The Reasonable Expectations Doctrine in Massachusetts Insurance Law

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Several recent Massachusetts appellate cases have signaled that the doctrine of "reasonable expectations" has been adopted as a rule of construction in insurance policy coverage disputes. Under this doctrine a court will construe a policy in accordance with the reasonable exceptations of the insured even if those exceptations are contrary to the ambiguous language of the policy.

Massachusetts court decisions have not yet, however, clarified whether the determination of reasonable expectations is a question of law or a question of fact. A related issue is whether a "subjective" as opposed to an "objective" standard will be used to evaluate reasonable expectations. Finally, the courts have not clarified which party — the insured or the insurer — has the burden of proof on these questions. This article addresses these issues in view of recent case law in Massachusetts and in other states.

A. Reasonable Expectations Doctrine as a Question of Law or a Question of Fact.

One of the earliest cases to consider the doctrine in Massachusetts was *Markline Company, Inc. v. Travelers Insurance Company*, 384 Mass. 139 (1981). In that case, the Supreme Judicial Court stated that "we are not prepared to make this the first case in which this court adopts such approach to the purchase of insurance." The Court went on to rule that even if the doctrine of reasonable expectations was applied in that case to a dispute arising under a commercial property insurance policy, the insured would still not recover. The Court cited the Restatement (Second) of Contracts as authority for the proposition that reasonable expectations should be determined from "prior negotiations" between the parties or "inferred from the circumstances." Additional relevent factors included whether a particular policy term is "bizarre or oppressive, from the fact that it eviscerates the non-standard terms explicitly agreed to, or from the fact that it eliminates the dominant purpose of the transaction." Also significant is whether the insured read the policy provision or if the term was illegible or hidden from view.

In the *Markline* decision, Justice Liacos wrote vigorous dissent in which he urged the explicit adoption of the reasonable expectations doctrine. Three years later, in the case of *Bond Brothers, Inc. v. Robinson*, 393 Mass. 546 (1984), both Justice Liacos and Justice Abrams dissented in a case involving coverage under a contractor's general liability policy. They urged that the doctrine of reasonable expectations should apply and should overcome an express policy provision which precluded coverage for a claim arising from faulty workmanship. The majority opinion written by Justice Wilkins noted that:

> in any analysis of the coverage of an insurance policy, it may be appropriate to consider what a policyholder reasonably should expect his coverage to be in the circumstances.

Following this statement, however, the Court equivocated by noting that "we have not yet explicitly adopted such an approach to the interpretation of an insurance policy." Still, the Court went on to reason that even if the reasonable expectations doctrine applied, it would not overcome the policy language in dispute.

Despite the equivocal language of Justice Wilkins in the *Bond Brothers* decision, the following year the Court, with Justice Wilkins again writing the opinion, expressly cited the reasonable expectations doctrine in support of its decision in *Home Indemnity Insurance Company v. Merchants Distributors, Inc.*, 396 Mass. 103 (1985). In that case the Court reversed a decision of a divided Appeals Court, which had found in favor of an insurer on a workman's compensation policy coverage question. The Court based its holding on a finding that a "reasonable insured" would not have expected the coverage position taken by the insurer. The Court cited nothing in the record to support this conclusion as to the coverage expectations of the insured contractor.

The next year, the Court again relied on the reasonable expectations principle in ruling against a homeowner's policy insurer in the case of *Worcester Mutual Insurance Company v. Marnell*, 398 Mass. 240 (1986). The *Marnell* case answered the question of whether a homeowner's insurance policy provided coverage to parents who negligently supervised their teenage son, who was involved in a car accident following a night of drinking at the family's home. Although the Court conceded that the "motor vehicle" exclusion in the policy was unambiguous and, by its terms, excluded such coverage, the Court reasoned that the insureds would "reasonably expect to be protected by their homeowner's policy" for claims arising from activities in their home. The Court found that this expectation reflected the "main manifested design" of the parties to the insurance agreement.

The difficulty with the *Marnell* decision is that it treated the reasonable expectations issue as one of law rather than one of fact. There was nothing in the record before the Court as to the education of knowledge of the insured or the manner in which the policy had been marketed. Furthermore, the Court did not criticize the "easy-to-read" homeowner's policy form as containing a "fine print" exclusion. Apparently, the Court determined what the Marnells' reasonable expectations were merely from examining the policy itself.

In a recent comment on the reasonable expectations doctrine by the Supreme Judicial Court, the Court noted in dicta that "if a reasonable policy holder thought about the subject at all it probably would have assumed (certain excess coverage) merely by looking at its insurance policy." *Massachusetts Insurers Insolvency Fund v. Continental Casualty Company*, 399 Mass. 598, 600 (1987). The Court ruled, however, that the reasonable expectations doctrine did not apply because the excess policy in question was ambiguous as to whether it would drop down to provide first dollar coverage in the event of the insolvency of the scheduled primary carrier.

