exclusions to theft. *Id.* Because the insurer did not mention fraudulent transactions within its list of exclusions, the court felt the insurer did not intend to exclude fraudulent transactions. *Id.*

136. *Id.* at 693.

137. *Id.*

138. *Id.*

139. *Id.* The court stated that "[t]o hold otherwise would in effect hold that the policy insures the consideration in business transactions or that [the insured] was insured against a lack of prudence in making a bad bargain." *Id.*

140. 358 N.W.2d 266 (Wis. 1984).

rule of construction and applied it to avoid an unconscionable or unfair result.¹⁴¹ In *Gross*, an insured completed a renewal application for aircraft liability insurance.¹⁴² The insurer's renewal application was in the form of a conditional binder.¹⁴³ Before the insurer issued the actual policy, the insured's unoccupied plane broke loose and caused extensive bodily injury to a spectator.¹⁴⁴ The injured party refused to settle and brought suit against the insured and the insurer.¹⁴⁵ According to the terms of a "tendered for settlements" provision in the policy, the insurer wished to pay its policy limit and be relieved of its duty to defend the insured.¹⁴⁶

However, the insured did not have notice of the "tendered for settlements" provision.¹⁴⁷ Although the actual policy did contain the provision, the insurer issued the policy to the insured four days after the accident.¹⁴⁸ Likewise, the binder did not contain the "tendered for settlements" provision.¹⁴⁹ The "tendered for settlements" provision reflected a "substantial change" to the insurer's duty to defend and no other jurisdiction, including Wisconsin, had yet construed a similar provision.¹⁵⁰ Thus, the court had to decide whether the "tendered for settlements" provision was enforceable.¹⁵¹

First, the court discussed its approach by stating that "[w]hen construing language covering an obligation such as the insurer's duty to defend the insured, courts must look to the reasonable expectations of

141. This is consistent with the second approach outlined *supra* Part III.

142. *Gross*, 358 N.W.2d at 268. Under a policy of liability insurance, the insurer has the duty to defend and indemnify the insured. *Id.* at 269. The insurer's duty to defend is broader than the duty to indemnify. ABRAHAM, *supra* note 61, at 511.

143. *Gross*, 358 N.W.2d at 268. A binder gives the insured protection pending investigation and issuance of the actual policy. BLACK'S LAW DICTIONARY 169 (6th ed. 1990). Moreover, "[b]inders are an integral part of the insurance industry, and insureds rely on binders to afford them the same coverage they would have under an issued policy." *Gross*, 358 N.W.2d at 271.

144. *Id.* at 268.

145. *Id.*

146. *Id.* The "tendered for settlements" provision allowed the insurer to terminate its duty to defend once the insurer tendered the policy limits for settlement. *Id.* at 269.

147. *Id.* at 269. The original liability policy that the insured wished to renew was not made part of the record. *Id.*

148. *Id.* at 268 n.4.

149. *Id.*

150. *Id.* at 269-70. In 1966, insurers revised standard form liability insurance policies to clarify when their duty to defend the insured had been satisfied. *Id.* at 270. However, the court felt that the "tendered for settlements" provision "is a further revision in the language of liability insurance policies which first appeared [in 1966]." *Id.*

151. *Id.* at 269.

the insured.¹⁵² The court noted that the insurer did not highlight the new "tendered for settlements" language in the policy.¹⁵³ As a result, the court believed the insurer did not give the insured notice that it changed its 1966 standard liability policy language with respect to its duty to defend.¹⁵⁴ The court opined that "[w]e believe the reasonable expectations of insureds would be that the policy language in use by the [insurance] industry since 1966 would be present in new policies unless they were specifically given notice of a change."¹⁵⁵ Moreover, the court noted that "[b]ecause the binder was silent concerning [the insurer's] obligation to defend, the reasonable expectation of an insured would be that the standard industry practice would apply."¹⁵⁶ Ultimately, the court held that the insurer had a duty to defend the insured even though it tendered a settlement equal to the policy limits.¹⁵⁷

The holding in *Gross* supports the court's willingness to apply the doctrine of reasonable expectations to avoid "unconscionable" results and avoid both "procedural unfairness" and "structural unfairness in insurance policies."¹⁵⁸

152. *Id.* at 271 (citing *Kocse v. Liberty Mut. Ins. Co.*, 387 A.2d 1259 (N.J. Super. Ct. Law Div. 1978)).

