STANDARDIZED AGREEMENTS AND THE PAROL EVIDENCE RULE: DEFINING AND APPLYING THE EXPECTATIONS PRINCIPLE*

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I. INTRODUCTION

Legal doctrines inevitably evolve to comport with advances in science and technology or to accommodate transformations in the social, economic and political climate. In the field of torts, the rise of strict liability[1] over the last several decades and the decline of negligence and privity[2] as predicates for consumer actions for harm caused by defective products illustrate the rapidity with which legal doctrines can adapt to meet the needs of an industrial society. In the area of contract law, however, evolutionary movements are often measured in terms of centuries, not decades.

Historically, the sanctity of written agreements was inviolate.[3] No "ac-

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1. In tracing the history of the doctrine of strict liability, the *Restatement (Second) of Torts* reporters noted the tendency of the courts to display "considerable ingenuity in evolving more or less fictitious theories of liability" in carving out exceptions to the general rule that a supplier of chattels was not liable to third persons in the absence of negligence or privity of contract. RESTATEMENT (SECOND) OF TORTS § 402A comment b (1965). In the wake of rapid and continuing social change, the courts have since discarded the general rule. *Id.* at comment c.

2. *See* Greenman v. Yuba Power Prods., Inc., 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963); Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960); Baxter v. Ford Motor Co., 179 Wash. 123, 35 P.2d 1090 (1934). *See generally* Prosser, *The Assault Upon the Citadel*, 69 YALE L.J. 1099 (1960); Prosser, *The Fall of the Citadel (Strict Liability to the Consumer)*, 50 MINN. L. REV. 791 (1966).

3. The application of the legal maxim of *pacta sunt servanda* to written agreements has existed since the days of the Norman Conquest. Prior to that time, any instrument purporting to memorialize the parties' understanding was merely one symbolic gesture formalizing the transaction itself, without regard to the content of the document or *carta*, much like the livery of seisin in real property

cident" or "inevitable necessity" excused performance unless the contract expressly provided for such an excuse.[4] Universally recognized exceptions to this wooden precept, such as supervening impracticability[5] and frustration of purpose,[6] are barely a century old.[7] Ironically, commercially realistic results were achieved through the application of judicial fictions about the presumed intent of the parties.[8] In essence, the courts inferred that the parties would have provided for termination of their agreement had they been sufficiently prescient to anticipate the event which interfered with the contract's performance.[9] In other words, by adding a term to the agreement, the courts could claim to be giving effect to what they perceived to be the "reasonable expectations" of the parties.[10]

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conveyance law. *See* 9 J. WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2426, at 81-82 (J. Chadbourne rev. ed. 1981). The witnesses to the transaction were the primary source of proof of the agreement and, through an elaborate testimonial ritual, they could rebut anything contained in the *carta*. *See id.* at 83. In the eleventh century, the seal (originally, a distinctive impression made in wax affixed to the instrument) was instituted as a means for authenticating the genuineness of royal edicts and for rendering their express terms indisputable. *See id.* at 84. By the thirteenth century, the use of the seal for this purpose filtered down through lesser nobility to ordinary freeman, and the *carta* became indisputable as the representation of the transaction. *See id.* at 84-85. With the advent of the printing press in the fifteenth century, literacy spread through the mercantile class, and the faithful observance of the literal terms of written agreements became a sacred legal precept. *See* Paradine v. Jane, Aleyn 26, 27, 82 Eng. Rep. 897, 897 (K.B. 1647) ("when the party by his own contract creates a duty or charge upon himself, he is bound to make it good, if he may, notwithstanding any accident by inevitable necessity, because he might have provided against it by his contract"); Countess of Rutland's Case, 5 Coke 25, 27, 77 Eng. Rep. 89, 90 (K.B. 1604) ("it would be inconvenient that matters in writing made by advice and on consideration, and which finally import the certain truth of the agreement of the parties, should be controlled by averment of the parties, to be proved by the uncertain testimony of slippery memory").

4. *See generally* Trakman, *Interpreting Contracts: A Common Law Dilemma*, 59 CAN. B. REV. 241, 241-46 (1981).

5. *See* RESTATEMENT (SECOND) OF CONTRACTS § 261 (1981). *See generally* Page, *The Development of the Doctrine of Impossibility of Performance*, 18 MICH. L. REV. 589 (1920); Posner & Rosenfeld, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83 (1977); Sommer, *Commercial Impracticability—An Overview*, 13 DUQ. L. REV. 521 (1975); Woodward, *Impossibility of Performance as an Excuse for Breach of Contract*, 1 COLUM. L. REV. 529 (1901).

6. *See* RESTATEMENT (SECOND) OF CONTRACTS § 265 (1981). *See generally* Gow, *Some Observations on Frustration*, 3 INT'L & COMP. L.Q. 291 (1953); Patterson, *Constructive Conditions in Contracts*, 42 COLUM. L. REV. 903 (1942).

7. *See* Krell v. Henry, [1903] 2 K.B. 740, 746; Taylor v. Caldwell, 3 Best & Smith 826, 839, 122 Eng. Rep. 309, 314 (1863).

8. For example, in Taylor v. Caldwell, 3 Best & Smith 826, 122 Eng. Rep. 309 (1863), the performance of a contract to rent a music hall was rendered objectively impossible by an unforeseen fire that swept the building. Even though the contract did not expressly allocate the risk of fire, the court engrafted an implied term excusing performance by the owner of the music hall "because from the nature of the contract is [was] apparent that the parties [had] contracted on the basis of [the music hall's] continued existence . . . ." *Id.* at 839, 122 Eng. Rep. at 314. The court imagined that the parties would have included a *force majeure* clause had they considered the possibility of this calamity. *Id.* at 833, 122 Eng. Rep. at 312. Such judicial inventions were ultimately replaced by the "basic assumptions" concept embodied in the *Restatement (Second) of Contracts*:

> Under the rationale of this Restatement, the obligor is relieved of his duty because the contract, having been made on a different "basic assumption," is regarded as not covering the case that has arisen. It is an omitted case, falling within a "gap" in the contract. Ordinarily, the just way to deal with the omitted case is to hold that the obligor's duty is discharged, in the case of changed circumstances, or has never arisen, in the case of existing circumstances, and to shift the risk to the obligee.

RESTATEMENT (SECOND) OF CONTRACTS, ch. 11 introductory note, at 311 (1981).

9. *See* Trakman, *supra* note 4, at 249-51.

10. See Patterson, *Constructive Conditions in Contracts*, *supra* note 6, for an often cited criticism of this form of judicial activism.

In its earliest formulations, the parol evidence rule[11] barred consideration of the expectations of the parties except to the extent those expectations were embodied in a writing.[12] Evidence of a contracting party's subjective intent, including uncontrovertible manifestations of that intent, was not admissible to alter the terms of a completely integrated,[13] written agreement.[14] The inequity of this rigid rule soon became obvious.[15] Contracting parties were occasionally induced by parties with superior bargaining power to enter into written agreements that not only omitted reference to unforeseen contingencies that could affect the parties' basic assumptions, but also contained terms that were contrary to their express understanding.[16] The courts even-

11. Nearly a century ago, Professor Thayer lamented that "a mass of incongruous matter" is lumped together under the heading "parol evidence rule." Thayer, *The "Parol Evidence" Rule*, 6 HARV. L. REV. 325, 325 (1893) ("Few things in our law are darker than this, or fuller of subtle difficulties."). This accounts for the time traditionally expended by courts sifting out false preconceptions about the rule before it is even applied. *See* Zell v. American Seating Co., 138 F.2d 641, 643 (2d Cir. 1943), *rev'd*, 322 U.S. 709 (1944) ("It is not surprising that confusion results from a rule called 'the parol evidence rule' which is not a rule of evidence, which relates to extrinsic proof whether written or parol, and which has been said to be virtually no rule at all."). For example, it is frequently noted that the parol evidence rule is not a rule of evidence, but rather a rule of substantive law. *See* J. CALAMARI & J. PERILLO, THE LAW OF CONTRACTS § 3-5 (2d ed. 1977); 3 A. CORBIN, CONTRACTS § 573 (rev. ed. 1960 & Supp. 1984). Similarly, the parol evidence rule is not a rule of interpretation, but rather a rule that identifies the subject matter that may be open to interpretation. *See* E. FARNSWORTH, CONTRACTS §§ 7.2-.6 (1982); J. MURRAY, CONTRACTS § 103, at 224-25 (2d ed. 1974) (the parol evidence rule plays a role "in the complex determination of the circle of assent which must be clearly distinguished from the process of interpretation").

Explaining that extensive citation of authority is unnecessary because the proposition is a "mere statement of the obvious," Professor Corbin summarizes the parol evidence rule as follows: "[I]f the parties have stated the terms of their contract in the form of a complete written integration, it cannot be varied or contradicted by proof of antecedent negotiations and agreements." 3 A. CORBIN, CONTRACTS § 573, at 368 (1960); *see also* C. MCCORMICK, HANDBOOK OF THE LAW OF EVIDENCE § 211, at 430 (1954) ("The phrase becomes a shibboleth, repeated in ten thousand cases."). Using the common label "parol evidence rule" only parenthetically, the *Restatement (Second) of Contracts* simply declares that a "binding integrated agreement discharges prior agreements to the extent that it is inconsistent with them." RESTATEMENT (SECOND) OF CONTRACTS § 213(1) (1981). *See also id.* at § 215 ("Except as stated in [§ 214], where there is a binding agreement, either completely or partially integrated, evidence of prior or contemporaneous agreements or negotiations is not admissible in evidence to contradict a term of the writing."). The exclusion of certain types of evidence is referred to in comment a to § 215 as an "evidentiary consequence" of the substantive rule.

12. Meres v. Ansell, 3 Wilson 275, 276 (1771) ("[N]o *proof* evidence is admissible to disannul and substantially to vary a written agreement . . . .") (emphasis in original); *see also* Raffles v. Wichelhaus, 2 Hurlstone & Coltman 906, 907, 159 Eng. Rep. 375, 375 (Ex. 1864) (strictly condemning any effort "to contradict . . . a written contract good upon the face of it").

13. The parol evidence rule was based on the premise that, if a writing was intended as the full and final expression of the parties' agreement, it superseded any antecedent understandings. A threshold question is whether a particular writing was so intended, *i.e.*, whether it was a "complete integration." The analytical process for answering this question has been the source of a famous academic debate between the Williston school, which proposes to examine the document itself for objective indicia of completeness, 4 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS §§ 600A, 629, 633, 636, 638-639 (3d ed. 1961 & Supp. 1980), and the Corbin faction, which proposes to seek out evidence of circumstances surrounding execution of the document to gauge the parties' actual intent, 3 A. CORBIN, *supra* note 11, §§ 581-582. Professor Corbin's view has found acceptance in the *Restatement (Second) of Contracts*. *See* RESTATEMENT (SECOND) OF CONTRACTS § 214 (1981).

14. *See* J. MURRAY, *supra* note 11, at 224.

15. In the eighteenth century, Lord Kenyon criticized these cases because "the determinations in them outrage common sense." Goodisson v. Nunn, 3 Durnford & East 761, 764, 100 Eng. Rep. 1288, 1289 (K.B. 1792).

16. *See* Meyer, *Contracts of Adhesion and the Doctrine of Fundamental Breach*, 50 VA. L. REV. 1178 (1964). One commentator has noted that "usually the one who sets up the spoken against the written word is economically the under-dog" who is more likely to appeal to the conscience of the

tually recognized various exceptions to the parol evidence rule,[17] including mistake,[18] misrepresentation,[19] and simple ambiguity.[20] Cases applying the exceptions soon became as common as cases applying the rule itself.[21] Recently, it is the alleged understanding of each contracting party—not the language of their writing—that has become the focus of the courts' attention.[22] Thus, it appears that over a period of three hundred years, the parol evidence rule has undergone a process of steady erosion; and at least one court[23] seems to have abandoned the rule altogether in the context of standardized agreements,[24] the most common means of documenting modern commercial and consumer transactions.

Standardized agreements, including such classic examples as insurance contracts, loan agreements, and security documents,[25] are not the product of negotiation. Rather, they consist of terms imposed by the drafter, a party having superior bargaining power,[26] and accepted by the other contracting

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jury. McCormick, *The Parol Evidence Rule as a Procedural Device for Control of the Jury*, 41 YALE L.J. 365, 366 (1932).

17. Professor Corbin contends that the parol evidence rule has no "exceptions" at all, properly understood, but only has inherent functional "limitations." *See* 3 A. CORBIN, *supra* note 11, § 572C, at 606 (Supp. 1984) ("If we could all agree to call this rule, the Rule Against Contradicting Integrated Writings, then we could expect to save thousands of future law students, lawyers and judges enormous amounts of sweat and mental anguish over the otherwise senseless exceptions and limitations."). The *Restatement (Second) of Contracts* "excepts" certain circumstances from the impact of the rule. *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 214-215 (1981).

18. *See* 3 A. CORBIN, *supra* note 11, § 580; 4 S. WILLISTON, *supra* note 13, § 634; RESTATEMENT (SECOND) OF CONTRACTS §§ 155, 214(d) (1981).

19. *See* 3 A. CORBIN, *supra* note 11, § 580; 4 S. WILLISTON, *supra* note 13, § 634; RESTATEMENT (SECOND) OF CONTRACTS §§ 166, 214(d) (1981).

20. *See* 3 A. CORBIN, *supra* note 11, § 579; RESTATEMENT (SECOND) OF CONTRACTS §§ 212(2), 214(c) (1981).

21. *See* 3 A. CORBIN, *supra* note 11, § 542; Corbin, *The Interpretation of Words and the Parol Evidence Rule*, 50 CORNELL L.Q. 161, 189 (1965); Farnsworth, *"Meaning" in the Law of Contracts*, 76 YALE L.J. 939 (1967).

22. *See, e.g.*, Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 682 P.2d 388 (1984), discussed at length *infra* in text accompanying notes 138-60.

23. *Id.*

24. The *Restatement (Second) of Contracts* does not specifically define the term "standardized agreement," although it suggests that an agreement is "standardized" if "like writings are regularly used to embody terms of agreements of the same type . . . ." RESTATEMENT (SECOND) OF CONTRACTS § 211(1) (1981). One commentator has defined "standardized forms" as "(1) a printed collection of proposed contract terms; (2) formulated in advance for use in a large number of similar transactions; and (3) presented to a nondrafter as a condition of doing business." Dugan, *Standardized Form Contracts—An Introduction*, 24 WAYNE L. REV. 1307, 1316 (1978).

25. An exhaustive list of the various types of "standardized" agreements presently in use would fill volumes. Professor Dugan has noted that the term encompasses most of the forms used in contemporary commercial transactions. "It includes: pre-contract forms, such as purchase orders and acknowledgements; post-contract forms, such as invoices and warranty manuals; as well as integrated forms, such as the standard retail installment sales contract and security agreements." Dugan, *supra* note 24, at 1316.

26. The standard form contract (or "standardized agreement") is a natural and necessary incident of "large scale" businesses engaged in interstate or international service or product distribution. As an economic matter, the cost of individually negotiated and tailored contracts for such businesses would be prohibitive. *See* Gluck, *Standard Form Contracts: The Contract Theory Reconsidered*, 28 INT'L & COMP. L.Q. 72, 73 (1979); RESTATEMENT (SECOND) OF CONTRACTS § 211, comment b (1981). Although standardized agreements are often viewed negatively as contracts of adhesion, *see, e.g.*, Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 631-32 (1943), it should also be recognized that standard terms are often used simply to achieve consistency and minimize costs where a high volume of transactions needs to be documented. Furthermore, the terms of standardized contracts sometimes favor one party over the other

party on the assumption that similar terms pervade the industry.[27] Although businesses often contract among themselves through the exchange of standardized forms,[28] the insurance contract is perhaps the most often cited example of a standardized agreement.[29] Few of an insurance contract's terms have been subject to real negotiation since business was conducted, in the earliest days of the industry's history, within the confines of Lloyd's Coffee House.[30]

Within the past fifteen years, the interaction of the parol evidence rule and the desire to honor the reasonable expectations of contracting parties has been the focus of considerable judicial[31] and academic[32] activity. It is in the realm of standardized agreements—generally policies of insurance—that courts and commentators have tried to come to grips with the disparity which sometimes exists between the language of a written contract and the alleged expectations of one of the contracting parties. Should the court enforce the contract as drawn, treating the writing as unimpeachable evidence of the parties' agreement, or should the court assume that such agreements

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because allocating the risks that way allows the costs of the goods or services, which are the subject of the contract, to be lower, thereby benefiting an entire class of consumers. Of course, standard clauses are also used in an effort to comply with a variety of consumer oriented laws. To the extent the efficiencies achieved through high volume, standardized transactions are substantially diminished because consumers are permitted to easily change the terms of the written "deal" after the fact, or because businesses are required to spend significant sums to litigate over such efforts, the costs to all consumers must inevitably increase.

Standardized agreements often form the starting point for negotiations between entities of roughly equal bargaining power. In this context, it is a mistake to regard the agreement as "standardized" even though it is pre-printed. Certainly a contract between IBM and General Motors is not a contract of adhesion even though a standard form IBM purchase contract may have formed the basis for further negotiations. *See* Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 549 (1971). *See also* Ostrager & Ichel, *Should the Business Insurance Policy Be Construed Against the Insurer? Another Look at the Reasonable Expectations Doctrine*, 33 FED. INS. COUNS. Q. 273 (1983); Ostrager & Ichel, *The Role of Bargaining Power Evidence in the Construction of the Business Insurance Policy: An Update*, 18 FORUM 577 (1983).