Justice O'Connor criticized this analysis of the reasonable expectations doctrine in his dissenting opinion and stated that there had been "no showing that the 'structure, content, manner of printing of the (insurance contract), or the methods and practices of marketing . . . creat(ed) reasonable expectations of a (greater area) of coverage.' " Justice O'Connor took the quoted language from the recent Appeals Court decision in the case of *Jefferson Insurance Company v. Holyoke*, 23 Mass. App. Ct. 972 (1987). In that case the Appeals Court took a different approach to the application of the reasonable expectations doctrine although the Court initially pointed out that "the (reasonable expectations) doctrine does not appear to have been explicitly adopted in Massachusetts." The Court did, however, analyze the insurance coverage question under the reasonable expectations doctrine and concluded that the lower court ruling in favor of the insurer would not differ.

The analysis in the *Holyoke* opinion focused on whether there was a factual showing to support the claim of reasonable expectations. The Appeals Court ruled that the insured, the City of Holyoke, had not made a showing that the form of the policy or the manner of marketing the policy would have created an expectation of coverage. The Court noted

that the city law department had reviewed the insurance contract and cited that as evidence against the reasonable claim.

Despite the Court's reliance on the reasonable expectations doctrine in the *Marnell* and *Continental Casualty Company* cases, the Court recently suggested in a rescript opinion construing underinsured motorist coverage that the adoption of the doctrine is still in doubt.

> Whatever form, if any, the principle of a policyholder's reasonable expectations may ultimately assume in this Commonwealth . . . it can have no application here. The insurer did not write the policy. The policy language is reasonably clear that stacking is not allowed. We have no evidence of any expectations of the insured, who was the plaintiff's father, nor do we have any indication whether any expectations he may have had were reasonable. *Moore v. Metropolitan Property and Liability Insurance Company*, 401 Mass. 1010 (1988).

In the most recent Appeals Court decision involving the reasonable expectations doctrine, *Commerce Insurance Company v. Koch*, 25 Mass. App. Ct. 383 (1988), the Court cited the doctrine in support of its decision upholding coverage for an insured under an automobile policy. The Court cited no basis for its conclusion other than a cyncial comment on the suspected motivation of the insurer.

> The policyholders would expect protection up to the limits shown on the policy in the event of casualty . . . ; in our judgment, policyholders would regard it as an unfair deal, foisted upon them by corporate guile, for the insurer to be able to renounce all liability on its own policy because of the adventious fact that owner's insurance was lacking." *Id.* at 386.

In the *Koch* case the Appeals Court did not express any reservations about the acceptance of the reasonable expectations doctrine in Massachusetts and instead cited the language in the *Bond Brothers* decision that "in any analysis of the scope of coverage in an insurance, it may be appropriate to consider what a policyholder should expect his coverage to be in the circumstances." *Bonds Brothers v. Robinson*, 393 Mass. 546, 551 (1984).

In contrast to the *Koch* decision, the analytical approach in the *Holyoke* case is consistent with the discussion in the seminal *Markline* case where the Supreme Judicial Court had listed the factors relevant to determining an insured's reasonable expectations. Nevertheless, the Supreme Judicial Court decided the *Home Indemnity* and *Marnell* cases without the benefit of a factual record relating to the reasonable expectations claim. For all the Court in *Marnell* knew, the insured may have been an attorney knowledgeable in the area of insurance law who may have had no expectation of the coverage which the Court read into the policy.

In *Marnell* there was no evidence in the record as to what coverage information had been given to the insured by his own insurance agent. Instead, the Court rather simplistically reasoned that since it was a homeowner's policy the insured would reasonably expect coverage for events occurring in the home. This reasoning is erroneous because the liability coverage of the standard homeowner's policy is not confined to liabilities arising from events in the home. It is a general liability policy offered in conjunction with property coverage on residential premises. Moreover, there are a number of liabilities that might occur in the home that are excluded from the coverage under the homeowner's policy. Indeed, the situs of the occurrence or negligent act is largely irrelevant to coverage under homeowners' liability policies. But under the Court's reasoning in *Marnell*, the fact that the word *home* apppears in the policy description gives rise to an expectation of coverage nowhere to be found in the policy language.

It is unfair to insurers for a Court to reach conclusions about an insured's reasonable expectations based only on a review of the policy especially if the policy provisions in question are conspicuous and unambiguous. The analytical approach in the *Holyoke* decision is preferable because it looks to the facts concerning the insured's knowledge and sophistication at the time of the purchase of the policy as well as the form of the policy and the method of marketing the policy.