153. *Id.* The insurer simply added the "tendered for settlements" provision to the end of a sentence. *Id.*

154. *Id.*

155. *Id.*

156. *Id.* However, one could argue that a reasonable insured would not believe that standard industry practice would govern the interpretation of his policy. For example, if a "reasonable insured" was asked whether *the specific terms of his insurance policy* would apply or whether standard industry language would apply to a coverage determination *under his policy*, he would more likely "reasonably expect" that *his own policy's language* would control. Thus, the court's reasoning turns on what a reasonable insured believes or expects, but does not elaborate on who or what is a "reasonable insured." For a discussion of this issue, see *infra* Part V.

157. *Id.* Although the court did not relieve the insurer from its duty to defend, this decision did contain a silver lining for insurers. The court discussed methods by which the insurance company could be relieved of its duty to defend in the future. *Id.* First, new policy language, such as "the 'tendered for settlements' language must be highlighted in the policy and binder by means of conspicuous print, such as bold, italicized, or colored type, which gives clear notice to the insured . . ." *Id.* Moreover, "[i]n cases where the insurer issues a binder and the policy to be issued will contain the 'tendered for settlements' language, the binder must also contain that language in conspicuous print, and the insured must be furnished with a copy of the binder." *Id.* at 272-73. Thus, the court allowed insurers to adopt this new language regarding an insurer's duty to defend, but stressed that the insured *must* have notice of the changes.

158. See *supra* Part III.B (discussing procedural and structural unfairness).

3. *Theis v. Midwest Security Insurance Co.*¹⁵⁹

In *Theis v. Midwest Security Insurance Co.*, the Wisconsin Supreme Court applied the doctrine of reasonable expectations to promote the purpose of uninsured motorist insurance.¹⁶⁰ In *Theis*, an insured was driving a truck on a highway when an unidentified truck passed him on the right.¹⁶¹ After the unidentified truck passed the insured's truck, the insured saw a dark object flying toward his windshield.¹⁶² The object smashed through the windshield of the insured's truck and injured the insured.¹⁶³

The passing truck caused the object to hit the insured's windshield, but it was unclear whether the object originated from the passing truck or another unidentified vehicle.¹⁶⁴ The insured sought coverage under the uninsured motorist provision of his policy, but the insurer denied coverage.¹⁶⁵ The insured then brought a declaratory judgment action

159. 606 N.W.2d 162 (Wis. 2000).

160. "The primary purpose of the uninsured motorist statute is to compensate an injured person . . . to the same extent as if the uninsured motorist were insured." *Id.* at 167. Moreover, this application of the doctrine of reasonable expectations is consistent with *Wood v. American Family Ins.*, as discussed *supra* Part III.

161. *Id.* at 163-64.

162. *Id.* at 164. The insured first saw this debris when the back of the passing truck was about thirty feet ahead of the insured's truck. *Id.*

163. *Id.*

164. *Id.* The object was found to be a leaf spring, which is part of a truck's suspension. *Id.*

165. *Id.* The insurer claimed that the insured's injury was not covered by the uninsured motorist provision. *Id.* The court cites the relevant part of the policy as follows:

PART C - UNINSURED MOTORISTS COVERAGE

Insuring Agreement

A. We will pay compensatory damages which an "insured" is legally entitled to recover from the owner or operator of an "uninsured motor vehicle" because of a "bodily injury":

1. Sustained by an "insured"; and

2. Caused by an accident

C. "Uninsured motor vehicle" means a land motor vehicle or trailer of any type:

. . . .

3. Which is a hit-and-run vehicle whose operator or owner cannot be identified and which hits:

a. You or any "family member"

b. A vehicle which you or any "family member" are "occupying"; or

c. "Your covered auto".