27. *See* RESTATEMENT (SECOND) OF CONTRACTS § 211(1) (1981).

28. An entire body of law has developed to assist courts in defining the terms of agreement when the terms of the standardized form "offer" differ from the terms of the standardized form "acceptance." *See, e.g.*, U.C.C. § 2-207 (1972).

29. *See* Keeton, *Insurance Law Rights at Variance With Policy Provisions*, 83 HARV. L. REV. 961, 963-65 (1970). See also Zuckerman v. Transamerica Ins. Co., 133 Ariz. 139, 144, 650 P.2d 441, 446 (1982) for a fairly typical judicial view of the modern insurance contract. "The insured is given no choice regarding terms and conditions of coverage which are contained on forms which the insured seldom sees before the purchase of the policy, which often are difficult to understand and which usually are neither read nor expected to be read by either the person who sells the policy or the person who buys it." *Id.*

30. Keeton, *supra* note 29, at 966.

31. *E.g.*, Van Orman v. American Ins. Co., 680 F.2d 301 (3d Cir. 1982); Auto-Owners Ins. Co. v. Jensen, 667 F.2d 714 (8th Cir. 1981); Crawford v. Ranger Ins. Co., 653 F.2d 1248 (9th Cir. 1981); American Home Prods. Corp. v. Liberty Mut. Ins. Co., 565 F. Supp. 1485 (S.D.N.Y. 1983); Nationwide Mut. Ins. Co. v. United States Fidelity & Guar. Co., 529 F. Supp. 194 (E.D. Pa. 1981); Mitford v. de Lasala, 666 P.2d 1000 (Alaska 1983); Perdue v. Crocker Nat'l Bank, 141 Cal. App. 3d 200, 190 Cal. Rptr. 204 (1983); Hallowell v. State Farm Mut. Auto. Ins. Co., 443 A.2d 925 (Del. 1982); Farm Bureau Mut. Ins. Co. v. Sandbulte, 302 N.W.2d 104 (Iowa 1981); Schnuck Markets, Inc. v. Transamerica Ins. Co., 652 S.W.2d 206 (Mo. Ct. App. 1983); Estrin Constr. Co. v. Aetna Cas. & Sur. Co., 612 S.W.2d 413 (Mo. Ct. App. 1981); Grimes v. Concord Gen. Mut. Ins. Co., 120 N.H. 718, 422 A.2d 1312 (1980). For a collection of pre-1980 opinions mentioning this principle, see Note, *A Reasonable Approach to the Doctrine of Reasonable Expectations as Applied to Insurance Contracts*, 13 U. MICH. J.L. REF. 603 (1980).

32. *E.g.*, Abraham, *Judge-Made Law and Judge-Made Insurance: Honoring the Reasonable Expectations of the Insured*, 67 VA. L. REV. 1151 (1981); Keeton, *supra* note 29.

are rarely read or understood[33] and attempt to look elsewhere for a solution? A trend is apparent.

Adopting the logic of the *Restatement (Second) of Contracts*,[34] courts are now frequently speaking in terms of the "reasonable expectations" of contracting parties when they determine whether the "boilerplate" terms of a standardized agreement accurately reflect the "true" understanding of the parties.[35] In the last fifteen years, several hundred decisions have adopted, or at least acknowledged, this approach.[36] Yet, remarkably, there has been little effort in the cases or the commentaries to explain when or how the so-called "expectations principle"[37] is to be applied in disputes arising out of standardized agreements. Is a "reasonable expectation" the expectation of the public at large, as perceived by the court, or is it the subjective anticipation of an individual contracting party? Does the law's desire to honor the reasonable expectations of the contracting parties require that every "expectations" claim arising out of a standardized agreement be submitted to the jury for determination? If a provision of a standardized agreement is beyond the objectively reasonable expectations of the public at large, does that mean it is to be judicially excised from the contract even though it was in fact read and understood by the non-drafting party? Can a term which is not unconscionable[38] nevertheless be invalidated on the grounds that it is beyond the expectations of one of the contracting parties? To the extent the courts have even attempted to address these questions, the answers are often in conflict or designed for expedient disposition of the case at hand without consideration of the broader policy implications of the decisional rule adopted.

The first section of this article explores the roots of the parol evidence rule and argues that, despite changes in the nature and volume of commercial transactions, the policies and principles underlying the rule are still valid today. The second section examines the emergence of the expectations principle in standardized contract disputes, while the third section of this article catalogues the different formulations of the principle which appear in the cases and commentaries. In the fourth section, we propose a new standard for honoring the reasonable expectations of the parties to a standardized agreement while maintaining the integrity of written agreements.

A review of the myriad decisions in this area suggests that the expecta-

33. *See* Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 391, 682 P.2d 388, 396 (1984) (hypothesizing that "those who make use of a standardized form of agreement neither expect nor desire their customers to 'understand or even to read the standard terms' ") (quoting RESTATEMENT (SECOND) OF CONTRACTS § 211 comment b (1981)).

34. *See* RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981).

35. *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 201, 211 (1981).

36. *See supra* note 31.

37. The "expectations principle" is the short-hand label for the principle of honoring the reasonable expectations of contracting parties. *See* Keeton, *supra* note 29, at 973.

38. Historically, a term was unconscionable if it was "such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other . . . ." Earl of Chesterfield v. Janssen, 2 Vessey Senior 125, 156, 28 Eng. Rep. 82, 100 (Ch. 1750). More recent decisions have described such arrangements, although not illegal, as "too hard a bargain and too one-sided an agreement to entitle the plaintiff to relief in a court of conscience." Campbell Soup Co. v. Wentz, 172 F.2d 80, 83 (3d Cir. 1948). *See also* U.C.C. § 2-302 (1972) (court may limit enforcement of contract or clause if found unconscionable "as a matter of law," in light of the evidence of commercial setting, purpose and effect).

tions principle is often applied in cases where traditional exceptions to the parol evidence rule could be employed to achieve the same result. Where there is evidence of inducement[39] and parol evidence is admissible, a subjective standard has long been used to determine the reasonable expectations of the contracting parties and the "true" terms of their contract; we argue that, absent such inducement, the subjective intent of one contracting party should not be admissible to contradict[40] the terms of an integrated agreement. In the absence of inducement, the terms of the writing should be held to constitute the terms of the contract unless they are so objectively unreasonable that, as a matter of public policy, they are unenforceable.

In the fifth section of this article, we discuss the procedural impact of the proposed standard and its relation to existing rules. Finally, we illustrate the proposed rule by demonstrating its application to various types of standardized contract disputes. By attempting to harmonize[41] the parol evidence rule with the expectations principle, we do not seek to eviscerate the rule but, rather, to demonstrate its continuing vitality.

One final note: This article does not delve deeply into the subject of reformation, a doctrine generally premised upon mutual mistake.[42] Nor does it choose sides in the great debate over the test for integration.[43] The discussion which follows purposes a standard for resolving disputes involving *fully integrated, standardized agreements.* If an agreement is completely "dickered"[44] or only partially integrated,[45] it is beyond the scope of this

39. "Inducement," as used in this context, is intended to refer to situations in which one contracting party's affirmative actions result in a material and justified misunderstanding on the part of the other contracting party. Included are cases that fall within the ambit of the doctrines of fraud, misrepresentation, mistake, and equitable estoppel, which would justify relief under the traditional exceptions to the parol evidence rule.

40. The drafters of the *Restatement (Second) of Contracts* carefully drew attention to the fact that they changed from "vary" to "contradict" in order "to avoid application to cases where more than one meaning is reasonably possible." RESTATEMENT (SECOND) OF CONTRACTS § 215 reporter's note (1981).

41. The parol evidence rule is sometimes applied automatically to exclude extrinsic evidence when a contract is clear and unambiguous. In the case of standardized agreements, the fact that the writing is unambiguous would be relevant, but not necessarily conclusive, in determining the reasonable expectations of the non-drafting party.

42. *See* 3 A. CORBIN, *supra* note 11, §§ 540, 543, 580; J. POMEROY, A TREATISE ON EQUITY JURISPRUDENCE §§ 857-867 (5th ed. 1941). Reformation may be available in the absence of mutual mistake. For example, reformation may be available to a party who is mistaken as to the contents or effect of a writing if there is clear and convincing evidence that the mistaken belief was induced by the fraudulent misrepresentation or inequitable conduct of the other contracting party. E. FARNSWORTH, *supra* note 11, § 7.5, at 467-70.

The standard proposed in this article parallels, in certain respects, the test usually applied to determine whether an agreement is subject to reformation to reflect the intent of the contracting parties. To that extent, application of the expectations principle would be consistent with the parol evidence rule.

43. *See supra* note 13.

44. This is Professor Llewellyn's term for provisions that are the product of actual negotiation between parties with bargaining power. *See* K. LLEWELLYN, THE COMMON LAW TRADITION 370 (1960). Professor Llewellyn contends that, in contrast to the "fine print," such provisions "constitute the dominant and only real expression of agreement . . . ." *Id.* He notes that standardized agreements often contain some negotiated provisions; however, "any contract with boiler-plate results in *two* separate contracts: the *dickered* deal and the collateral one of *supplementary* boilerplate." *Id.* at 371. *But see* Dugan, *The Application of Substantive Unconscionability to Standardized Agreements—A Systematic Approach*, 18 N. ENG. L. REV. 77, 89 (1982) ("[I]t is doubtful whether the majority of standardized forms involve any dickered terms.").

analysis.

II. THE PAROL EVIDENCE RULE: A HISTORICAL PERSPECTIVE

The parol evidence rule, though subject to countless formulations, generally has the effect of preventing extrinsic evidence, whether testimonial or documentary, of prior or contemporaneous negotiations from contradicting the terms of a completely integrated written agreement. While often mischaracterized as a rule of evidence, it is actually a rule of substantive contract law.[46]

Nevertheless, early commentators frequently pointed to evidentiary concerns as the justification for the parol evidence rule.[47] The first concern was that "honest expectations, based upon carefully considered written transactions, may be defeated through sympathetic, if not credulous, acceptance by juries of fabricated or wish-born oral arguments."[48] The second concern was that written documents were inherently more reliable than "the uncertain testimony of slippery memory."[49]

These concerns date back at least to the Statute of Fines[50] and, not surprisingly, were also partly responsible for the Statute of Frauds.[51] While

45. That is, something less than a complete and final expression of the parties' agreement. *See supra* note 13. *See also* RESTATEMENT (SECOND) OF CONTRACTS § 210(2) (1981).

46. Thus, for example, the failure to make an objection to the admissibility of such evidence at trial does not necessarily preclude raising the parol evidence rule on appeal. *See* Tahoe Nat'l Bank v. Phillips, 4 Cal. 3d 11, 23-24, 480 P.2d 320, 329-30, 92 Cal. Rtpr. 704, 714 (1971). *But see* Cedic Dev. Corp. v. Sibole, 25 Ariz. App. 185, 187, 541 P.2d 1169, 1171 (1975). Also, in diversity cases, federal district courts are bound to apply the state rather than the federal law on this subject. *See* Betz Laboratories, Inc. v. Hines, 647 F.2d 402, 405 (3d Cir. 1981); Centronics Fin. Corp. v. El Conquistador Hotel Corp., 573 F.2d 779, 782 (2d Cir. 1978) (both applying Erie R.R. v. Tompkins, 204 U.S. 64 (1938)). Likewise, the rule is not considered procedural for conflict of laws purposes. *See* RESTATEMENT (SECOND) CONFLICT OF LAWS § 140 (1971).

Naturally, the rule has evidentiary consequences, inasmuch as extrinsic testimony or documents are rendered irrelevant. *See* FED. R. EVID. 402 ("Evidence which is not relevant is not admissible."). *See also* RESTATEMENT (SECOND) OF CONTRACTS § 215 (1981).

47. *See* E. FARNSWORTH, *supra* note 11, § 7.2, at 449.

48. *See* C. MCCORMICK, *supra* note 11, § 210, at 428. Professor McCormick voiced strong distrust of the "peculiar institution of the untrained jury, a body numerous enough to invite emotional organ-playing by counsel, and usually unguided in this country by any specific advice from the trial judge." *Id.* § 211, at 429. However, he also acknowledged, in passing, the dangers posed by the calculating pressures occasionally exerted and the assurances sometimes given in transactions involving standardized agreements. *Id.* § 210, at 428 n.6 (citing Llewellyn, *What Price Contract?*, 40 YALE L.J. 704, 747 (1931)).

49. *See* Countess of Rutland's Case, 5 Coke 25, 26, 77 Eng. Rep. 89, 90 (K.B. 1604). *See also* J. MURRAY, *supra* note 11, § 107, at 236 ("[T]he question is not whether the parol evidence rule operates to prevent perjury but whether jurors would be sophisticated enough to regard written evidence of an agreement as superior to what may be the favorable recollection of a party in relation to extrinsic agreement.").

50. Statute of Fines Levied, 27 Edw. 1299. One outgrowth of the law of fines, which dealt with the conclusiveness of title to real property, W. WALSH, A HISTORY OF ANGLO-AMERICAN LAW § 90 (2d ed. 1932), was considered in the case generally considered to be the source of the parol evidence rule, Countess of Rutland's Case, 5 Coke 25, 77 Eng. Rep. 89 (K.B. 1604), *quoted supra* note 3.

51. Act for the Prevention of Frauds and Perjuries, 1676, 29 Car. 2, ch. 3, §§ 4, 17. The Statute of Frauds stated that documents—even those not under seal, *see supra* note 3—constituted the operative element of certain transactions. Writings had come into their own. The common thread running through the parol evidence rule and the Statute of Frauds is apparent in the early case of Meres v. Ansell, 3 Wilson 275 (1771), a real property conveyance dispute which, although approached from

other factors, including the use of the seal and the spread of literacy,[52] influenced the historical preference for writings, it was distrust of juries that accounted for the longevity of the rule.[53] Whether out of fear that those who are untrained in the subtle distinctions of Anglo-American law may undermine the stability of commercial transactions[54] or fear that those who are easily touched by emotional appeal may seek to do "deep pocket" justice,[55] the rule still functions to withdraw certain issues of contract law from the hands of the jury. This is true notwithstanding the fact that writings have lost their aura of infallibility,[56] due in part to the proliferation of standardized agreements.[57]

Though often criticized,[58] the parol evidence rule, until recent times, has enjoyed a peaceful coexistence with the expectations principle in the context of standardized agreements.[59] The rule does not seek to undermine the expectations of the parties, but to give effect to those expectations as they are embodied in a completely integrated written agreement.[60] As a result, the parol evidence rule lends consistency and predictability to the enforcement

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a parol evidence perspective, might easily have been treated as a pure Statute of Frauds case. *See* Thayer, *supra* note 11, at 337-38.

52. *See supra* note 3.

53. *See, e.g.*, C. MCCORMICK, *supra* note 11, §§ 210-211. According to Professor McCormick:

> Thayer and Wigmore have traced too clearly the origin of the parol evidence formula against "varying the writing," to a primitive formalism which attached a mystical and ceremonial effectiveness to the *carta* and the seal. The writer merely ventures to submit that this formalism, abandoned elsewhere in so many areas of modern law, had here a special survival value—the escape from the jury—which led the judges to retain for writings the conception that they had a sort of magical effect of erasing all prior oral agreements.

Id. § 211, at 430 n.4. *See generally* H. KALVEN & H. ZEISEL, THE AMERICAN JURY (1971).

54. Sixty years ago, the justification for the parol evidence rule was so expressed:

> Were it otherwise, written contracts would be enforced, not according to the plain effect of their language, but pursuant to the story of their negotiation as told by the litigant having at the time being the greater power of persuading the trier of fact . . . . If such assurance were removed today from our law, general disaster would result, because of the consequent destruction of confidence, for the tremendous but closely adjusted machinery of modern business cannot function at all without confidence in the enforceability of contracts. They must not be reduced to the innocuous character of a mere "scrap of paper."

Cargill Comm'n Co. v. Swartwood, 159 Minn. 1, 6-7, 198 N.W. 536, 538 (1924).

55. *See* McCormick, *supra* note 16.

56. *E.g.*, Wood v. Lucy, Lady Duff-Gordon, 222 N.Y. 88, 91, 118 N.E. 214, 214 (1917) (Cardozo, J.) ("The law has outgrown its primitive stage of formalism when the precise word was the sovereign talisman, and every slip was fatal.").

57. *See, e.g.*, U.C.C. § 2-207 (1972) ("battle of the forms"); Wallach, *The Declining "Sanctity" of Written Contracts—Impact of the Uniform Commercial Code on the Parol Evidence Rule*, 44 MO. L. REV. 651 (1979).

58. *See, e.g.*, Calamari & Perillo, *A Plea for a Uniform Parol Evidence Rule and Principles of Contract Interpretation*, 42 IND. L.J. 333 (1967); Murray, *The Parol Evidence Rule: A Clarification*, 4 DUQ. L. REV. 337 (1966); Sweet, *Contract Making and Parol Evidence: Diagnosis and Treatment of a Sick Rule*, 53 CORNELL L. REV. 1036 (1968).

59. One of the earliest expressions of the expectations principle is found in Kessler's comprehensive study published over forty years ago:

> In dealing with standardized contracts courts have to determine what the weaker contracting party could legitimately expect by way of services according to the enterpriser's "calling," and to what extent the stronger party disappointed reasonable expectations based on the typical life situation.

Kessler, *supra* note 26, at 637.