B. Burden of Proof

If Massachusetts courts decide that the application of the reasonable expectations doctrine is an issue of fact, they then must decide who has the burden of proving whether the doctrine should apply. Several other jurisdictions have addressed this burden of proof issue. The Supreme Court of California ruled in *Smith v. Westland Life Insurance Company*, 539 P.2d 433 (Cal. 1975), that in order to overcome a reasonable expectations claim a life insurer had the burden of proving either that it had called a limiting condition in a policy to the attention of the applicant or that the applicant had actually read the policy provision. This holding may be limited to the facts of that case since it involved a temporary life insurance binder, subject to avoidance if the insured failed a background check. In that case the insured died before the company formally notified him that the policy was canceled and refunded his premium.

In *Estrin Construction Company, Inc. v. Aetna Casualty and Surety*, 612 S.W.2d 41[illegible] (Mo. App. 1981), a Missouri appellate court stated that where there was an ambiguous policy exclusion the insured would be entitled to prove that the insured, in fact, had no expectation of coverage. This placement of the burden of proof seems fair where there is an ambiguity in the policy. In the absence of an ambiguity, however, the insured should have the burden of proving that his reasonable expectations were sufficiently compelling to defeat the policy language.

C. Objective or Subjective Standard

A secondary issue to the question of whether the determination of reasonable expectations is a question of law for the Court or a question of fact, is the question of whether reasonable expectations should be measured by a "subjective," as opposed to an "objective," standard. A leading proponent of the doctrine, Judge Robert Keeton, argued in his *Insurance Law* text that the doctrine should apply if the "average" insured would have had such expectations even if a particular insured with special knowledge was familiar with the coverage exclusion and had no expectations of coverage. R. Keeton, Insurance Law 357–58 (1971). This application of the doctrine was adopted by the New Hampshire Supreme Court in the case of *Karol v. New Hampshire Insurance Company*, 414 A.2d 939 (N.H. 1980), where the Court ruled that the "intelligence and knowledge" of the insured was not to be considered in applying the reasonable expectations doctrine. In the *Karol* case the insurer was an attorney who purchased a commercial property policy and had in fact read the policy prior to the property loss.

This objective standard, however, while having the virtue of consistency, is no easier to apply in a given case, and works an inequity on one of the contracting parties. The insurance relationship is, after all, a contractual one and the function of a court should be to determine the intentions of the parties as set forth in the written agreement. It is not unfair to apply an objective standard to the issue of what is reasonable for the insured to have expected. But the threshold question of whether the insured had an expectation of coverage should be determined by a subjective standard based on the facts of each case. The reasonable expectations doctrine is based on the idea that an insured should get the coverage that he believed he was buying. By using a subjective standard at the threshold, this goal is satisfied. By allowing an insured with special knowledge or special expertise to have his expectations determined by a lesser, objective standard such an insured would obtain coverage beyond what he intended to buy. Thus, the in-

sured should have the burden of proving both that he had a subjective expectation of coverge and that such an expectation was reasonable from an objective standpoint.

In the majority of decisions in other jurisdictions courts have decided the reasonable expectation issue after a consideration of the facts of the particular case. For example, the Minnesota Supreme Court recently held in *Atwater Creamery Company v. Western Mutual Mortgage Insurance Company*, 366 N.W.2d 271 (Minn. 1985), that the "factfinder" should determine the reasonableness of the insured's expectations and the knowledge that the insured had at the time of the purchase of the insurance. In that case testimony was taken from the insured's insurance agent. The Court reasoned:

> In our view, the reasonable expectations doctrine does not automatically mandate either pro-insurer or pro-insured results. It does place a burden on insurance companies to communicate coverage and exclusions of policies accurately and clearly. It does not require that expectations of coverage by the insured be reasonable under the circumstances. Neither of those requirements seem overly burdensome. Properly used the doctrine will result in coverage in some cases and in no coverage in others. *Id.* at 278.

Similarly, in *Great Southwest Fire Insurance Company v. Harms*, 212 Cal. Rptr. 106 (Cal. App. 1985), the trial court made a finding of fact after hearing evidence on the expectations of the insureds in the circumstance of the procurement of a contractor's liability policy. In that case testimony was taken from the insured and the insurance broker. *Accord Mills v. Agrichemical Aviation, Inc.*, 250 N.W.2d 663 (N.D. 1977) (testimony taken from insured and insurance agent to determine reasonable expectations).

D. Conclusion

While it is reasonably clear that the Massachusetts Appellate Courts will continue to apply the reasonable expectations doctrine to unambiguous policy provisions, it is less clear where the courts stand onthe subsidiary objective/subjective, fact/law, and burden of proof issues. The better course would be for the Massachusetts appellate courts to require that an insured invoking the reasonable expectations doctrine have the burden of proving to the factfinder that he subjectively had an expectation of coverage and that such an expectation was objectively reasonable.