Id. at 164 n.2 (alterations in original).

seeking to determine that he had coverage for the accident.¹⁶⁶

The court had to determine whether Wisconsin's uninsured motorist statute compelled the insurer to provide coverage to the insured.¹⁶⁷ More specifically, the court had to determine whether a piece of an unidentified motor vehicle that comes into physical contact with an insured's vehicle satisfies a "hit" under the terms of the statute.¹⁶⁸ The court found that the language of the uninsured motorist statute, relevant case law, and the legislative history did not "mandate[]" a decision of this issue.¹⁶⁹ As such, the court looked to three legislative purposes behind the uninsured motorist statute and its language in order to "discern legislative intent."¹⁷⁰

166. *Id.* at 164. If the court deemed the insured to be covered, the insured could then proceed with arbitration under the terms of the policy. *Id.*

167. *Id.* at 165. Section 632.32(4) of the Wisconsin Statutes requires insurers to provide uninsured motorist coverage. The relevant part of the statute reads as follows:

(4) REQUIRED UNINSURED MOTORIST AND MEDICAL PAYMENTS COVERAGES. Every policy of insurance subject to this section that insures with respect to any motor vehicle registered or principally garaged in this state against loss resulting from liability imposed by law for bodily injury or death suffered by any person arising out of the ownership, maintenance or use of a motor vehicle shall contain therein or supplemental thereto provisions approved by the [insurance] commissioner:

(a) *Uninsured motorist.* 1. For the protection of persons injured who are legally entitled to recover damages from owners or operators of uninsured motor vehicles because of bodily injury . . . in limits of at least \$25,000 per person and \$50,000 per accident.

2. In this paragraph "uninsured motor vehicle" also includes:

....

b. An unidentified motor vehicle involved in a hit-and-run accident.

WIS. STAT. § 632.32(4) (1999–2000). If a statute requires insurance coverage, courts compel coverage even if the terms of a particular policy do not provide coverage or exclude coverage. *Theis*, 606 N.W.2d at 165 (citing *Hayne v. Progressive N. Ins. Co.*, 339 N.W.2d 588, 590 (Wis. 1983)).

168. *Theis*, 606 N.W.2d at 165. The court found that the first and third elements of the uninsured motorist statute were satisfied: (1) An unidentified motor vehicle caused the harm, and (3) the unidentified motor vehicle fled the scene. *Id.*

169. *Id.* at 167.

170. *Id.* The court stated two other purposes underlying the uninsured motorist statute: First, the court discussed the "primary purpose" of compensating injured persons. *Id.* Second, the court discussed the purpose of the phrase "hit-and-run accident" within the statute. *Id.* at 168. The legislature did not define "hit" or "hit-and-run" as used in the statute. *Id.* at 166. The Legislative Council Note states that "[a] precise definition of hit-and-run is not necessary for in the rare case where a question arises, the court can draw the line." *Id.* at 166 n.3. Wisconsin courts have drawn the line and interpret this phrase as requiring "physical contact between the insured and the unidentified motor vehicle [in order to avoid] fraudulent claim[s]." *Id.* at 168. However, the court thought that "it seems unlikely that future claimants

During this analysis, the court found that "[another] purpose of the [uninsured motorist] statute is that the reasonable coverage expectations of an insured should be honored."¹⁷¹ The court examined the court of appeals' analysis of the policy language and the insured's reasonable coverage expectations.¹⁷²

The court of appeals concludes that *because the insurance policy promises to pay compensatory damages for injuries an insured suffers "arising out of the ownership, maintenance or use" of an uninsured motor vehicle, a reasonable insured would expect coverage when an unidentified motor vehicle propels a detached piece of an unidentified motor vehicle into the insured's vehicle.*¹⁷³

will be able to fraudulently assert that a piece from an unidentified motor vehicle was propelled into their vehicle by an unidentified motor vehicle." *Id.* Thus, the court believed that the "policy of preventing fraud[]" was not present in the case. *Id.*