60. *See* RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981).

of written contracts and especially to standardized agreements,[61] a form of contract whose very existence may be traced to the rule. Without confidence in the enforceability of such agreements, it has been said that modern business could not function at all.[62]

Historical observations about the basis for the parol evidence rule are still valid today. Consistency and predictability in the enforcement of contracts is more important than ever[63] and fear of perjury is as prevalent today as it was in centuries past.[64] Juror prejudice also remains a concern and this concern is heightened in disputes over standardized agreements, since the "deep pocket" is often readily identifiable.[65] Finally, litigants' memories are no less "slippery" today than they were three centuries ago.

In short, there appears to be no basis for retreating from the parol evidence rule. Yet, in the past three decades, we have witnessed just such a retreat in the area of standardized agreements. Under the pretext of honoring the reasonable expectations of contracting parties, courts have chosen, in many instances, to ignore the written manifestation of the parties' intent in favor of self-serving testimony relating to previously unexpressed, subjective expectations. Some courts have expressly abandoned the parol evidence rule, while others have simply avoided its effect by a variety of fictions.[66] In large part, we reject the current trend. The parol evidence rule should be preserved, although its inherent limitations must be recognized and some practical guidelines must be observed when dealing with standardized agreements.

III. THE EMERGENCE OF THE EXPECTATIONS PRINCIPLE

A systematic approach to contracts is said to have originated with Dean Langdell, whose pioneering casebook distilled common principles from the areas of sales, bailment, agency, property and maritime law.[67] While this theory of contract law has proved to be a convenient pedagogical tool, the fact remains that "pure" contract law—that is, abstract and impersonal con-

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61. In the words of a comment to the *Restatement (Second) of Contracts*:

> Such treatment has the effect of limiting the power of the trier of fact to exercise a dispensing power in the guise of a finding of fact, and thus contributes to the stability and predictability of contractual relations. In cases of standardized contracts such as insurance policies, it also provides a method of assuring that like cases will be decided alike.

RESTATEMENT (SECOND) OF CONTRACTS § 212 comment d (1981).

62. One commentator asserts that 99% of all contemporary commercial transactions involve standardized agreements. *See* Slawson, *supra* note 26, at 529.

63. *See supra* note 62.

64. It has been said that any large group inevitably contains a substantial number of people who are willing to commit fraud, and who are able to lie convincingly. *See* 3 A. CORBIN, *supra* note 11, § 572C, at 607 (Supp. 1984). Although this supposition is a matter of legitimate concern, an issue of even greater concern may be that to the extent there is not certainty, or there is reduced certainty resulting from the use of a standardized document, the risk to the drafting party is greater. The greater the risk, the greater the cost of doing business and, ultimately, the higher the price to the consumer. In that sense, an ill-defined and loosely applied expectations analysis, which reduces consistency and predictability, may be viewed as anti-consumer.

65. *See* MCCORMICK, *supra* note 11, § 210.

66. For a criticism of the tendency of courts to create fictions, see Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 388 n.6, 682 P.2d 388, 393 n.6 (1984).

67. *See* G. GILMORE, THE DEATH OF CONTRACT 12-14 (1974).

cepts that govern in the absence of economic regulation[68]—is becoming increasingly rare.[69] The "expectations principle" may be viewed as a fundamental precept of "pure" contract law that courts are now struggling to apply to "impure" cases,[70] or as a special principle born in the insurance area that courts are now seeking to generalize as part of a new theory of modern contract law.[71] In either case, the fate of the expectations principle remains uncertain.[72]

The expectations principle dictates that, in determining and interpreting the terms of a contract, courts should honor the "reasonable expectations" of the contracting parties.[73] Given this broad formulation of the doctrine, the absence of any academic effort to trace its origins should not be surprising.[74] The expectations principle is derived from the concept of mutual assent,[75] often called "meeting of the minds."[76] Thus, in that sense, the principle may be as old as the law of contracts.[77]

The emergence of the expectations principle in the enforcement of standardized agreements is, however, a relatively recent phenomenon. Historically, deference to the written terms of agreement precluded inquiry into the alleged, but unwritten expectations of the contracting parties,[78] much as it precluded inquiry into the parties' unexpressed mental reservations in assess-

68. *See* L. FRIEDMAN, CONTRACT LAW IN AMERICA 20 (1965).

69. For example, the Uniform Commercial Code, the Uniform Residential Landlord-Tenant Act, and the profusion of statutes regulating the insurance industry all depart from "pure" contract law in several respects. L. FRIEDMAN, *supra* note 68, at 22-24 (while pure contract law "grew fat" during the industrial revolution, the country's growing social conscience later "systematically robbed" it in the areas of labor, antitrust and insurance law); *see also* G. GILMORE, *supra* note 67, at 95-103 ("The decline and fall of the general theory of contract and, in most quarters, of laissez-faire economics may be taken as remote reflections of the transition from nineteenth century individualism to the welfare state and beyond.").

70. That is, cases where public policy considerations or economic controls are so pervasive that abstract contract concepts are almost meaningless. *See* R. POUND, THE SPIRIT OF COMMON LAW 29 (1921) ("[W]e have taken the law of insurance practically out of the category of contract, and we have established that the duties of public service companies are not contractual, as the nineteenth century sought to make them, but are instead relational; they do not flow from agreements which the public servant may make as he chooses, they flow from the calling in which he has engaged and his consequent relation to the public."). *See also* Noble v. National Am. Life Ins. Co., 128 Ariz. 188, 624 P.2d 866 (1981); Gruenberg v. Aetna Life Ins. Co., 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

71. *See* Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 392 n.8, 682 P.2d 388, 397 n.8 (1984).

72. For example, the Pennsylvania Supreme Court has recently rejected earlier Pennsylvania cases which adopted a kind of expectations analysis. Standard Venetian Blind Co. v. American Empire Ins. Co., 503 Pa. 300, 469 A.2d 563 (1983). *See also* Casey v. Highlands Ins. Co., 100 Idaho 505, 600 P.2d 1387 (1979) (Idaho Supreme Court retreated from the expectation analysis approved in an earlier case).

73. *See* R. KEETON, BASIC TEXT ON INSURANCE LAW 350-57 (1971).

74. Indeed, some cases assert that this has long been the primary objective of the courts in construing contracts. *See, e.g.*, Pirkey v. Hospital Corp. of Am., 483 F. Supp. 770, 773-74 (D. Colo. 1980); Mitford v. de Lasala, 666 P.2d 1000, 1005 (Alaska 1983); Ashton v. Ashton, 89 Ariz. 148, 152, 359 P.2d 400, 402-03 (1961); Healy Tibbitts Constr. Co. v. Employers' Surplus Lines Ins. Co., 72 Cal. App. 3d 741, 748, 140 Cal. Rptr. 375, 379 (1977).

75. *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 17-23 (1981).

76. On the origin of this term, see Farnsworth, *supra* note 21, at 943-44.

77. *See generally* M. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1780-1860, at 180-88 (1977).

78. *See supra* note 3.

ing whether there was mutual assent.[79] Considerations of finality and certainty gave rise to the rule that a completely integrated written agreement was the exclusive authority for the intended terms of the contract. This principle, embodied in the parol evidence rule, effectively precluded any evidence of the expectations of the contracting parties outside the "four corners" of their written accord.

Early decisions appeared to establish an absolute rule of law: merchants had the "utmost liberty in contracting"[80] and their written agreements were not subject to contradiction. The role of the court was merely to give effect to the *consensus ad idem*,[81] to be determined whenever possible from the plain meaning of the contract terms.[82] If an otherwise desirable or expected provision did not appear in the written document, then it was not a part of the parties' agreement.[83] The law presumed that merchants were sufficiently attuned to the risks inherent in their respective businesses that their written contracts would include all of the terms which were actually within their reasonable expectations.[84]

Industralization, the rise of the merchant class, and the attendant increase in the complexity of most business agreements[85] required liberalization of this rule.[86] The "absolute" rule of *pacta sunt servanda* was simply too inflexible to meet the needs of a mercantile society.[87] Merchants often omitted from their written agreements any reference to the unusual, but arguably foreseeable, hazards which could disrupt or prevent performance.[88] When such events occurred, merchants looked to the courts to excuse or suspend their performance or to grant some form of relief from the unconditional performance commitment of the written agreement.[89]

As one commentator has observed, the courts responded by adopting the "role of reasonable interpreters."[90] Doctrines such as "impracticabil-

79. *See* Hotchkiss v. National City Bank, 200 F. 287, 293 (S.D.N.Y. 1911).

80. *See supra* note 3.

81. That is, the provisions to which there was a common manifestation of assent.

82. Traditionally, the "plain meaning" rule has meant that "[w]here parties bind themselves by a lawful contract in the absence of fraud a court must give effect to the contract as it is written, and the terms or provisions of the contract, where clear and unambiguous, are conclusive." Shattuck v. Precision-Toyota, Inc., 115 Ariz. 586, 588, 566 P.2d 1332, 1334 (1977). *See also* RESTATEMENT (SECOND) OF CONTRACTS § 212 comment b (1981) ("[m]eaning can almost never be plain except in a context . . . [b]ut after the transaction has been shown in all its length and breadth, the words of an integrated agreement remain the most important evidence of intention").

83. The rule is summarized as follows:

> The intent of the parties, as ascertained by the language used, must control the interpretation of a contract. It is not within the province or power of the court to alter, revise, modify, extend, rewrite or remake an agreement. Its duty is confined to the construction or interpretation of the one which the parties have made for themselves. Where the intent of the parties is expressed in clear and unambiguous language, there is no need or room for construction or interpretation and a court may not resort thereto.

Goodman v. Newzona Inv. Co., 101 Ariz. 470, 472, 421 P.2d 318, 320 (1966) (internal citations omitted).

84. *See* Trakman, *supra* note 4, at 242-44.

85. *See* L. FRIEDMAN, *supra* note 68, at 20-24.

86. *See generally* Trakman, *supra* note 4.

87. *See generally* Wehberg, *Pacta Sunt Servanda*, 53 AM. J. INT'L L. 775 (1959).

88. *Id.* at 779.

89. *See supra* note 8.

90. *See* Trakman, *supra* note 4, at 246.

ity,"[91] "frustration of purpose,"[92] and "excuse of conditions"[93] quickly evolved. On occasion, decisions excusing non-performance were justified on the grounds that equity demanded such a result[94] or that the object or purpose of the contract had been destroyed by an unanticipated event.[95] More often the courts simply "assumed" that the parties would have provided for a discharge of contractual obligations at the time of contracting had they anticipated the event that eventually made performance impracticable.[96] The fiction of "complete integration" was thus qualified by the fiction of "implied understandings." The needs of commerce had compelled the courts to divine the reasonable expectations of the parties, even though those expectations were not expressed in the written agreement.

In this early form, the expectations principle was a negative doctrine employed to excuse performance by adding an "intended" but unspoken term to an apparently integrated agreement. The expectations principle did not become a tool for redefining express terms until the mid-twentieth century.[97] When the principle re-emerged as an affirmative doctrine for modifying contract terms, it was usually in the context of insurance contracts,[98] and its application was based principally upon the notion that such agreements were contracts of adhesion.[99] The principle was again invoked to "excuse" performance of certain contractual obligations because courts were persuaded that performance of those obligations was, at least for the non-drafting party, beyond his reasonable expectations at the time of contracting. But the doctrine had evolved significantly. In the insurance context, the ex-

91. RESTATEMENT (SECOND) OF CONTRACTS § 261 (1981).

92. *Id.* § 265.

93. *Id.* §§ 185, 229, 255, 271.

94. In cases involving economic collapse, political upheavals, and natural disasters, the courts concluded that the strict demands of the contract were outweighed by the special demands of justice. *See* Trakman, *supra* note 4, at 251 (quoting *Hirji Mulji v. Cheong Yue S.S. Co.* [1926] A.C. 497, 510 (P.C.)).

95. *See* Taylor v. Caldwell, 3 Best & Smith 826, 122 Eng. Rep. 309 (K.B. 1863).

96. This early illustration of judicial contract-making foreshadowed the emergence of the expectations principle:

> Common law judges invoked diverse rationalizations in terminating commercial contracts by operation of law. The intention of the parties remained, throughout, an important consideration in reaching this conclusion. Yet it was intention with a difference. It was the court's own construction of the intention of the parties that predominated. The design of the parties was objectivized. The judge himself determined what was a reasonable excuse in the circumstances and the judge imputed his own determinations to the parties. For some judges, this was a power which the court exercised ". . . irrespective of the individuals concerned, their temperaments and failings, their interests and circumstances." For other judges this judicial gap-filling power was a necessary function in a court of equity.

Trakman, *supra* note 4, at 250-51.

97. Keeton, *supra* note 29, at 962.

98. *E.g.*, Steven v. Fidelity & Cas. Co., 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 172 (1962); Kievit v. Loyal Protective Life Ins. Co., 34 N.J. 475, 170 A.2d 22 (1961).

99. The term "contracts of adhesion," describing agreements whose terms are dictated by the economically stronger party, was coined at the turn of the century. *See* R. SALLEILLES, DE LA DÉCLARATION DE VOLONTE 229 (1901) (noting that such "*contrats d'adhesion*" resemble much more a law than a meeting of minds). It was introduced into Anglo-American jurisprudence following World War I. *See* Patterson, *The Delivery of a Life-Insurance Policy*, 33 HARV. L. REV. 198, 222 (1919). The academic studies that followed are legion. *See supra* note 26. The *Restatement (Second) of Contracts* adopts the term "standardized agreements," instead. RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981).

pectations principle was not only invoked by litigants seeking to supplement the terms of the written contract (as was generally the case with mercantile agreements), but also by litigants who were seeking to supplant the terms of the written agreement.[100] While the law had once inflexibly held that a written agreement could never be contradicted, the expectations principle was now being employed, at least in the limited context of standardized insurance agreements, to suggest that even an unambiguous written agreement could always be contradicted by extrinsic evidence of the reasonable expectations of the non-drafting party.[101]

In the late 1950's and early 1960's the expectations principle began to receive judicial recognition as a basis for finding the existence of insurance coverage despite express—and often unambiguous—policy provisions negating coverage. The earliest decisions involve life insurance policy provisions[102] while subsequent decisions have applied the doctrine to accident,[103] liability,[104] and other types of insurance as well. A recent compilation reveals more than one hundred decisions in which the expectations principle is either adopted as the *ratio decidendi* or applied without formal acknowledgement.[105] Nevertheless, until 1970, there had been little academic or judicial effort expended in an effort to define the parameters of the principle or to determine when and how it was to be applied.

The Objective Standard

In his seminal article, Professor (now Judge) Robert E. Keeton proposed a modern role for the expectations principle in the insurance con-

100. *See generally* Abraham, *supra* note 32; Keeton, *supra* note 29.

101. *See, e.g.*, O'Neill Investigations, Inc. v. Illinois Employers' Ins., 636 P.2d 1170, 1177 (Alaska 1981); Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 393-94, 682 P.2d 388, 398-99 (1984); Corgatelli v. Globe Life Ins. Co., 96 Idaho 616, 619, 533 P.2d 737, 740 (1975); R.R. Connelley & Sons v. Henry-Williams, Inc., 422 N.E.2d 353, 356 (Ind. Ct. App. 1981); Farm Bureau Mut. Ins. Co. v. Sandbulte, 302 N.W.2d 104, 112 (Iowa 1981); Estrin Constr. Co. v. Aetna Cas. & Sur. Co., 612 S.W.2d 413, 418-19 (Mo. Ct. App. 1981). *But see* Auto-Owners Ins. Co. v. Jensen, 667 F.2d 714, 721 (8th Cir. 1981) (in Minnesota, expectations principle applies only if contract terms are ambiguous); Hallowell v. State Farm Mut. Auto. Ins. Co., 443 A.2d 925, 926-28 (Del. 1982) (in Delaware, expectations principle to be applied only if terms are ambiguous or policy contains hidden trap); Casey v. Highlands Ins. Co., 100 Idaho 505, 508-09, 600 P.2d 1387, 1390-91 (1979) (retreating from plurality's expectation principle in *Corgatelli, supra*, in favor of traditional principles of contract interpretation); Trombly v. Blue Cross/Blue Shield of N.H.-Vt., 120 N.H. 764, 423 A.2d 980, 985 (1980) (in New Hampshire, expectations principle now to be applied only if terms are ambiguous); *cf.* Di Santo v. Enstrom Helicopter Corp., 489 F. Supp. 1352, 1363 (E.D. Pa. 1980) (in Pennsylvania, expectations principle does not apply if parties have relatively equal bargaining power); Standard Venetian Blind Co. v. American Empire Ins., 503 Pa. 300, 469 A.2d 563 (1983) (expectations principle does not apply to equal bargaining situations). Professor Keeton has criticized courts that "continued to tarry at a way station on the road to new doctrine by straining for ambiguities to resolve." Keeton, *Reasonable Expectations in the Second Decade*, 12 FORUM 275, 276 (1976). One wonders about his feeling toward courts who have later purchased return-trip tickets.

102. Ransom v. Penn Mut. Life Ins. Co., 43 Cal. 2d 420, 274 P.2d 633 (1954); Lachs v. Fidelity & Cas. Co., 306 N.Y. 357, 118 N.E.2d 555 (1954).

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

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

105. *See* Note, *A Reasonable Approach to the Doctrine of Reasonable Expectations as Applied to Insurance Contracts*, 13 U. MICH. J.L. REF. 603 (1980). *See also* Keeton, *Reasonable Expectations in the Second Decade*, 12 FORUM 275 (1976).

text.[106] He advocated a purely "objective standard"[107] under which the standardized provisions of an insurance contract would be binding upon the parties to that contract only if the terms of the agreement comport with the "objectively reasonable expectations" of the insured or the intended beneficiary.[108] In Professor Keeton's words:

> 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.[109]

Professor Keeton argued that an objective standard produces "an essential degree of certainty and predictability about legal rights."[110] The objective standard, however, allows the court to ignore the terms of the written agreement. Under a purely "objective" test, the written contract not only lacks the absolute "sanctity" of its historic past, but also may not even be "evidence" (at least in a practical sense) of the terms of the agreement. When the objective test is applied to a coverage dispute, it is incumbent upon the court to determine the nature and extent of coverage which a mythical "objective, reasonable man" would expect to obtain in the same or similar circumstances. Even an express, bold-face, unambiguous coverage exclusion might be unenforceable if the court concludes that a reasonable man would not anticipate such an exclusion in his policy.

What about the salutary "duty to read"[111] which charges a contracting

106. Keeton, *Insurance Law Rights at Variance With Policy Provisions*, 83 HARV. L. REV. 961 (1970).

107. *Id.* at 967-68.

108. Under a purely "objective" test, an intended beneficiary of an insurance policy occupies precisely the same position as the insured who actually contracted for the policy, since neither the terms of the policy itself nor the actual knowledge of the contracting party establishes the terms of the contract. Rather, if a policy provision is contrary to the reasonable expectations of the public at large (or at least the policy-holding public), it will not be enforced "even against those who know of its restrictive terms." Keeton, *supra* note 29, at 974.

109. Keeton, *supra* note 29, at 967.

110. *Id.* Professor Keeton also noted that an objective standard achieves a certain degree of equity among insureds whose premiums ultimately pay judgments against insurers. *See id.* This may be true but the notion of enforcing objectively reasonable "expected" terms is contrary to the principle of contractual freedom. Despite the supposed benefits of uniformity, consistency and predictability inherent in imposing objectively reasonable contract terms (assuming that all courts will view similar contract provisions in essentially the same way), the law generally enforces the contract which the parties made and not the contract which the parties could have made or should have made. Thus, the law usually applies an objective test only to invalidate terms which are contrary to public policy or to impose terms required by public policy considerations. In these cases, the desire for uniformity prevails over the desire to permit contractual freedom. The doctrine of unconscionability, for example, involves the application of an objective test.

111. A person who signs a contract is generally charged with notice of its contents, whether or not he has read the contract. *See, e.g.*, Bradley v. Industrial Comm'n, 51 Ariz. 291, 299, 76 P.2d 745, 748 (1938); *In re* Estate of Henry, 6 Ariz. App. 183, 186, 430 P.2d 937, 940 (1967) ("a person who is competent is held as a matter of law to know the contents of an agreement he signs"); Rossi v. Douglas, 203 Md. 190, 192, 100 A.2d 3, 7 (1953) (one who has the capacity to understand a written document and who reads it, or without reading it signs it, is bound by his signature); Standard Venetian Blind Co. v. American Empire Ins., 503 Pa. 300, 303, 469 A.2d 563, 566 (Pa. 1983) ("[I]n the absence of proof of fraud, 'failure to read [the contract] is an unavailing excuse or defense and cannot justify an avoidance, modification or nullification of the contract or any provision thereof.' ") (citations omitted); RESTATEMENT (SECOND) OF CONTRACTS § 211 comment b (1981) (one who manifests assent to a standardized agreement is bound thereby, subject to such limitations as the law may impose, though ignorant of its terms or proper interpretation).

Historically, this "duty to read" has applied to insurance contracts as well as to more tradi-

party with the duty to review and comprehend the unambiguous terms of his contract? Professor Keeton initially suggests that the question whether a policyholder has actually read his policy is "one part of the objective reasonableness of his expectations."[112] However, in the final analysis, this is not really the case. If the appropriate standard is purely "objective," then the terms of the contract are not dependent upon the writing or the insured's knowledge of the writing.[113] Rather, the reasonable expectations of a hypothetical reasonable man, not necessarily the insured, are to be honored "even though painstaking study of the policy provisions would have negated those expectations."[114]

While Professor Keeton's observations have proven invaluable in defin-

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tional commercial contracts. *See, e.g.*, Steward v. Mutual Life Ins. Co., 127 S.W.2d 22, 23-24 (Mo. Ct. App. 1939); Heake v. Atlantic Cas. Ins. Co., 15 N.J. 475, 483-84, 105 A.2d 526, 530 (1954); Davern v. American Mut. Liab. Ins. Co., 241 N.Y. 318, 326, 150 N.E. 129, 131 (1925).

The "duty to read," however, has never been absolute. *See* Calamari, *Duty to Read—A Changing Concept*, 43 FORDHAM L. REV. 341, 342-49 (1974). Fraud and misrepresentation, for example, have been recognized as exceptions to the rule. *See, e.g.*, Belew v. Griffis, 249 Ark, 589, 591, 460 S.W.2d 80, 82 (1970) (deceived party was fraudulently induced into not reading). However, some courts have held that a deceived party has no right to rely upon misrepresentations regarding the contents of a document where that party had the opportunity to review the writing and failed to do so. *See, e.g.*, Hintz v. Lazarus, 58 Ill. App. 3d 64, 67, 373 N.E.2d 1018, 1020 (1978); Sanger v. Yellow Cab Co., 486 S.W.2d 477, 481 (Mo. 1972).

112. Keeton, *supra* note 29, at 967. The concept of "unconscionability" does create a generally recognized exception to the common law duty to read. A contract provision which is unconscionable will not be enforced simply because the party against whom enforcement is sought failed to read the document. *See, e.g.*, Weaver v. American Oil Co., 257 Ind. 458, 461-62, 276 N.E.2d 144, 148 (1972).

113. Indeed, some cases and commentators go so far as to suggest that there is no "duty to read" an insurance policy. *See, e.g.*, Georgia Farm Bureau Mut. Ins. Co. v. Wall, 242 Ga. 176, 179, 249 S.E.2d 588, 591 (1978) (mere failure to read insurance policy will not bar insured from seeking reformation); C & J Fertilizer Inc. v. Allied Mut. Ins. Co., 227 N.W.2d 169, 174 (Iowa 1975) ("It is generally recognized that the insured will not read the detailed, cross-referenced, standardized, mass-produced insurance form, nor understand it if he does."); Estrin Constr. Co., Inc. v. Aetna Cas. & Sur. Co., 612 S.W.2d 413, 419 (Mo. Ct. App. 1981) (in a contract of adhesion the terms are imposed by the proponent of the form; they are not expected to be read and even if read, the adherent had no choice but to conform); Pribble v. Aetna Life Ins. Co., 84 N.M. 211, 215, 501 P.2d 255, 259 (1972) (insurance policies contain unfamiliar and technical language in an awkward and unclear arrangement); Colonial Sav. Ass'n v. Taylor, 544 S.W.2d 116, 119 (Tex. 1976) (the presumption that an insured knows the contents of his policy can be overcome by a showing that he did not examine it); 3 A. CORBIN, *supra* note 11, § 559, at 265-66 ("one who applies for an insurance policy . . . may not even read the policy, the number of its terms and the fineness of its print being such as to discourage him"); 7 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 906B, at 300 (3d ed. 1957), ("the majority rule is that the insured is not bound to know [an insurance contract's] contents"); Keeton, *supra* note 29, at 961, 968 (1970) ("insurers know that ordinarily policyholders will not in fact read their policies [because the] [p]olicy forms are long and complicated and cannot be fully understood without detailed study").

114. *See supra* note 110. This concept has been applied outside the insurance context. For example, in Wheeler v. St. Joseph Hosp., 63 Cal. App. 3d 345, 133 Cal. Rptr. 775 (1977), a patient entering a hospital was required to sign a pre-printed "Condition of Admissions" form which required the arbitration of any medical malpractice claim which might subsequently arise. Finding the contract to be adhesive and the arbitration provision to be beyond the reasonable expectation of the patient, the California court refused to enforce the arbitration clause. The "duty to read" was held not to apply in the circumstances presented. "[T]he general proposition that a person who signs a contract is bound by all of its terms even though he signed it without reading it may not be given full sweep where the contract is one of adhesion." *Id.* at 359, 133 Cal. Rptr. at 785; *see also* St. John's Episcopal Hosp. v. McAdoo, 94 Misc. 2d 967, 968, 405 N.Y.S.2d 935, 936 (Civ. Ct. 1978). The court also noted that a "self-serving recital" in the standard form agreement stating that the signing party had read and assented to the contract terms was insufficient to charge the patient with knowledge of the unexpected provision. 63 Cal. App. 3d at 368-69, 133 Cal. Rptr. at 791. *But see* Carpenter v. Suffolk Franklin Sav. Bank, 370 Mass. 314, 323, 346 N.E.2d 892, 900 (1976) (unread terms of

ing the concepts underlying the expectations principle,[115] they reveal a degree of uncertainty regarding the precise nature of the standard to be applied. On one hand, Professor Keeton suggests that an objective standard produces an essential degree of certainty in the law and that insurers ought not be allowed to use qualifications or exceptions from coverage that are inconsistent with "the reasonable expectations of a policyholder having an ordinary degree of familiarity with the type of coverage involved."[116] He emphasizes that this must be true even if the exclusionary clause is explicit and unambiguous because the objective standard assumes that ordinary policyholders do not read or understand their insurance contracts.[117] On the other hand, Professor Keeton suggests that even an unusual provision might be enforced if the insurer can demonstrate that the policyholder's failure to read the clause was unreasonable[118] or that the qualification was brought to the attention of the policyholder at the time of contracting "thereby negating surprise to him."[119] But is "surprise" really a consideration if the law is to honor the objective reasonable expectations of the public? Can consistency and predictability be achieved if an exclusion may be enforced against a party who happened to read it and is willing to admit it, but negated with respect to the insured who either did not read his policy or denies that he did so?

Professor Keeton does recognize this inconsistency. In announcing his formulation of one "element" of the expectations principle, he is forced to conclude:

> If the enforcement of a policy provision would defeat the reasonable expectations of the great majority of policyholders to whose claims it is relevant, it will not be enforced against those who know its restrictive terms.[120]

Thus, despite his initial reluctance to discard unambiguous, known policy provisions in favor of those terms which a supposedly reasonable man would anticipate, Professor Keeton finally opts for a purely "objective" stan-

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adhesion contract enforced); Vandendries v. General Motors Corp., 130 Mich. App. 195, 196-97, 343 N.W.2d 4, 6 (1983) (unread terms of adhesion contract enforced).

115. Although expectations principle decisions certainly pre-date Professor Keeton's article (and subsequent insurance law text, *see* R. KEETON, BASIC TEXT ON INSURANCE LAW 350-57 (1971)), virtually every commentator has credited Professor Keeton with providing the first coherent formulation of the "reasonable expectations" doctrine. While careful analysis of Professor Keeton's work suggests that he envisioned a purely "objective" expectations test, even those courts which have proposed far more "subjective" standards have cited Professor Keeton as their inspiration. *See, e.g.*, Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 389, 682 P.2d 388, 394 (1984).

116. Keeton, *supra* note 29, at 968.

117. *Id.*

118. *Id.* Is failure to read an insurance contract "reasonable" for an unsophisticated businessman but "unreasonable" for a sophisticated businessman? Professor Keeton offered no answer to this question, presumably because a pure, objective standard does not inquire into the experience or sophistication of the party before the court. For a sampling of the opinions of others not burdened by an objective expectations doctrine, compare Fraase Surgical Mfg. Co. v. United States, 571 F.2d 34, 40 (Ct. Cl. 1978) (in case of renewal policy, experienced businessmen could not rely on coverage of prior policies), with 7 S. WILLISTON, *supra* note 113, § 906B, at 308 (insured under no duty to read a renewal policy to determine whether material terms remain unchanged).

119. Keeton, *supra* note 29, at 968.

120. Keeton, *supra* note 29, at 974.

dard.[121] Under such a standard, the terms of an insurance contract are what the court believes the public at large would expect them to be.[122]

In the final analysis, under Professor Keeton's approach, even the express, unambiguous and known language of the policy is essentially irrelevant in determining the "true" terms of the contract. While early decisions may have overemphasized freedom of contract and assumed that all intended terms had in fact been negotiated and included in the writing, the objective reasonable expectations rule effectively assumes that the written contract does *not* embody the intended terms of the agreement.[123] Despite centuries of exhortation against such a procedure,[124] the objective standard empowers the court to rewrite the contract between the parties; the contract thus becomes whatever a particular judge, with the benefit of hindsight, thinks it should have been under the circumstances. The objective reasonable expectations rule is thus, in every material sense, an abrogation of the

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121. There is, nevertheless, some discomfort apparent in Professor Keeton's conclusion:

> It is a sound rule to strike down a surprising policy provision uniformly, sustaining even the claim of that occasional policyholder who can be shown to have known of its restrictive terms. To apply a different rule among various policyholders would produce the result that those who remained ignorant of the terms would receive substantially more protection for their premium dollars than those aware of them. At least when such a knowledgeable policyholder would receive coverage disproportionately small in comparison with his premiums (which ordinarily would be the case if the total premiums received from all policyholders combined were adequate for the coverage afforded), it would be unduly harsh to deprive him of the protection the great majority of policyholders receive at the same price.

Keeton, *supra* note 29, at 974-75. Suppose policyholder *A*, an insurance agent himself, purchased a disability policy fully aware that it excluded disability resulting from certain specified causes. Is it appropriate to extend coverage to this insured simply because another policyholder (or even the majority of all policyholders) supposedly expected coverage for the excluded risk? *None* of *A*'s premium dollars went to pay for this extended coverage, as neither *A* nor his insurer intended that the policy provide such coverage. If *A* suffers a loss which is then paid simply because other policyholders presumably expected such coverage, the loss will be spread among those other policyholders through increased premiums. While this may be an equitable result in a limited sense, we cannot share Professor Keeton's conclusion that it would be "unduly harsh" to grant to *A* only the coverage he in fact expected and, indeed, intended to purchase.

122. A few cases do suggest an "objective-subjective" test. Under this standard, the court must attempt to determine the expectation of an ordinary layman *who actually reviewed the policy. See, e.g.*, Continental Ins. Co. v. Bussell, 498 P.2d 706, 710 (Alaska 1972) (insurance policy is "construed so as to provide that coverage which a layman would reasonably have expected given his lay interpretation of the policy's terms"); Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 270, 419 P.2d 168, 171-72, 54 Cal. Rptr. 104, 108 (1966) (to construe insurance contract, court must "ascertain that meaning of the contract which the insured would reasonably expect"); Rodman v. State Farm Mut. Auto. Ins. Co., 208 N.W.2d 903, 908 (Iowa 1973) (insureds' expectations are reasonable if based upon ordinary layman's understanding of what the policy actually provides). This approach differs significantly from the "objective" test, which effectively ignores the actual policy terms, and the "subjective" test, which focuses on the individualized expectation of the insured.

123. While Professor Keeton's rule is not stated in terms of a presumption *against* the contents of the writing, there is clearly no presumption *in favor* of the written agreement. Under a purely objective standard, the policy itself is only relevant evidence if its terms are so widely known in the community that they may be introduced as evidence of what a reasonable man should expect to find in his policy. In the case of a new or not widely distributed policy form, the trial of a coverage dispute could theoretically proceed to conclusion without the policy ever being introduced into evidence! In short, under an objective standard, the actual terms of the contract will never be dispositive and, though admissible, they may not be relevant in a practical sense.

124. *See, e.g.*, Lawrence v. Beneficial Fire & Cas. Ins. Co., 8 Ariz. App. 155, 158, 444 P.2d 446, 449 (1968) ("We cannot expand the language used beyond its plain and ordinary meaning, nor should we add something to the contract which the parties have not put there."). *But see* J. MURRAY, *supra* note 11, at 221-25.

parol evidence rule.[125]

The Restatement Rule

At roughly the same time that Professor Keeton was preparing his insurance law text,[126] the American Law Institute was meeting to consider publication of the *Restatement (Second) of Contracts*. The expectations principle was a subject of considerable discussion and its application was in no sense limited to contracts of insurance.[127] Rather, the drafters of the *Restatement (Second) of Contracts* felt that the trend was to recognize the expectations principle as applicable to all forms of standardized agreements.[128]

In what ultimately became section 211 of the *Restatement (Second) of Contracts*,[129] the drafters sought to codify the expectations principle. That section now provides that where one party to a contract (the drafting party) has "reason to believe"[130] that the other contracting party would not have assented to the contract had he known of the presence of a particular term, then that term "is not part of the agreement."[131]

When does one party have "reason to believe" that another party would not accept a particular term in a standardized contract if he were aware of that term? Does the *Restatement (Second) of Contracts* adopt Professor Keeton's "objective" standard or does it suggest that evidence of the subjective (actual) intent of the contracting parties is to be considered? The answer is not clear.

Comment e to section 211 suggests an objective standard. It notes that in construing a standardized contract courts seek to give effect to the reasonable expectations of "the average member of the public who accepts it."[132] In contrast, comment f provides that "reason to believe" may be shown by prior negotiations or inferred from the circumstances, thus suggesting a

125. The objective standard would always permit the introduction of extrinsic evidence (*i.e.*, evidence regarding the expectations of the public at large) to contradict, supplement, vary or simply replace the terms of a fully integrated, unambiguous writing.