171. *Id.* In support of this proposition, the court cites three authorities. *Id.* at 168 n.9. First, the court cites *Kremers-Urban Co. v. Am. Employers Ins. Co.*, 351 N.W.2d 156 (Wis. 1984). *Theis*, 606 N.W.2d at 168 n.9. See *infra* notes 177-91 and accompanying text for a detailed discussion of this case. Second, the court cites *Handal v. Am. Farmers Mut. Cas. Co.*, 255 N.W.2d 903, 908 (Wis. 1977). *Theis*, 606 N.W.2d at 168 n.9. This cite mystifies the author. The court in *Handal* applied Iowa law when it interpreted the insurance policy at issue. *Handal*, 255 N.W.2d at 906 (stating that "the trial court correctly concluded that the law of Iowa controls"). In *Handal*, the court focused on the reasonable expectations of the named insured and her son. *Id.* at 908. The court documented a series of letters sent between the named insured's husband and the automobile insurer regarding coverage for the insured's son. *Id.* Although the court held one of the letters to be ambiguous, the court believed that "[a]n average reasonable person could understand [the ambiguous sentence] to mean that [the son] was protected by the policy." *Id.* at 907. After this correspondence, the son was involved in an automobile accident in Wisconsin. *Id.* The insurer denied coverage because the named insured did not notify the insurer that the insured's car was kept in Wisconsin. *Id.* at 908. However, the court held that the insurer could not deny coverage because

[t]he public policy which supports such a holding has been described as the principle of honoring reasonable expectations. This principle states that "objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations."

Id. (citing ROBERT E. KEETON, *INSURANCE LAW—BASIC TEXT* (1971)). Assuming the court's citation to *Handal* supports its agreement with Iowa's rules of insurance policy interpretation, the court would seem to have adopted Keeton's stronger approach to the doctrine of reasonable expectations. See *supra* Part II for a discussion of Iowa's approach to the doctrine of reasonable expectations before 1981; see also *supra* notes 21-29. However, whether the Wisconsin Supreme Court adopts this stronger version remains unclear because, as noted earlier, it most often applies the doctrine of reasonable expectations as a rule of insurance policy interpretation to resolve ambiguity. See *supra* Part IV.A.1. Third, the court cites *Patrick v. Head of Lakes Coop. Elec. Ass'n*, 295 N.W.2d 205 (Wis. Ct. App. 1980).

172. *Theis*, 606 N.W.2d at 168.

173. *Id.* (emphasis added) (quoting insurance policy language).

The Wisconsin Supreme Court agreed with this reasoning.¹⁷⁴ Relying on this purpose and the other two purposes of the statute,¹⁷⁵ the court held that the uninsured motorist statute "requires that the uninsured motorist clauses of an insurance policy provide coverage when a detached piece of an unidentified motor vehicle is propelled into the insured's motor vehicle by an unidentified motor vehicle."¹⁷⁶

4. *Kremers-Urban Co. v. American Employers Insurance Co.*¹⁷⁷

The Wisconsin Supreme Court decision of *Kremers-Urban Co. v. American Employers Insurance Co.* applied the doctrine of reasonable expectations to protect the interests of third parties.¹⁷⁸ In *Kremers*, a pharmaceutical manufacturer brought a declaratory judgment action to determine whether its liability insurer had the obligation to defend and indemnify the manufacturer from product liability claims.¹⁷⁹ The pharmaceutical company manufactured and marketed stilbestrol, or diethylstilbestrol, also referred to as DES.¹⁸⁰ Daughters of mothers who had taken DES during pregnancy sued the pharmaceutical company.¹⁸¹

In order to determine whether the manufacturer had liability coverage from 1954 to 1974, the court needed to construe five different comprehensive general liability (CGL) policies that had been in effect

174. *Id.* But see *Smith v. Gen. Cas. Ins. Co.*, 619 N.W.2d 882, 888 (holding the "reasonable expectation of the insured regarding the language . . . is not relevant to our analysis of Wis. Stat. § 632.32(4)(a)2.b") (emphasis added). Similar to *Theis*, the court in *Smith* determined whether the 1993–1994 uninsured motorist statute required coverage when an unidentified hit-and-run vehicle hits an intermediate vehicle, and the intermediate vehicle then hits the insured. *Smith*, 619 N.W.2d at 883. Relying on *Theis*, both parties claimed that the court should consider the policy of honoring the reasonable expectations of the insured. *Id.* at 887. However, the court opined that "[t]he public policy purpose of honoring the reasonable expectations of the insured is applied when the language of an insurance contract is interpreted and construed. . . . The question to be decided here . . . is not the construction of the policy, but what the [statute] requires." *Id.* at 887–88 (emphasis added) (citing *Kremers-Urban Co. v. Am. Employers Ins. Co.*, 351 N.W.2d 156 (Wis. 1984)). The court decided *Smith* approximately ten months after it decided *Theis*. *Id.*

175. See *supra* note 170 and accompanying text.

176. *Theis*, 606 N.W.2d at 170.