126. R. KEETON, BASIC TEXT ON INSURANCE LAW (1971).

127. *See* 47 A.L.I. PROC. 524-37 (1971).

128. *See* RESTATEMENT (SECOND) OF CONTRACTS § 211 comment a (1981); 47 A.L.I. PROC. 529 (1971); (principle applicable to leases as well as other forms of commercial contracts). *See generally* Murray, *The Parol Evidence Process and Standardized Agreements Under the* Restatement (Second) of Contracts, 123 U. PA. L. REV. 1342 (1975).

129. In the early drafts, the "standardized agreements" section of the *Restatement (Second) of Contracts* was designated as § 237.

130. In Professor Robert Braucher's early draft, § 211 (then § 237) provided that the contracting party had to have "reason to know" that his counterpart would not assent to the standardized term in order to invalidate that provision. The modification suggested by Charles Willard was accepted with the comment that "reason to believe" was somewhat more restrictive than "reason to know" and would result in the invalidation of fewer contract terms. *See* 47 A.L.I. PROC. 525 (1971).

131. RESTATEMENT (SECOND) OF CONTRACTS § 211(3) (1981).

132. RESTATEMENT (SECOND) OF CONTRACTS § 211 comment e (1981). Neither the *Restatement* comments nor the American Law Institute proceedings discuss whether reference should be made to the reasonable expectations of the public at large or just that portion of the public which normally enters into standardized contracts of the type in issue. This seemingly academic distinction could be crucial in a case where the standardized agreement is a commercial financing agreement or complex real estate security agreement, since parties entering into such contracts are likely to be far more sophisticated in their expectations than the public at large. *See* Keeton, *supra* note 29, at 974 (reference to the "reasonable expectations of the great majority of policyholders").

"subjective" standard is to be applied by the trier of fact.[133] This uncertainty is compounded by comment d to section 212, which strongly suggests that questions relating to the interpretation of standardized contracts are "questions of law"[134] because determination by the court (as opposed to the jury)[135] will provide a "method of assuring that like cases will be decided alike."[136] Reference to the transcript of the American Law Institute's proceedings reveals only that the internal inconsistency in the *Restatement (Second) of Contracts* is a product of the uncertainty which prevailed during the discussion that preceded its drafting.[137]

The Subjective Standard

One recent decision suggests that a purely subjective standard may be appropriate.[138] "Subjectivity" downplays the reasonable expectations of the public at large and looks, instead, to the expectations of the specific contracting party against whom the standardized agreement provisions are

133. RESTATEMENT (SECOND) OF CONTRACTS § 211 comment f (1981). This comment may also be read as supporting an "objective-subjective" hybrid standard, *see supra* note 122, under which the clause or agreement in question is examined from the perspective of a reasonable layman (or a reasonable layman of the type who generally enters into this type of agreement) possessing the actual knowledge of the party who entered into the agreement in issue. Under a "pure" objective standard, the terms of agreement are not dependent upon the content of the pre-agreement negotiations. Thus, the *Restatement (Second) of Contracts* appears to reject the objective test proposed by Professor Keeton.

134. The term "question of law" is used in this article and in the *Restatement (Second) of Contracts* to refer to matters reserved for determination by the court. *See* RESTATEMENT (SECOND) OF CONTRACTS § 212 comment d (1981). We recognize that questions of contract interpretation may technically be "questions of fact" since they involve the meaning of language; they are, nevertheless, questions "that should be answered by the judge rather than by a jury." 3 A. CORBIN, *supra* note 11, § 554, at 219-20. *Accord* 4 S. WILLISTON, *supra* note 13, § 661.

135. Numerous reasons have been suggested to explain the preference for treating contract interpretation as a question of law for determination by the court. Williston suggests that this preference indicates "a distrust for the jury's ability to answer questions of fact that call for nice discrimination and an educated mind." 4 S. WILLISTON, *supra* note 13, § 661, at 649. Farnsworth echoes this view, E. FARNSWORTH, *supra* note 11, § 7.14, at 516 ("This view may reflect a distrust of unsophisticated, uneducated, and at one time illiterate jurors."), but goes further and suggests that the preference for contract interpretation by the court "may also indicate a desire by appellate judges to enhance their scope of review over questions of interpretation which, in the case of standard agreements, may have the salutary effect of promoting both expeditious decisions and consistent interpretation." *Id.* (footnote omitted).

136. RESTATEMENT (SECOND) OF CONTRACTS § 212 comment d (1981).

137. 47 A.L.I. PROC. 534-35 (1971) contains the following somewhat confused colloquy:

> MR. RAPSON [N.J.]: In making the determination whether the other party has reason to believe, it is a subjective determination as to what that particular party had in mind, or do you make an objective determination what a reasonable person would have believed under the circumstances?
>
> PROFESSOR BRAUCHER: Well, "reason to believe" is an objective standard requiring the exercise of judgment by the reasonable man, but it is a judgment exercised in the light of the facts available to the party whose reason to believe is in question, and particular communications might well be relevant to show that in this particular case there was reason to believe that this would not be signed with the dog clause in it.
>
> DIRECTOR WECHSLER: Well, if he knew it, he certainly had reason to believe.
>
> PROFESSOR BRAUCHER: That's right. If he actually knows it, that's certainly reason to believe.

138. *See* Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 682 P.2d 388 (1984).

sought to be enforced.[139] For the most part, the reasonable expectations of this party would be a question for the trier of fact. Judicial rhetoric notwithstanding,[140] predictability and consistency fall by the wayside. For example, a provision that might be beyond the reasonable expectations of the average citizen could still be enforced against someone who actually read it—and admitted that he had done so.[141] As the Pennsylvania Supreme Court recently noted, "[f]ocusing on what was and was not said at the time of contract formation rather than on the parties' writing, . . . makes the question of the scope of insurance coverage in any given case depend upon how a fact finder resolves questions of credibility."[142] The court observed that, among other things, "such a process" involves "obvious uncertainty of . . . results."[143]

Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co.[144] involved two policies of liability insurance issued by Universal to Darner. Darner was an automobile sales, service, and leasing business. Darner purchased the policies of insurance through Doxsee, an agent who was a full time employee

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139. The opinion is open to a variety of interpretations. At one point the court does place at least one limit on the expectations principle adopted by it:

> [I]f not put in proper perspective, the reasonable expectations concept is quite troublesome, since most 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. Such a limitation is easily found in the postulate contained in Corbin's work—that the expectations to be realized are those that "have been induced by the making of a promise."

Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 390, 682 P.2d 388, 395 (1984) (quoting 1 A. CORBIN, CONTRACTS § 1, at 2 (1960)). However, in other places, the court uses broad, sweeping language that suggests the reasonableness of the insured's alleged expectation is always a question for the jury, based on the totality of the circumstances. *See, e.g., id.* at 393-94, 682 P.2d at 398-99. Ironically it is often those courts which seem to have been most critical of the alleged ambiguities of other's writings which have themselves created a greater uncertainty over the interpretation and application of their own opinions. As the dissent in *Darner* points out, the opinion does little more than encourage "a swearing contest between the insured and the insurance company's agents" with the inevitable result that the "matter will then be resolved by trial based on the most convincing story." *Id.* at 401, 682 P.2d at 406 (Holohan, C.J., dissenting). *See also* Casey v. Highlands Ins. Co., 100 Idaho 505, 508, 600 P.2d 1387, 1391 (1979) (traditional principles of contract construction protect insured without danger inherent in expectations principle that "the periphery of what losses would be covered could be extended by an insured's affidavit of what he 'reasonably expected' to be covered.").

140. Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 392, 682 P.2d 388, 397 (1984) ("Hopefully, the adoption of [the expectations principle] as the rule for standardized contracts will provide greater predictability and uniformity of results—a benefit to both the insurance industry and the consumer."). There are at least two sources of unpredictability and inconsistency in cases so decided: (1) how the trier of fact will evaluate evidence that there was a "dickered" deal different from the express provisions of a standardized agreement; and (2) whether a particular provision will be refused enforcement because of nebulous and ever-changing "public policy" grounds. *See, e.g.*, Zuckerman v. Transamerica Ins. Co., 133 Ariz. 139, 650 P.2d 441 (1982) (court refused to enforce one year period of limitations authorized by legislature and expressly included in policy because the limitation supposedly defeated insured's reasonable expectations).

141. Because of this, it has been said that "any person who reads his insurance policy would be a fool since it is far better to plead ignorance of the contents of the policy and claim coverage to the broadest possible extent." Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 401, 682 P.2d 388, 406 (1984) (Holohan, C.J., dissenting).

142. Standard Venetian Blind Co. v. American Empire Ins., 503 Pa. 300, 303, 469 A.2d 563, 567 (1983).

143. *Id.*

144. 140 Ariz. 383, 682 P.2d 388 (1984). The facts of *Darner* are set forth at 140 Ariz. at 385-87, 682 P.2d at 390-92.

of Universal. The basic policy insured Darner and its lessees for automobile liability risks in amounts up to $15,000 per person and $30,000 per accident. Darner's umbrella policy limits were $100,000 for any one injury and $300,000 for all injuries arising out of one accident. The umbrella policy defined the word "insureds" so as to exclude lessees.

Darner's owner claimed that he had called Doxsee and explained that the basic policy did not include the full coverage he desired for lessees and that he was particularly concerned because Darner's rental contract contained a statement that coverage in the amount of $100,000/$300,000 was available to all lessees. The insured claimed that Doxsee had represented that the umbrella policy would provide coverage up to the desired limits.[145] Darner did receive a copy of the umbrella policy but it was never read.[146]

Darner subsequently rented a car to Crawford, who injured a pedestrian while driving the vehicle. The pedestrian sued Crawford, who looked to Universal for coverage. Universal claimed that the lessee's coverage was limited to $15,000 under the basic policy and that he was not an "insured" under the umbrella policy. Crawford then sued Darner under the rental agreement, claiming that since $100,000 was stated to be the amount of coverage available, Darner was liable for the difference between the amount recovered by the pedestrian ($60,000) and the amount paid by Universal ($15,000). Darner, in turn, filed a third party complaint against Universal and Doxsee.

The Arizona Court of Appeals affirmed a summary disposition in favor of Universal and Doxsee relying, at least in part, upon the undisputed facts that the umbrella policy was not ambiguous and that Darner simply had not read its policy.[147] The court found that the insured's purported reliance on Doxsee's alleged statement could not "expand the insurer's liability beyond the terms of the umbrella policy issued by Universal."[148]

The Arizona Supreme Court reversed and remanded the case for trial, holding that the policies delivered to Darner did not necessarily form the contract between Universal and Darner.[149] The court recognized that the parol evidence rule generally prevented contradiction of the terms of an unambiguous, integrated agreement.[150] However, the court adopted *Restate-*

145. Justice Feldman's comment on this aspect of the case betrays his personal attitude about insurance agents and also lends credibility to the dissent's forecast of the return to "swearing contests" to circumvent written agreements:

> As might be expected, although Doxsee does not remember the substance of the conversation, he is quite sure he could have told Darner no such thing. Darner's testimony was impeached by evidence that he subsequently reduced the limits on his rental forms from 100/300 to 15/30. Darner explains this by stating that Doxsee told him that it was better to represent the coverage limits at the minimum required by the state so as to discourage plaintiffs' lawyers from pursuing claims for their badly injured clients. As in most such cases, who told what to whom is hotly contested, and there is much to be said for both versions of the facts.

Id. at 385-86 n.3, 682 P.2d at 390-91 n.3.

146. Darner explained that he never read the policy because "it's like reading a book." *Id.* at 386, 682 P.2d at 391.

147. *Id.* at 386-87, 682 P.2d at 391-92.

148. *Id.* at 387, 682 P.2d at 392.

149. *Id.* at 396, 682 P.2d at 401.

150. *Id.* at 390, 682 P.2d at 395.

ment (Second) of Contracts §211 and held that the subjective, reasonable expectations of Darner would determine the amount of coverage which existed.[151] The court further suggested that the logic of its opinion would apply to all standardized contracts.[152] According to the court, its adoption of the expectations principle did not "set a premium on failure to read" because the rule announced applies only to "contracts [or parts of contracts] made up of standardized forms which, because of the nature of the enterprise, customers will not be expected to read and over which they have no real power of negotiation."[153] Whether the non-drafting party could be expected to read the agreement becomes a question for the jury.[154]

All of its ambiguities and unanswered questions aside, the *Darner* decision clearly held that the traditional parol evidence rule would no longer be applied to disputes arising out of standardized contracts, even when the contract is unambiguous.[155] *Darner* strongly implies—if it does not actually state—that the terms of standardized commercial documents will be what the non-drafting party reasonably expects them to be, rather than the terms which actually appear in the written contract.[156]

The *Darner* decision is subject to criticism on a variety of grounds, some of which are noted in a rather pointed dissent.[157] For present purposes, however, the decision is significant because it seems to adopt a standard which is quite different from that suggested by Professor Keeton some fifteen years ago.[158] While the Keeton objective standard permits virtually all standardized contract disputes to be resolved by the court,[159] the *Darner* subjective standard appears to require the submission of all such disputes to the jury.[160] Similarly, while the contracting party's actual knowledge of a provision may be irrelevant under an objective approach, as a practical matter it is likely to be outcome determinative if a subjective standard is applied. Yet, in at least one significant sense, the two approaches are alike. Neither the objective standard nor the subjective standard gives any real deference to the plain language of the document which the parties actually exchanged. Both standards essentially abrogate the parol evidence rule which, through its recognized exceptions, has accommodated the realities of the modern commercial world while generally preserving the integrity of written agreements. The need for a hybrid model is apparent although, to date, none has been proposed.

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151. *Id.* at 391-92, 682 P.2d at 396-97.

152. *Id.* at 392 n.8, 682 P.2d at 397 n.8.

153. *Id.* at 394, 682 P.2d at 399.

154. *Id.* at 395, 682 P.2d at 400.

155. *Id.* at 387 n.5, 682 P.2d at 392 n.5; *see also id.* at 393-94, 682 P.2d at 398-99.

156. *See id.* at 393-94, 682 P.2d at 398-99.

157. *See id.* at 401-02, 682 P.2d at 406-07 (Holohan, C.J., dissenting).

158. *See supra* notes 106-25 and accompanying text for a discussion of Professor Keeton's objective standard.

159. Keeton, *supra* note 106, at 984-85.

160. *See supra* notes 149-154 and accompanying text. *See also infra* note 243 and Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 401, 682 P.2d 388, 406 (1984) (Holohan, C.J., dissenting).

IV. TOWARD A NEW STANDARD FOR HONORING THE REASONABLE EXPECTATIONS OF CONTRACTING PARTIES

There have been previous attempts to catalogue and critique the "reasonable expectations" cases handed down during the past thirty years.[161] Professor Abraham,[162] for example, divided the cases into those which evidenced a "misleading impression theme"[163] and those which revealed a "mandated coverage theme."[164] While academically interesting, this analysis did not address the dichotomy between the objective and subjective standards and thus offered no guidance to the courts for determining when and how to apply the expectations principle.[165] Indeed, in his conclusion, Professor Abraham advised that it was time for the expectations principle to "mature into a body of doctrine composed of a discrete set of rules."[166]

Defining this "discrete set of rules" is, perhaps, a less imposing task than attempting to classifying all of the cases which have employed these rules without acknowledging their existence. The policies underlying the law of contracts generally, and the expectations principle in particular, suggest the following fundamental precepts:

(1) In the absence of a compelling reason for adopting a different course, all unambiguous, completely integrated, written agreements (including standardized agreements) should be enforced in accordance with their terms.

(2) When there is substantial evidence[167] that one contracting party

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161. *See* Abraham, *supra* note 32; Baker, *From Sanctity of Contracts to Reasonable Expectation?*, 32 CUR. LEGAL PROBS. 17 (1979); Gardner, *Reasonable Expectations: Evolution Completed or Revolution Begun?*, 1978 INS. L. J. 537; Keeton, *supra* note 29; Keeton, *supra* note 101; Kelso, *Idaho and the Doctrine of Reasonable Expectations: A Springboard for an Analysis of a New Approach to a Valuable but Often Misunderstood Doctrine*, 47 INS. COUNS. J. 325 (1980); Perlet, *The Insurance Contract and the Doctrine of Reasonable Expectations*, 6 FORUM 116 (1971); Squires, *A Skeptical Look at the Doctrine of Reasonable Expectations*, 6 FORUM 252 (1971); Note, *Reasonable Expectations: The Insurer's Dilemma*, 24 DRAKE L. REV. 853 (1975); Note, *Opening the Gate: The* Steven *Case and the Doctrine of Reasonable Expectations*, 29 HASTINGS L.J. 153 (1977); Note, *Reasonable Expectations Approach to Insurance Contract Interpretation Modified in Missouri*, 47 MO. L. REV. 577 (1982).

162. *See* Abraham, *supra* note 32.

163. Abraham, *supra* note 32, at 1154-62. In the "misleading impression" cases, Professor Abraham includes all cases in which the insurer misleads the insured about the scope of coverage. These include automated marketing cases like Lachs v. Fidelity & Cas. Co., 306 N.Y. 357, 118 N.E.2d 555 (1954), which is discussed *infra* at text accompanying notes 319-25.

164. Abraham, *supra* note 32, at 1154, 1162-68. In these cases, according to Professor Abraham, the insurer does not act misleadingly and does not affirmatively induce the insured to expect a policy provision contrary to that which actually appears in the written instrument.

165. Professor Abraham expressly recognized the limits of his analysis and concluded that the "expectations principle still functions more like a general standard than a discrete set of rules." Abraham, *supra* note 32, at 1197. Nothing in our research suggests a contrary conclusion. The purpose of this commentary, and the task of future writers, is to attempt to define a discrete set of rules for application of the expectations principle without falling into the trap of attempting to reconcile the hundreds of "unprincipled" cases which have been decided under the expectations rubric.

166. Abraham, *supra* note 32, at 1197.

167. In essence, the expectations principle provides a basis for "reformation" of a written contract. As a safeguard against "slippery memory" and perjury, the courts have traditionally required a higher standard of proof before a contract will be modified or altered. 2 A. CORBIN, CONTRACTS § 345, at 208 n.19, § 345, at 208 n.17, § 615, at 743 n.40 (1950); 13 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1597, at 109-13, 125, § 31-35, at 595-605 (3d ed. 1957). *See, e.g.*, Evans v. Hartford Life Ins. Co., 704 F.2d 1177 (10th Cir. 1983); Hoffa v. Fitzsimmons, 499 F. Supp. 357

has been "induced" by the affirmative conduct of the other to believe that a certain provision is included as a term of a standardized agreement, the court[168] may determine that the term constitutes a part of the contract even though it does not appear in the written agreement.

(3) Generally, standardized agreements should be interpreted in such a way so as to assure certainty and predictability and to permit summary disposition of most standardized contract disputes.

(4) In recognition of the fact that standardized agreements are generally contracts of adhesion, "non-dickered" terms of the written agreement which are clearly objectively unreasonable may be refused enforcement even though they are not technically unconscionable.

Analysis of each of these principles will assist in establishing a practical set of rules for application of the expectations principle to disputes arising out of standardized contracts.

Preserving The Sanctity Of The Written Agreement

Abrogation of the parol evidence rule is not warranted. The same considerations which have supported the rule for centuries require its retention. The expectations principle is not a satisfactory or workable substitute for written agreements, and it is neither a rule of evidence nor a rule of substantive law.[169] It is a loose formulation of an abstract objective which requires the application of discrete rules of law with predictable results if confusion and, indeed, mischief are to be avoided.

In many circumstances, the expectations principle is compatible with the parol evidence rule.[170] The written agreement is at least substantial evidence of the true agreement between the contracting parties.[171] If the primary rules of contract construction[172] do not enable the court to ascertain the parties' intention, and if the written agreement is truly ambiguous, then it is properly construed against the drafter.[173] If a court is convinced that

(D.D.C. 1980), *aff'd in part and vacated in part*, 673 F.2d 1345 (D.C. Cir. 1982); Highway Prods., Inc. v. United States, 530 F.2d 911 (Ct. Cl. 1976).

168. Since reformation actions are equitable in nature, the jury generally sits in an advisory capacity. *See* Mission Bay Campland, Inc. v. Sumner Fin. Corp., 72 F.R.D. 464 (M.D. Fla. 1976); Alaska N. Dev., Inc. v. Alyeska Pipeline Serv. Co., 666 P.2d 33 (Alaska 1983), *cert. denied*, 104 S. Ct. 706 (1984). Sanguinetti v. Strecker, 94 Nev. 200, 577 P.2d 404 (1978); Chopping v. First Nat'l Bank, 419 P.2d 710 (Wyo. 1966), *cert. denied*, 387 U.S. 935 (1967); FED. R. CIV. P. 39(c); 9 C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE: CIVIL § 2335, at 124-28 and cases cited at 124 n.56 (1971).

169. In that sense, it is something even more gossamer than the parol evidence rule which, for all its exceptions, has at least evolved into a rule of substantive law with definite evidentiary implications.

170. To the extent the expectations principle states an objective of all contract interpretation, it has coexisted with the parol evidence rule for centuries. *See* ADAM SMITH LECTURES ON JURISPRUDENCE 472 (R. Meek, D. Raphael & P. Stein ed. 1978) ("The obligation to performance which arises from contract is founded on the reasonable expectations produced by a promise, which considerably differs from a mere declaration of intention."). The much debated issue is how the courts are to ascertain a party's legitimate expectations.

171. *See* J. MURRAY, *supra* note 11, § 2, at 5.

172. Polk v. Koerner, 111 Ariz. 493, 496, 533 P.2d 660, 662 (1975); 4 S. WILLISTON, *supra* note 13, § 601; 3 A. CORBIN, *supra*, note 11, §§ 535-536, 538-539.

173. *See* 3 A. CORBIN, *supra* note 11, § 559; 4 S. WILLISTON, *supra* note 13, § 621; RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981). This is often referred to as a "secondary" rule of

the reasonable expectations of one party legitimately differ from the written terms of the agreement, and if that expectation was induced by the affirmative conduct of the other contracting party, then it is proper to "reform" the parties' agreement to reflect the induced expectation.[174] The parol evidence rule has long recognized this principle through its various "exceptions."[175] Indeed, there are only two classes of expectations cases in which the parol evidence rule is likely to lead to a result different from that obtained by applying some formulation of the expectations principle. The first class involves cases in which the subjective expectation of one party differs from the terms of the written agreement, but the expectation was not induced by the other party.[176] The second class involves cases in which the expectations of the public at large would preclude enforcement of a specific term, even though the contracting parties might not have had such an expectation.[177] The parol evidence rule does not give effect to the "reasonable expectations" of the parties or the public in either case.

Deference to the alleged expectations of the parties should not be given in the first class of cases. As suggested below, the problems of proof inherent in adoption of a purely subjective standard are insurmountable.[178] Moreover, predictability and consistency cannot be achieved.[179] The same agreement may be interpreted differently in similar circumstances simply because similarly situated contracting parties had different subjective expectations or because a contracting party in one case read his agreement while the corresponding party in another case wisely did not.[180] At least in some cases, the

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contract interpretation, *i.e.*, it is to be applied in cases where the intent of the parties is in doubt and no other factors are decisive. *See, e.g.*, Consolidated Pac. Eng'g, Inc. v. Greater Anchorage Area Borough, 563 P.2d 252, 256 (Alaska 1977); Insurance Agencies Co. v. Weaver, 124 Ariz. 327, 329, 604 P.2d 258, 260 (1979); District of Columbia Dep't of Hous. & Community Dev. v. Pitts, 370 A.2d 1377 (D.C. 1977); N.B. Harty Gen. Cont., Inc. v. West Plains Bridge & Grading Co., 598 S.W.2d 194 (Mo. Ct. App. 1980).

174. *See supra* notes 18 and 19.

175. *Id.*

176. Assume, for example, that in marketing a standardized policy of insurance, neither the insurer nor its agent does anything to induce the insured to believe the coverage is other than that provided by the written contract. An insured later claims to have had either an unexpressed expectation of coverage at the time the policy was purchased, or contends that such an expectation would be reasonable to most policyholders, despite unambiguous (but unread) language in the policy to the contrary. Professor Keeton would find coverage, as long as the expectation was "objectively reasonable." *See* Keeton, *supra* note 29, at 967. At least one court which has applied the expectations principle seems to have rejected this analysis. *See* Gilbreath v. St. Paul Fire & Marine Ins. Co., 141 Ariz. 92, 96, 685 P.2d 729, 733 (1984) ("Our belief in the need for such coverage for the protection of third parties who might reasonably have expected an operator of a day care center to purchase insurance coverage, cannot lead us to write such insurance where neither the parities nor the legislature has acted for their protection."). *Cf.* Statewide Ins. Corp. v. Dewar, __ Ariz. __, __, 694 P.2d 1167, 1171 (1984) ("We do not believe that unexpressed intent of either party may be given effect over their expressed [written] intent."). In *Dewar*, the court refused to give effect to the arguably reasonable—but unexpressed—expectation of the insurance company that the insured's check, tendered as payment for a binder, was supported by funds on deposit.

177. Professor Keeton has argued for this approach: "If the enforcement of a policy provision would defeat the reasonable expectations of the great majority of policyholders to whose claims it is relevant, it will not be enforced even against those who know of its restrictive terms." Keeton, *supra* note 29, at 974.

178. *See supra* notes 138-60 and accompanying text.

179. *Id.*

180. *See supra* note 141.

subjective standard will place a "premium on failure to read."[181]

Marketplace considerations also suggest the undesirability of a subjective test. Standardized agreements are generally employed in industries which engage in a high volume of transactions. Most if not all of these businesses determine the price of their goods or services at least in part in reliance on the allocation of risks set forth in their standardized agreements; many require some degree of actuarial certainty in their day-to-day operations.[182] Banking and insurance are the most obvious examples.[183] One can only imagine the impact upon the mortgage and real estate financing industries if the enforceability of due-on-sale[184] or acceleration-on-default[185] clauses turned upon the borrower's review of his note and security instrument or upon his subjective expectations regarding the terms of those instruments.[186]

Economic analysis also suggests that a subjective expectations standard is inappropriate.[187] While it may be true that loss-spreading considerations will almost always favor placing a loss on the drafter of a standardized agreement (for example, a bank or an insurer[188]), primary cost avoidance[189]

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181. For example, if a layman actually reads and understands an exception or limitation, the advocate of a subjective standard could not deny that there was mutual assent, even though one might argue that the majority of laymen could not be expected to examine the document and educate themselves about its terms. *See generally* Calamari, *Duty to Read—A Changing Concept*, 43 FORDHAM L. REV. 341, 359 (1974).

182. *See generally supra* notes 26 and 64; *see also* Slawson, *supra* note 26, at 529; Note, *A Common Law Alternative to the Doctrine of Reasonable Expectations in the Construction of Insurance Contracts*, 57 N.Y.U.L. REV. 1175, 1179 (1982).

183. To a significant extent, the content of consumer lending agreements and insurance policies is determined by federal and state law. *See, e.g.*, 15 U.S.C.A. §§ 1601-1693 (1982) (Consumer Credit Protection Act); ARIZ. REV. STAT. ANN. §§ 20-1110 to -1113 (1975 & Supp. 1983-1984) (content of insurance policies).

184. Due-on-sale clauses permit lenders to declare the entire principal balance of a loan secured by real property immediately due and payable upon transfer of the property by the borrower. *See, e.g.*, Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141 (1982); Scappaticci v. Southwest Sav. & Loan Ass'n, 135 Ariz. 456, 457, 662 P.2d 131, 132 (1983). The Garn-St. Germain Depository Institutions Act, Pub. L. No. 97-320, 96 Stat. 1469 (1982) preempts state restrictions on the enforcement of such clauses.

185. Acceleration-on-default clauses permit lenders to declare the entire unpaid principal balance of a loan immediately due and payable in the event the borrower breaches any material provision of the lending agreement.

186. *See* Darner Motor Sales Co., Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 401, 682 P.2d 388, 406 (1984) (Holohan, C.J., dissenting).

187. A subjective expectations rule destroys the predictability necessary in most industries that rely on standardized agreements. In the insurance industry, for example, if insurers could not rely upon certain express policy exclusions, premiums would have to be calculated as if there were no such exclusions. The inevitable result, of course, is that the cost of coverage for the average policyholder will increase because (1) he may well be receiving coverage he does not want and did not intend to purchase; and (2) the insurer will be forced to absorb, as a cost of its business, the increased administrative expense (*i.e.* legal fees) associated with litigating the extent of coverage in every instance in which an exclusion appears to be applicable. Theoretically, the result could be to eliminate all but the broadest (and most expensive) insurance policies.

188. The drafter of a standardized agreement will generally be a corporation able to spread the loss among all consumers of its goods or services. Loss spreading may be justified on a number of grounds. While recognizing the limits of this generalization, Professor Calabresi has noted:

> The advantages of interpersonal loss spreading would probably be stated as a pair of propositions: (1) taking a large sum of money from one person is more likely to result in economic dislocation, and therefore in secondary or avoidable losses, than taking a series of small sums from many people; (2) even if the total economic dislocation were the same,

considerations do not mandate such a result.[190] In the case of the "unexpected" insurance exclusion, a rule of law which places the risk of loss upon the insured who fails to read his policy is more likely to result in an informed populace then a rule which places the risk of loss on the insurer who may already be required to set forth the exclusion in bold type and in plain English.[191] Professors Calabresi and Hirschoff have suggested, in a different context, that the law impose liability (or, more properly, the risk of loss) on the party in the best position to determine the most efficient course of action.[192] Recognizing that Professor Abraham has reached a contrary conclusion,[193] we submit that it is most often the non-drafting party who is in the best position to avoid a loss by simply reading the agreement he signs or by acting to verify the accuracy of his subjective and generally unarticulated expectations.[194]

It is not as easy to reject the "objective" expectations standard, although the deficiencies of this rule are equally obvious. An objective standard discounts the actual, signed agreement, even though expressed in clear and understandable language;[195] carried to its logical extreme, application of the objective standard means that the written agreement, even when read, understood, and accepted, may not be evidence of the "true" contract between the parties.[196] "Objectivity" is tantamount to judicial legislation.[197] In other words, reference to the supposed "expectations of the public at large"—which can neither be proven nor disproven—ignores distinctions based upon the sophistication or actual knowledge of the non-drafting party before the court.[198] Is it appropriate that Ms. Palsgraf (a young woman on Long Island), Darner Motor Sales, and General Motors should all have the ability to reject certain standard insurance policy exclusions, or perhaps,

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many small losses would be preferable to one large one simply because people feel less pain if 10,000 of them lose one dollar apiece than if one person loses $10,000.

G. CALABRESI, THE COSTS OF ACCIDENTS 39 (1970) (footnote omitted).

189. In the context of contract law, "primary cost avoidance" refers to the goal of allocating risks in such a manner so as to cause the contracting parties to act to minimize the number of unexpected losses. In the insurance context, this means placing the risk of an unexpected, uncovered loss on the party best able to act to avoid the loss. *Cf.* G. CALABRESI, *supra* note 188, at 21, 68-129 (1970) (defining and applying the term "primary accident cost avoidance" to tort law situations).

190. For example, when an insurer provides an unambiguous specimen policy to an insured who then fails to read it, it is the insured who is in the best position to avoid an uncovered loss.

191. *See, e.g.*, ARIZ. ADMIN. COMP. R. R4-14-212 (rev. 1980) (setting forth readable policy guidelines promulgated by state director of insurance). *See also* R. FLESCH, THE ART OF READABLE WRITING (2d ed. 1974); Gardner, *supra* note 161, at 581 ("If such a policy did not put a duty on the insured to read it, it may at least create the reasonable expectation that he is familiar with the terms [used in the] contract").

192. *See* Calabresi & Hirschoff, *Toward a Test for Strict Liability in Torts*, 81 YALE L.J. 1055, 1060 (1972).

193. *See* Abraham, *supra* note 32, at 1170-72.

194. *See* Gardner, *supra* note 161, at 581-82.

195. *See* Keeton, *supra* note 29, at 968: "[N]ot only should a policyholder's reasonable expectations be honored in the face of difficult and technical language, but those expectations should prevail as well when the language of an unusual provision is clearly understandable, unless the insurer can show that the policyholder's failure to read such language was unreasonable."

196. *See id.*

197. *See* Keeton, *supra* note 29, at 964 n.4. *See generally* Abraham, *Judge-Made Law and Judge-Made Insurance: Honoring the Reasonable Expectations of the Insured*, 67 VA. L. REV. 1151 (1981).

198. *See* Keeton, *supra* note 29, at 974-75.

due-on-sale clauses, because such provisions are beyond the reasonable expectations of the "public at large" or the "average insured"? We think not.

Yet there are certain types of cases in which rejection of standardized agreement terms on the basis of "objective expectations" does appear to be appropriate. The doctrine of "unconscionability"[199] represents an important exception to the parol evidence rule and an appropriate application of an objective expectations principle. Indeed, most non-inducement cases in which standardized agreement terms have been rejected or modified can be classified broadly as illustrations of the unconscionability doctrine. The remainder involve terms which may be classified as "objectively unreasonable," that is, terms which do not violate public policy but which the public at large would clearly find to be intolerable. These would include terms in a standardized agreement (i) which were either bizarre or oppressive;[200] (ii) which eviscerated the "dickered" terms of the agreement;[201] (iii) which

199. *See supra* note 38. The *Restatement (Second) of Contracts* avoids any definition of unconscionability, *see* RESTATEMENT (SECOND) OF CONTRACTS § 208 (1981), although the close relationship of this doctrine to the subject of standardized agreements, *see id.* § 211, was mentioned by the drafting committee, *see* 49 A.L.I. PROC. 523 (1971). Certainly, the doctrine has received considerable academic attention. *See, e.g.*, Braucher, *The Unconscionable Contract or Term*, 31 U. PITT. L. REV. 337 (1970); Ellinghaus, *In Defense of Unconscionability*, 78 YALE L.J. 757 (1969); Leff, *Unconscionability and the Code—The Emperor's New Clause*, 1156 U. PA. L. REV. 485 (1967); Leff, *Unconscionability and the Crowd—Consumers and the Common Law Tradition*, 31 U. PITT. L. REV. 349 (1970); Murray, *Unconscionability: Unconscionability*, 31 U. PITT. L. REV. 1 (1969); Spanogle, *Analyzing Unconscionability Problems*, 117 U. PA. L. REV. 931 (1969); Spiedel, *Unconscionability, Assent and Consumer Protection*, 31 U. PITT. L. REV. 359 (1970); Note, *Unconscionability Redefined: California Imposes New Duties on Commercial Parties Using Form Contracts*, 35 HASTINGS L.J. 161 (1983).