177. 351 N.W.2d 156 (Wis. 1984).

178. *Id.* at 168. This approach is consistent with the fourth approach outlined *supra* Part III.

179. *Id.* at 159.

180. *Id.* at 158. Physicians prescribed DES to pregnant women to prevent certain birth related complications and estrogen deficiencies. *Id.*

181. *Id.* at 158–59. The plaintiffs filed forty-nine claims in sixteen different states. *Id.* at 159.

over this period.¹⁸² Specifically, the court had to determine if "there was an 'occurrence' within the meaning of the various policy provisions, at a time the policies were in force."¹⁸³

In one of the policies, the insurer agreed:

"To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of:

"Coverage B—Bodily Injury Liability—Except Automobile

"bodily injury, caused by an occurrence, sustained by any person."

"Occurrence" was defined in this policy to mean:

"(1) an event, or continuous or repeated exposure to conditions, or (2) an accident, which *causes* bodily injury or property damage during the policy period, which is neither expected nor intended by the insured"¹⁸⁴

The court analyzed this provision and believed "[c]overage is predicated . . . upon the event or accident *which occurred during the policy period*."¹⁸⁵ The court remarked that "[a]lthough the event or accident which causes the bodily injury must occur during the policy period, *there is no provision that bodily injury must result during that period*."¹⁸⁶ Thus, the court asserted that coverage would be triggered if an event or accident had occurred during the policy period that caused bodily injury.¹⁸⁷

In contrast, the insurer argued "that the phrase, 'during the policy period,' modifies the phrase, 'bodily injury,' and not the words, 'event' or 'accident.'"¹⁸⁸ According to the insurer, only bodily injury occurring

182. *Id.* at 159. Adding to the court's task, each of these policies contained different language in their coverage provisions. *Id.* After 1966, liability insurers began using the word "occurrence" rather than "accident" as the trigger of coverage. *See id.* at 166. The purpose of this change was to expand coverage. *Id.*

183. *Id.* at 163 (quoting insurance policy language).

184. *Id.* at 165 (alteration in original). This policy was in effect from March 16, 1966 to March 16, 1968. *Id.*

185. *Id.* (emphasis added).

186. *Id.* (emphasis added).

187. *Id.* Essentially, the court believed the phrase "during the policy period" modified the words "event" or "accident," not the phrase "bodily injury." *Id.*

188. *Id.* (quoting insurance policy language). The insurer also argued that the phrase "which causes bodily injury or property damage" would be rendered superfluous by the court's interpretation. *Id.* (citations omitted).

during the policy period triggered coverage.¹⁸⁹ The court replied to the insurer's argument as follows:

To accept such a *contorted construction* of the policy language is to deviate from our mandate to construe policies as would a reasonable insured. A reasonable insured would understand that the phrase, "during the policy period," modifies when the occurrence (event or accident) must take place in order that coverage under the policy be invoked. . . . There is no indication when the bodily injury must result—only that the event or accident which caused the bodily injury or property damage must happen during the policy period.

. . . .

A reasonable insured in the position of [the manufacturer] would have understood that the ingestion of DES by pregnant mothers and [the manufacturer's] marketing activities are events or accidents which, if they allegedly happened during the policy period and subsequently caused bodily injury, would trigger coverage and [the insurer's] obligation to defend and pay on behalf of [the manufacturer] all sums which it shall be obligated to pay.¹⁹⁰

As a result of this reasoning, the court held that an injury-causing event or accident during the policy period triggered coverage in the policies issued from 1966 to 1968.¹⁹¹

B. Which Approach Has Evolved in Wisconsin?

As *Katze*, *Gross*, *Theis*, and *Kremers* make clear, the Wisconsin Supreme Court applies the doctrine of reasonable expectations under all four of the approaches used by other courts.¹⁹² Further, the court's application of all four approaches makes it difficult to determine which