200. *See* RESTATEMENT (SECOND) OF CONTRACTS § 211 comment f (1981).

201. It is universally recognized that, in the event of conflict, the "dickered" terms of an agreement prevail over the non-dickered or standardized terms. *See, e.g.*, Industrial Mach., Inc. v. Creative Displays, Inc., 344 So. 2d 743 (Ala. 1977); How v. Fulkerson, 22 Ariz. App. 467, 528 P.2d 853 (1974); *In re* Sanderson's Estate, 510 P.2d 452 (Colo. Ct. App. 1973); Hurt v. Leatherby Ins. Co., 380 So. 2d 432 (Fla. 1980); Desbien v. Penokee Farmers Union Co-op. Ass'n, 220 Kan. 358, 552 P.2d 917 (1976); Hoerner Waldorf Corp. v. Bumstead Woolford Co., 158 Mont. 472, 494 P.2d 293 (1972); Lanni v. Smith, 89 A.D.2d 782, 453 N.Y.S.2d 497 (1982); Dooley v. Cordes, 434 P.2d 289 (Okla. 1967); Bank of Ephraim v. Davis, 559 P.2d 538 (Utah 1977); Weaver v. Fairbanks, 10 Wash. App. 688, 519 P.2d 1403 (1974). Williston states the rule as follows:

> Where part of the contract is in writing and part is in printing, the writing will be given effect if there is repugnancy between the two portions of the instrument. Also, if there is reasonable doubt as to the sense and meaning of the whole document, the words in writing will control the construction of the contract . . . .

4 S. WILLISTON, *supra* note 13, § 622, at 774-75. Corbin echoes this view:

> [Printed and written terms] should be interpreted so as to give them some effect rather than no effect, and should be harmonized if possible with the provisions that are in handwriting or typewriting. If, however, there is a conflict and inconsistency between a printed provision and one that was inserted by the parties especially for the contract that they are then making, the latter should prevail over the former.

3 A. CORBIN, *supra* note 11, § 548, at 181-82.

The principle underlying the law's deference to the dickered terms of agreement is simply stated: "[The rule favoring dickered terms] flows from the fundamental principle governing the interpretation of integrated agreements; the written words are the symbols chosen by the parties themselves to express their meaning . . . ." 4 S. WILLISTON, *supra* § 622 at 776. Professor Murray has observed: "[S]tandardized writings are particularly suspect in identifying the true intent of the parties . . . . Conscious assent can be given only to 'dickered' terms, the terms reasonable parties normally and consciously negotiate." Murray, *supra* note 11, at 1374. *See* Patton, *The Interpretation and Construction of Contracts*, 64 COLUM. L. REV. 833, 855 (1964) (Language inserted by the parties "is a more recent and more reliable expression of their intentions than is the language of a printed form.").

eliminated the dominant purpose of the transaction;[202] or (iv) which placed an unreasonable burden upon one contracting party, which the public at large would not anticipate in such an agreement.[203]

In sum, properly defined and reasonably applied, the expectations principle is generally consistent with the parol evidence rule and its recognized exceptions. This well-established, historic doctrine should remain the starting point for all contract analysis, including the interpretation of standardized agreements. While a subjective expectations standard should be rejected, the parol evidence rule needs to be restated so that it is clear that, under certain circumstances, cases of "inducement" and "objective unreasonableness" are exceptions to the rule.

The Inducement Principle

Various authors have compiled and classified the myriad decisions applying the traditional "exceptions" to the parol evidence rule.[204] For example, evidence of prior negotiations or agreements is admissible to show whether a contract has been made,[205] whether it is completely integrated,[206] the meaning of certain terms,[207] invalidating forces,[208] and grounds for resorting to equitable remedies.[209] It is a worthwhile endeavor to seek a common thread in these decisions. It is a mistake, however, to conclude that such exceptions represent a desire to honor the subjective intentions of the non-drafting contracting party. To the contrary, no decision, including *Darner*, has rejected an unambiguous contract term or submitted a question of contract interpretation to the jury simply because one contracting party contended that the term was contrary to his expectations.[210] Rather, the decisions suggest that a standardized contract term may be varied or contradicted if it is contrary to the expectation of one contracting party only if that expectation was the result of some affirmative conduct by the other contracting party.[211] This is the "inducement principle."

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202. *See id.*
203. *See id.*
204. *See supra* notes 17-21.
205. *See* RESTATEMENT (SECOND) OF CONTRACTS § 214(a) (1981).
206. *See id.* § 214(b) (adopting the Corbin approach discussed *supra* note 13).
207. *See id.* § 214(c).
208. *See id.* § 214(d) (illegality, fraud, duress, mistake, or lack of consideration).
209. *See id.* § 214(e) (rescission or reformation).
210. There are, however, decisions which purport to apply the expectations principle to reject unambiguous contract terms in the absence of inducement evidence. These decisions generally find the provision in issue to be beyond the objective expectations of the public at large and do not focus on the expectations of the particular insured before the court. Nevertheless, it is significant to note that these decisions, on the cutting edge of the expectations revolution, often expressly reject historical concepts such as the parol evidence rule and the duty to read. *See, e.g.*, Kievit v. Loyal Protective Life Ins. Co., 34 N.J. 475, 483, 170 A.2d 22, 30 (1961); Collister v. Nationwide Life Ins. Co., 479 Pa. 579, 589, 388 A.2d 1346, 1351 (1978), *cert. denied*, 439 U.S. 1089 (1979) ("the adhesionary nature of insurance documents is such that the insured is under no duty to read the policy sent by the company").
211. The decision in Continental Ins. Co. v. Bussell, 498 P.2d 706 (Alaska 1972), is illustrative. The Alaska court held that it was unreasonable for an insured to expect life insurance coverage where the policy was unambiguous and contained no language which a layman could reasonably construe as providing coverage. In the absence of an induced expectation, the court held that the insurance contract would be given effect as drawn. This principle was clearly articulated in Rodman v. State Farm Mut. Auto. Ins. Co., 208 N.W.2d 903 (Iowa 1973):

In inducement cases, parol and extrinsic evidence is admissible to establish the act of inducement and the expectation induced.[212] This is a long-recognized exception to the parol evidence rule. Indeed, *Darner* itself can be viewed as a classic inducement case[213] in which the Arizona Supreme Court properly remanded the case for trial on the inducement issue. To the extent *Darner* suggests that the same result would have been reached in the absence of inducement evidence,[214] it is aberrational.[215] The key to *Darner* is not the fact that Mr. Darner thought his lessees had $100,000 in liability coverage, but the fact that he alleged he was induced by Doxsee's statements to believe that such coverage was provided. Thus, while Justice Feldman[216] purports to adopt a new rule (at least for Arizona), it would not have been difficult to fit the *Darner* decision into a more traditional mold.[217]

Summary Disposition of Standardized Contract Disputes

Recognizing that inducement cases often present questions for resolution by the trier of fact need not remove the predictability and consistency necessary in an ordered system of law. Inducement cases historically and inevitably involve questions of fact.[218] However, relatively few standardized

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> Plaintiff does not contend he misunderstood the policy. He did not read it. He now asserts in retrospect that if he had read it he would not have understood it. . . . We refuse to extend application of the principle of reasonable expectations to cases where an ordinary layman would not misunderstand his coverage from a reading of the policy unless there are other circumstances attributable to the insurer which cause such expectations.

Id. at 906-07.

212. *See* E. FARNSWORTH, *supra* note 11, at § 7.4-.5; RESTATEMENT (SECOND) OF CONTRACTS § 214(d)-(e) (1981).

213. In fact, the plaintiff's complaint relied on the doctrines of equitable estoppel, negligent misrepresentation, and fraud, based on the alleged statements of the insurance agent. *See* Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 400, 682 P.2d 388, 405 (1984).

214. *See id.* at 393-94, 682 P.2d at 398-99.

215. Even courts which have employed the expectations principle to void relatively unambiguous policy provisions have held that plain, clear provisions free of ambiguity will be given effect even if they are contrary to the subjective expectations of the insured. These decisions recognize a "duty to read" but find an exception where (1) the insurer (through its agents) has induced the insured not to read the policy; or (2) the policy terms are so ambiguous, technical or unclear as to create confusion in the mind of the insured; or (3) the representations of the insurer's agents are contrary to the terms of the policy and thus create confusion regarding the meaning of an otherwise unambiguous provision. *See, e.g.*, Pribble v. Aetna Life Ins. Co., 84 N.M. 211, 501 P.2d 255 (1972).

216. Justice Stanley Feldman, the author of the *Darner* decision, appears to be the moving force behind the adoption of the expectations principle in Arizona. The *Darner* decision was foreshadowed by Justice Feldman's opinion in Zuckerman v. Transamerica Ins. Co., 133 Ariz. 139, 650 P.2d 441 (1982) and his concurring opinion in Sparks v. Republic Nat'l Life Ins. Co., 132 Ariz. 529, 642 P.2d 1127, *cert. denied*, 459 P.2d 1070 (1982). The *Darner* rationale was subsequently applied by Justice Feldman in his opinions in Statewide Ins. Corp. v. Dewar, __ Ariz. __, 694 P.2d 1167 (1984), and Gilbreath v. St. Paul Fire & Marine Ins. Co., 141 Ariz. 92, 685 P.2d 729 (1984). Just one year before Justice Feldman joined the Arizona Supreme Court, the court unanimously rejected an expectations analysis. *See* Isaak v. Massachusetts Indem. Life Ins. Co., 127 Ariz. 581, 623 P.2d 11 (1981) (plaintiff's counsel, Stanley Feldman).

217. When *Darner* was before the Arizona Court of Appeals, that court did engage in a traditional parol evidence rule analysis and, contrary to the subsequent decision of the Supreme Court, found that because "Mr. Darner received a copy of the umbrella policy and made no contention that it was ambiguous or confusing, he cannot expand the insurer's liability beyond the terms of the umbrella policy issued by Universal." Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., No. 1 CA-CIV 5796 (Ariz. Ct. App. Feb. 22, 1983) (unpublished memorandum decision).

218. In the case of fraud, for example, the element of intent is a question of fact for resolution by the jury. Moreover, in inducement cases there is often a factual dispute as to whether the inducing

contract disputes involve allegations of inducement, although many of the cases which reach the point of a reported decision do involve such allegations. It is important that the law permit summary disposition of cases in which inducement is not alleged or cannot be proven and in which the contract provision in question is clear and unambiguous.[219] Adoption of a rule which permits summary disposition of contract disputes assures that "like cases will be decided alike."[220]

Historically, contract interpretation has been recognized as a question of law to be determined by the court.[221] This rule applies to both standard-

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representation was made at all. Indeed, *Darner* involved just such a question. *See* 140 Ariz. at 385 n.3, 682 P.2d at 390 n.3.

219. There are some decisions in which courts applying a form of expectations analysis have, nevertheless, granted summary disposition in favor of the insurer. *See, e.g.*, Wilson v. Insurance Co. of N. Am., 453 F. Supp. 732 (N.D. Cal. 1978); Davenport Peters Co. v. Royal Globe Ins. Co., 490 F. Supp. 286 (D. Mass. 1980); Farm Bureau Mut. Ins. Co. v. Sanbulte, 302 N.W.2d 104 (Iowa 1981). Other courts have applied an expectations analysis and granted summary disposition in favor of the insured. *See, e.g.*, Wainscott v. Ossenkop, 633 P.2d 237 (Alaska 1981); Farmers Home Mut. Ins. Co. v. Insurance Co. of N. Am., 583 P.2d 644 (Wash. App. 1978), *cert. denied*, 442 U.S. 942 (1979).

In the *Wainscott* case, for example, the Alaska Supreme Court reversed an order granting summary judgment in favor of the insurer and ordered that summary judgment be entered in favor of the insured. The insured had sought to recover under the uninsured motorist provision of his automobile policy for the death of his daughter resulting from an accident with an uninsured motorist. The policy expressly provided coverage for the insured and "residents of his household." At the time of the accident, the insured had separated from his wife and moved into an apartment. His wife and children remained in the family home. The issue before the court was whether the insured's daughter was, at the time of the accident, a resident of her father's household within the meaning of his insurance policy.

The court found that the insured's daughter "should be found to have been an additional insured under the rule of construction that the policy must be construed so as to provide that coverage which a layman would reasonably have expected given his lay interpretation of the policy's terms." 633 P.2d at 244. The court reasoned:

> [It is] entirely reasonable for [the insured] to expect, during the interim period before the bonds of marriage had been officially dissolved and before any provisions had been made for the care and custody of the minor children of the marriage, that his policy would continue to include within its coverage those who lived within the household for which he continued to be the sole source of support, even though he had recently, and perhaps permanently, discontinued his actual physical presence at [his former home].

Id.

In *Davenport*, the district court rejected the plaintiff's argument that coverage should be found because of the allegedly reasonable expectations of the insured under a comprehensive business insurance policy written by defendant. The policy in issue contained a $50,000 limit on coverage for losses due to employee dishonesty. Plaintiff contended that the limit applied on a per-year-per-dishonest-employee basis, rather than a per effective period-per-dishonest-employee basis. The court rejected plaintiff's arguments and entered summary judgment in favor of the insurer.

> [T]he principle of honoring reasonable expectations is no guarantee of victory for a plaintiff against an insurer. The present case is an apt illustration of this point. Despite the skill and ingenuity of counsel applied to the development of plaintiff's argument, nothing has been called to the court's attention—nothing, for example, about the structure, content, manner of printing of the policy, or the methods and practices of marketing—that would create reasonable expectations of a higher limit of coverage under the Policy than the limit stated in the applicable declaration. Under these circumstances, the doctrine of reasonable expectation is of no avail.

490 F. Supp. at 291-92.

In each of the cited decisions, the courts applied some form of objective standard to permit summary adjudication. It is instructive to note that in each case in which summary judgment was granted in favor of the insurer, the insured sought to create an issue of fact by arguing that their reasonable expectations were contrary to the terms of the policy.

220. *See* RESTATEMENT (SECOND) OF CONTRACTS § 212 comment d (1981).

221. *See* E. FARNSWORTH, *supra* note 11, § 7.14; 4 S. WILLISTON, *supra* note 13, § 661; RESTATEMENT (SECOND) OF CONTRACTS § 212 comment d (1981). Professor Farnsworth has noted,

ized and negotiated agreements.[222] Recognition of an "objective unreasonableness" exception to the parol evidence rule should not alter this fact.

Indeed, the determination whether a standardized contract term is objectively unreasonable is a matter for resolution by the court.[223] In resolving a standardized contract dispute, assuming none of the primary rules of contract construction enable the court to ascertain the intention of the parties, the court must first determine whether the questioned provision is ambiguous.[224] If it is not, the court must then determine whether the provision is objectively unreasonable. If the term is neither ambiguous nor objectively unreasonable, the term should be enforced as drawn unless there is evidence of an induced expectation[225] at variance with the contract terms. The available evidence of inducement must be sufficient to withstand a motion for summary disposition[226] and to bring the case within a traditional exception to the parol evidence rule. Naked allegations of inducement, or the mere hope that inducement evidence will be available at trial, is not sufficient to withstand a motion for judgment as a matter of law.[227]

Excising Objectively Unreasonable Terms From Standardized Agreements

Many decisions arising out of standardized agreements have resulted in the negation of unambiguous contract provisions.[228] Various attempts have been made to rationalize these decisions. Focusing upon insurance cases, which make up the vast majority of standardized contract cases, Professor Abraham has suggested that these decisions turn upon the unavailability of certain types of insurance in the marketplace.[229] In these "mandated coverage" cases,[230] the court in effect rewrites the insurance contract to provide the unavailable coverage.[231] If Professor Abraham is correct, then these

however, that in recent times "courts have shown greater willingness to send questions of interpretation to the jury." E. FARNSWORTH, *supra* note 11, at 516. *See, e.g.* Meyers v. Selznick Co., 373 F.2d 218, 222 (2d Cir. 1966).

222. *See* RESTATEMENT (SECOND) of CONTRACTS § 212 comment d (1981).

223. While the "reasonableness" of any act is generally a question of fact, the unconscionability of a contract provision is a question of law. *See, e.g.*, U.C.C. § 2-302(a) (1972). Questions of objective unreasonableness, though involving a slightly different standard, should be treated like the issue of unconscionability and should be determined by the court as a matter of law.

224. Even ambiguous contract terms may be subject to interpretation by the court, rather than by the jury. If the noted ambiguity "does not arise from, and cannot be solved by, any special local meaning of the words used, or any usage or surrounding circumstances," then the issue of interpretation remains one for the court. 4 S. WILLISTON, *supra* note 13, § 661, at 663. Similarly, even if extrinsic evidence is introduced, if it is not disputed or conflicting as to any material fact, the issue of interpretation remains one for determination by the court. *Id.* at n.7.

225. *See supra* note 39.

226. In other words, the evidence must be sufficient to create a genuine issue as to some material fact. *See* FED. R. CIV. P. 56(c).

227. It is axiomatic that in opposing a properly documented motion for summary judgment, a party may not rest upon the mere allegations or denials of his pleadings. Furthermore, "[o]ne against whom a motion for summary judgment is filed is . . . under a duty to show that he can produce evidence at the trial and is not entitled to a denial of that motion upon the unsubstantiated hope that he can produce such evidence at the trial." Chapman v. Rudd Paint & Varnish Co., 409 F.2d 635, 643 (9th Cir. 1969).

228. *See, e.g.*, Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966) (discussed *infra* at notes 278-295 and accompanying text.

229. *See* Abraham, *supra* note 32, at 1163.