189. *Id.*

190. *Id.* at 165–66 (emphasis added). The *Kremers* court also cited *Handal* in its discussion of the rules of insurance contract interpretation. The court stated that "[t]he reasonable expectations of coverage of the insured should be furthered by the interpretation given." *Id.* at 163 (citing *Handal v. Am. Farmers Mut. Cas. Co.*, 255 N.W.2d 903 (Wis. 1997)). As noted earlier, the court in *Handal* applied Iowa law when it construed the insurance policy at issue. See *supra* Part IV.A.3 n.171 for a discussion of this issue. Unlike Wisconsin, Iowa has explicitly adopted the doctrine of reasonable expectations. See *supra* Part II.

191. *Kremers*, 351 N.W.2d at 166.

192. See *supra* Part III for a discussion of the four approaches to the doctrine of reasonable expectations.

approach the court will apply in any particular case. Indeed, how the court approaches the doctrine has puzzled at least one Justice. In *Gross*, Justice Abrahamson agreed with the majority's invocation of the doctrine, but stated that "[t]he majority's application of the principle of reasonable expectations is not entirely clear. The principle has more than one meaning."¹⁹³ Thus, according to one Justice, confusion exists regarding how the court will apply the doctrine of reasonable expectations.

However, in the overwhelming majority of cases, the court applies the doctrine of reasonable expectations as a tool of construction to resolve ambiguity.¹⁹⁴ In *Katze*, the court relied on the presence of ambiguity to invoke the doctrine of reasonable expectations.¹⁹⁵ The court limited the application of the insured's reasonable expectations to what a particular term or clause meant and did not extend the doctrine to promote fairness,¹⁹⁶ the purpose of insurance,¹⁹⁷ or to protect third parties.¹⁹⁸

In others words, the court did not interject its own coverage expectations into the interpretation of the policy. The court focused solely on the language of the policy and determined what a *reasonable person in the position of an insured would have understood the words to mean*.¹⁹⁹ This "ambiguity" approach to the doctrine of reasonable expectations represents the better approach because it confines the court to its traditional role of interpreting the bargain struck between the insured and insurer.

V. WHY THE WISCONSIN SUPREME COURT SHOULD FOLLOW *KATZE* AND LIMIT ITS APPLICATION OF THE DOCTRINE OF REASONABLE EXPECTATIONS TO A TOOL OF CONSTRUCTION

Gross, *Theis*, and *Kremers* illustrate some of the criticism surrounding the doctrine of reasonable expectations. These criticisms include judicial manipulation of clear policy language, misplaced assumptions regarding the insurance bargaining process, judicial

193. *Gross v. Lloyds of London Ins. Co.*, 358 N.W.2d 266, 272 n.1 (Wis. 1984) (Abrahamson, J., concurring) (citing *Rodman v. State Farm Mut. Auto Ins. Co.*, 208 N.W.2d 903, 905-08 (Iowa 1973)).

194. *See supra* note 129.

195. *Katze v. Randolph & Scott Mut. Fire Ins. Co.*, 341 N.W.2d 689, 691 (Wis. 1984).

196. *Gross*, 358 N.W.2d at 271.

197. *Theis v. Midwest Security Ins. Co.*, 606 N.W.2d 162, 168 (2000).

198. *Kremers-Urban Co. v. Am. Employers Ins. Co.*, 351 N.W.2d 156, 166 (Wis. 1984).

199. *Katze*, 341 N.W.2d at 692.

overreaching, and increased premium costs.²⁰⁰

In *Gross*, the court relied heavily on the insured's knowledge of standard insurance industry practice and language in order to find coverage.²⁰¹ In addition to ignoring the policy's unambiguous language, the court assumed that the insured actually read and *understood* his old policy. According to the court's analysis, the insured specifically knew and understood the standard 1966 coverage provisions.²⁰²

However, most insureds do not read, yet even understand their insurance policies.²⁰³ If most insureds do not read their policies, then they have no "reasonable expectations" of coverage from the policy language. The "reasonable expectations of the insured" thus becomes a legal fiction where the court inserts its own expectations of coverage. This approach may fairly be characterized as judicial overreaching.

In a similar vein, *Theis* also illustrates judicial overreaching. In *Theis*, the court granted coverage under an uninsured motorist provision by relying on the purpose of uninsured motorist insurance and the policy's language.²⁰⁴ A "reasonable insured" would not have expected coverage when struck by a *piece* of an uninsured motor vehicle because the policy clearly defined "uninsured motor vehicle" as a "*motor vehicle or trailer of any type*."²⁰⁵ In addition to applying Iowa law,²⁰⁶ the court simply interjected its own expectations of what the policy and the uninsured motorist statute should cover. The court strayed from its traditional role and no longer umpired the bargain struck between the insurer and insured. By analyzing the purpose of the insurance transaction and determining what should be covered, the court therefore arguably took on the role of a legislative body.

Likewise, the *Kremers* decision represents judicial manipulation of clear insurance contract language.²⁰⁷ The court's conclusion that "during the policy period" modified "event or accident" stretches the reasonable

200. See generally Rahdert, *supra* note 1, at 115-44 (discussing objections to the four approaches of the doctrine of reasonable expectations); see also Ware, *supra* note 51, at 1468 (arguing that the doctrine of reasonable expectations should be abandoned).

201. See *supra* Part IV.A.2 for a discussion of the case. Indeed, Justice Abrahamson wanted to remand the case to determine exactly what the insured knew and expected from his aviation policy. *Gross*, 358 N.W.2d at 272 n.1 (Abrahamson, J., concurring).

202. See *Gross*, 358 N.W.2d at 271.

203. Ware, *supra* note 51, at 1479.

204. *Theis v. Midwest Security Ins. Co.*, 606 N.W.2d 162, 170 (Wis. 2000).

205. See *supra* note 167 for a relevant portion of the policy.

206. See *supra* note 173.

207. See *supra* Part IV.A.4 for a discussion of this case.

insured test to an unworkable position.²⁰⁸ Contrary to the court's assertion, a reasonable insured would not agree with the court's interpretation of the policy because the policy *did* indicate that bodily injury must have occurred "during the policy period."²⁰⁹ Indeed, the insurer would have been hard pressed to draft a clearer coverage provision.²¹⁰

Ironically, the *Kremers* court discussed its role regarding the interpretation of insurance policy language. After discussing that the insurer should have used more limiting language regarding what types of events or accidents trigger coverage, the court noted "[we] will not rewrite the contract to create a new contract to release the insurer from a risk it could have avoided through a more foresighted drafting of the policy."²¹¹ Nevertheless, the court did not hesitate to "rewrite" the 1966 to 1968 policy to bind the insurer to risks that it arguably avoided through its drafting. The *Kremers* court firmly believed that freedom of contract was subservient to the protection of third parties. Thus, it is the supreme court who "contorted" the true meaning of the policy provision and essentially eviscerated the bargain struck between the parties.²¹²

VI. CONCLUSION

The doctrine of reasonable expectations is a principle that relies on the objectively "reasonable expectations of the insured" as a guide in insurance contract interpretation.²¹³ Under the doctrine of reasonable expectations, courts often grant coverage to an insured *even when the express language of the policy does not provide coverage.*²¹⁴

The Supreme Court of Wisconsin has applied four different approaches to the doctrine of reasonable expectations. In the majority of cases, the court has applied the doctrine as a tool of construction to resolve ambiguity. This represents the best approach because it confines the court to its traditional role of interpreting the bargain struck between the insured and insurer. As such, the court should

208. *Kremers-Urban Co. v. Am. Employers Ins. Co.*, 351 N.W.2d 156, 165 (Wis. 1984).

209. *Id.* The court noted that "[t]here is no indication when the bodily injury must result—only that the event or accident which caused the bodily injury or property damage must happen during the policy period." *Id.*

210. *See supra* note 185 and accompanying text for relevant policy language.

211. *Kremers*, 351 N.W.2d at 167 (emphasis added).

212. *See id.* at 165. The court characterized the insurer's interpretation of the policy as "contorted." *Id.*

213. Rahdert, *supra* note 1, at 108.

214. *Id.*

continue to limit its application of the doctrine of reasonable expectations to a rule of construction to resolve ambiguity.

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