230. *See id.* at 1162-68.

231. *See id.* at 1163.

cases involve the worst form of judicial activism.[232] In fact, his focus is too narrow and the suggested rationale too restricted to explain all of the non-inducement cases in which the courts have recognized rights at variance with the policy provisions.

It is also an error to attempt to explain these cases as simple applications of the expectations principle.[233] While it is true that doctrines have all too often been stretched to reach desired results,[234] this frequently occurs because the courts have been unable to articulate the conceptual basis for their decisions. It may be just as much of a fiction to suggest that a contract provision is beyond the reasonable expectation of the contracting party as it is to conclude that a reasonably clear contract provision is ambiguous.

Only Professor Keeton seems to have touched upon the true basis of these non-inducement cases. Again limiting his analysis to the insurance context, he concluded that "[a]n insurer will not be permitted an unconscionable advantage in an insurance transaction even though the policyholder or other person whose interests are affected has manifested fully informed consent."[235]

The same analysis applies to all standardized agreements. The keys are the disparity between the bargaining position of the drafting and non-drafting parties and the perceived unfairness of the provision in dispute. Although the realities of modern business require both the use and enforceability of standardized agreements, attempts at overreaching will be rejected—not because certain terms are beyond the expectations of the non-drafting party, but because they are clearly unreasonable and are beyond his power to prevent. The law recognizes that certain contract terms will never be enforced[236] and that, in the case of adhesion contracts, the universe of unenforceable provisions is broader than in the case of freely negotiated contracts.[237] Thus, it is not surprising that most commentators[238] (including

232. It is often said that the legislature makes the law and the courts are only supposed to interpret it. It is equally fundamental that courts are not supposed to "make contracts" for the parties. Professor Abraham somewhat ironically notes that the mandated coverage cases at least recognize an implicit limit on the courts' role by mandating coverage only where it is unavailable in the marketplace. *See* Abraham, *supra* note 32, at 1163.

233. Reliance upon the expectations principle often results in the creation of fictions at least as unprincipled as those sometimes employed under the rubric of traditional parol evidence rule analysis. For example, in Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 419 P.2d 1678, 54 Cal. Rptr. 104 (1966), the court suggested that the insured "expected" coverage for his alleged assault and battery. *See infra* note 288 and accompanying text. One doubts that the insured in that case ever thought about the possibility he would assault someone, let alone that his insurer would pay for it if he did.

234. *See, e.g.*, Gyler v. Mission Ins. Co., 10 Cal. 3d 216, 514 P.2d 1219, 110 Cal. Rptr. 139 (1973), discussed *infra* at notes 296-301 and accompanying text.

235. Keeton, *supra* note 29, at 963.

236. This principle is embodied in the doctrine of "unconscionability" and in a variety of legislative enactments proscribing certain contract terms. *See, e.g.*, ARIZ. REV. STAT. ANN. § 20-1115 (1975).

237. This concept of an "unenforceability" standard somewhat below the "unconscionability" standard is implicitly recognized in a number of expectations decisions. In the case of an adhesion contract, terms will be scrutinized more carefully than in the case of a dickered agreement. A thirty-day contractual claims limitation period in a products liability policy issued to General Motors might well be enforceable if it was the subject of arms-length negotiations. The same policy issued to Mom's Rent-A-Car might be found to impose an undue burden on the consumer and thus be held to be unenforceable—not because it is technically an unconscionable provision but simply because, as a

the *Restatement (Second) of Contracts* draftsmen)[239] have noted a close relationship between the expectations principle and the doctrine of unconscionability.

In the case of a standardized agreement, as with any other contract, a contract term may be negated if it is unconscionable or if it is objectively unreasonable. If a standardized term is oppressive, if it contradicts a negotiated term, if it eliminates the basic purpose of the transaction, or if it imposes a truly unreasonable burden upon the non-drafting party, then it is objectively unreasonable and will not be enforced.[240]

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matter of policy, it is objectively unreasonable to impose such a burden on a party lacking sufficient bargaining power to insist upon a longer claims period. *See also* 47 A.L.I. PROC. 533 (1970).

238. *See, e.g.*, Keeton, *supra* note 29, at 963-65.

239. *See* 47 A.L.I. PROC. 523-37 (1970). The debates surrounding the drafting of § 211 of the *Restatement (Second) of Contracts* are also instructive because they indicate the intent of the draftsmen to permit invalidation of certain contract clauses even though they might not be technically unconscionable. The following colloquy is illustrative:

> MR. CHARLES T. BEECHING, JR. [N.Y.]: I should like to ask whether there is some significant area covered by subsection (3) [of §211] that is not covered on the one hand either by unconscionability, or on the other hand by reformation. It seems to me, particularly from the comment, if you are inquiring primarily whether or not any reasonable man would have expected the term to be either included or not, you are primarily talking about unconscionability. If you are talking about an inquiry into the particular facts and assumptions of the particular parties involved, you are talking primarily about reformation.
>
> Is there, then, a significant area between those two established principles that this is intended to cover?
>
> MR. WILLARD: Mr. Reporter, I believe there's a very large area. One of the situations I gave in my letter to you. We all know that the maturity of a note is suspended over a holiday. Does interest run during the period of suspension or not?
>
> In 1952, I think New York had a statute saying that unless otherwise agreed, it would not. Very obviously, all the banks thereupon put in a clause saying that it was agreed that the interest would run. There is no unconscionability, and this is the kind of thing which I think my language was designed to take care of.
>
> PROFESSOR BRAUCHER: You were trying to validate the clause?
>
> MR. WILLARD: Correct.
>
> PROFESSOR BRAUCHER: Being a fair clause, it resolved a problem; and it does.
>
> MR. WILLARD: And yet most certainly the party signing it—the whole issue never entered his mind at all.
>
> PROFESSOR BRAUCHER: But I think the question that was being raised is: Do we invalidate any clauses which could not be invalidated by some other principle? And I think you have a couple of illustrations in the Comments and in the Reporter's Note.
>
> The ones I think of are cases of bizarre clauses, but they probably are not unconscionable if they have been flagged and agreed to. The one that I think of most quickly is the auction sale of real estate subject to restrictions noted in certain pages of the real estate records, and the case is cited in the Reporter's Note 237 on page 141. They had some building restrictions which the court thought were not within reason or precedent, and the incorporation by reference, in the view of the New York Court of Appeals, was just not good enough in that situation.
>
> Now, maybe that could have been handled under unconscionability, but the restriction was there. I don't think the restriction had been held invalid. The problem was, in fact, at an auction sale the natural presumption was that those were sort of usual building restrictions, and that unusual one was not adequately flagged. That's the sort of thing we have in mind here.

Id. at 532-33.

240. This standard is somewhat broader than that suggested in RESTATEMENT (SECOND) OF CONTRACTS § 211 comment f (1981), as it adds the notion of a contract term which imposes a truly unreasonable burden upon the non-drafting party. Such a term might include an unreasonably short claims period in an insurance policy, a fifty percent default interest rate in a loan agreement (assuming no applicable usury laws), or an oppressive penalty provision in an automobile rental policy which applies upon failure by the consumer to return the car within ten minutes of the required time.

Let us examine, for example, the standard policy of fire insurance.[241] It imposes upon the insured a contractual limitations period of one year—a period shorter than that imposed by the statute of limitations generally applicable to actions based upon written contracts.[242] Absent evidence of inducement, should this limitations provision be enforced against an insured who innocently waits thirteen months after a loss to file suit?

Proponents of a subjective expectations rule would probably invalidate or refuse to enforce such a provision on the grounds that the insured did not anticipate such a relatively short limitations period. Of course, the truth is that the insured probably had no expectation at all regarding this particular term. It is naive in the extreme, however, to expect a citizen facing an uninsured loss of his home to admit that the requirement was consistent with his expectations. "Subjectivity" invites perjury.[243]

"Objectivity" in contrast, substantially undermines the right of the industry to establish its own procedures and set its own rules within the bounds prescribed by the legislature.[244] Further, objectivity invites the courts to legislate. While the public at large might not "expect" such a limitations provision,[245] why should this fact invalidate or result in a refusal to enforce such a simple, clear, rational contract clause? Yet at least one court has invalidated such a clause upon the tenuous grounds that such a limitation provision "should not be allowed to defeat an otherwise valid claim."[246]

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241. The New York Standard Fire Insurance Policy provides, in pertinent part: "No suit or action on this policy for the recovery of any claim shall be sustainable in any court of law or equity . . . unless commenced within 12 months next after the inception of loss." *See* N.Y. INS. LAW § 168 (McKinney 1966); ARIZ. REV. STAT. ANN. § 20-1503 (1975) (adopting New York Standard Fire policy form).

242. In Arizona, the statutory limitations period for contracts in writing is generally six years. ARIZ. REV. STAT. ANN. § 12-548 (1982). The Arizona statutes also expressly prohibit provisions in certain insurance policies which significantly shorten the statutory limitations period. However, ARIZ. REV. STAT. ANN. § 20-1115 (1975) provides that the time during which a claim may be filed under a property, marine, or transportation policy may not be limited to less than one year from the date of occurrence of the event resulting in the loss.

243. Arguably, under a purely subjective standard, a party may avoid summary disposition of his claim by simply asserting that, at the moment of contracting, his expectation was that coverage for a certain risk existed even though he subsequently learned that the risk was among those expressly excluded from coverage. If, for example, an insured can avoid summary disposition of his claim simply by stating that his insurance agent said (in a conversation in which no one else was present) that he would be covered, then the likelihood that such conversations will be fabricated by desperate litigants increases significantly. Whether the allegation of such a statement, standing alone, should be treated as sufficient evidence of "inducement" to preclude, as a matter of law, enforcement of an otherwise unambiguous provision remains to be analyzed.

244. The legislature often mandates or prohibits certain contract terms. This is particularly true in the case of insurance contracts. *See, e.g.*, ARIZ. REV. STAT. ANN. § 20-1115 (1975) (prescribing certain minimum contractual limitations periods). However, "[w]hen the meaning and intent of the contract is clear, it is not the prerogative of the courts to change or rewrite it in an attempt to avoid harsh results." Lawrence v. Beneficial Fire & Cas. Ins. Co., 8 Ariz. App. 155, 159, 444 P.2d 446, 450 (1968). *See also* Zuckerman v. Transamerica Ins. Co., 133 Ariz. 139, 147, 650 P.2d 441, 449 (1982) (Holohan, C.J., dissenting).

245. In the final analysis, such an assertion cannot be proven or disproven.

246. Zuckerman v. Transamerica Ins. Co., 133 Ariz. 139, 650 P.2d 441 (1982). *Zuckerman* foreshadowed the decision in *Darner*. In *Zuckerman*, a decision also authored by Justice Feldman, with Chief Justice Holohan dissenting, the Arizona Supreme Court refused to give effect to the one-year limitations period in the standard fire insurance policy after noting that "the fact that the law permits the existence of such a clause does not mean that it must be applied in every situation." *Id.* at 143, 650 P.2d at 445. The court held that the provision "is not one which is bargained for and its application in the face of an otherwise valid claim defeats the reasonable coverage expectations of the

While couched in terms of the insured's supposed "expectations," the decision is a classic illustration of the misuse of the expectations principle to reach a desired result.

Surely the one-year limitation provision is not unconscionable.[247] Nor is it oppressive or contrary to the basis purposes of the policy. In short, there is no legitimate basis for refusing to enforce this provision even though it may be contrary to both the "objective" expectations of the public and the "subjective" expectations of one contracting party. A rational rule of law, founded in freedom of contract, should give effect to this provision.[248]

Now suppose that a liability or fire insurer in a state lacking applicable regulations[249] modified its standard form policy to provide for a twenty-four hour claims period. Coverage was provided only for claims submitted to the insurer within twenty-four hours of the injury or damage-causing event. In this case, the limitations period is oppressive and eviscerates the basic purpose of the contract. Once an insured loss is established under the terms of a policy, payment for that loss should not turn upon the availability of a telephone, the physical condition of the insured, or his presence of mind immediately after the accident. Stated differently, the provision is objectively unreasonable.

An objective unreasonableness standard[250] permits the court—not the jury—to "draw lines" in circumstances like those presented in the two illustrations discussed above. While application of such a standard arguably reduces the element of predictability to some extent, in reality it should not

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insured; in the absence of prejudice to the insurer, caused by the late filing of suit, enforcement leads to an effectual forfeiture of the claim, thus creating an inequitable result." *Id.* at 145, 650 P.2d at 447. *Zuckerman*, when read with *Darner*, suggests that in Arizona, at least in the insurance context, the parol evidence rule has been effectively discarded in favor of judicially constructed contracts and "equitable" results.

247. The one-year limitation provision in the New York Standard policy or in similar policies has been challenged as unconscionable on a number of occasions. In each instance, with the exception of *Zuckerman*, the contractual limitation provisions have been upheld and enforced. *See, e.g.*, Draughn v. United States Fidelity & Guar. Co., 144 Ga. App. 272, 241 S.E.2d 52 (1977); Jet Set Travel Club v. Houston Gen. Ins. Group, 30 Wash. App. 882, 639 P.2d 220 (1982); Meadows v. Employers Fire Ins. Co., 298 S.E.2d 874 (W. Va. 1982).

248. In fact, the one-year limitations provision has withstood challenges on a number of different theories in addition to the claim of unconscionability, *see supra* note 247. For example, numerous cases have considered the argument that because the contractual limitations period is shorter than the otherwise applicable statutory limitations period, *see supra* note 242, it is contrary to public policy. Again, these challenges have been uniformly rejected. *See, e.g.*, Prete v. Royal Globe Ins. Co., 533 F. Supp. 332 (N.D. W. Va. 1982); Murray v. Lititz Mut. Ins. Co., 44 Del. 447, 61 A.2d 409 (Super. Ct. 1948); Queen Tufting Co. v. Fireman's Fund Ins. Co., 141 Ga. App. 792, 234 S.E.2d 354 (1977); Darnell v. Fireman's Fund Ins. Co., 115 Ga. App. 367, 154 S.E.2d 741 (1967); Johnson v. Calvert Fire Ins. Co., 298 Ky. 669, 183 S.W.2d 941 (1944); Rhodes v. Continental Ins. Co., 180 Neb. 10, 141 N.W.2d 415 (1966); Globe Am. Cas. Co. v. Goodman, 41 Ohio App. 2d 231, 325 N.E.2d 257 (1974). *But cf.* Hiram Scott College v. Insurance Co. of N. Am., 187 Neb. 290, 188 N.W.2d 688 (1971) (contractural limitations period could not limit time within which action was to be commenced where statute prohibited provisions reducing time periods set forth in applicable statute of limitations).

249. As noted above, statutes often restrict the extent to which insurance contracts can limit the period within which the insured can commence suit. *See, e.g.*, ARIZ. REV. STAT. ANN. § 20-1115 (1975). *Cf.* Adams v. Northern Ins. Co., 16 Ariz. App. 337, 493 P.2d 504 (1972) (analyzing the one-year limitations period in the New York Standard policy in light of ARIZ. REV. STAT. ANN. § 20-1115).

250. The objective unreasonableness standard should not be confused with the objective expectations theory of Professor Keeton.

if properly applied by courts with a sense of judicial restraint;[251] in other words, if application of the objective unreasonableness test is limited to truly unreasonable terms and provisions and is not utilized as a talisman to produce a desired result, such application should come as no surprise to the drafting party. On the other hand, the objective and subjective expectations tests almost entirely eliminate predictability.[252]

One subclass of standardized contract disputes warrants consideration at this juncture. In many circumstances, the non-drafting party does not have possession of the written agreement or all of the documents constituting the agreement at the time the contract is formed. This is true, for example, in the case of airline tickets, which generally incorporate by reference the Warsaw Convention,[253] and transport or car rental agreements which incorporate by reference other instruments, such as insurance policies.[254] It is also true in the case of most automobile or general liability insurance policies for which binders are given long before the actual policy arrives by

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251. Just as courts are generally slow to void a policy provision on the ground that it is contrary to "public policy," Guardian Life Ins. Co. of Am. v. Zerance, —Pa.—, 479 A.2d 949 (1984), so they should be hesitant to refuse enforcement of a policy provision on the ground that it is "objectively unreasonable."

252. The various theories applied by different courts present a continuum; the traditional parol evidence rule assures relatively consistent results in most circumstances; the objective expectations rule at least permits consistency within each judicial body (presumably the public's expectations will be viewed as relatively static and each contract interpretation case will make reference to the public's expectations as defined in earlier cases); and the subjective rule abandons the goals of consistency and predictability in favor of honoring the individualized expectations of the non-drafting contracting party.

253. Convention for the Unification of Certain Rules Relating to International Transportation by Air, Oct. 12, 1929, 49 Stat. 3000, T.S. No. 876. The *Darner* court noted that the standardized "contract" for air transportation contains the following terms; whose enforceability was questioned:

> Conditions of contract
>
> As used in this contract "ticket" means this passenger ticket and baggage check, of which these conditions and the notices form part, "carriage" is equivalent to "transportation", "carrier" means all air carriers that carry or undertake to carry the passenger or his baggage hereunder or perform any other service incidental to such air carriage, "Warsaw Convention" means the convention for the unification of certain rules relating to international carriage by air signed at Warsaw, 12th of October, 1929, of that convention as amended at the Hague, 28th September, 1955, whichever may be applicable.

140 Ariz. at 394 n.9, 682 P.2d at 399 n.9 (quoting Uniform Passenger Ticket and Baggage Check, ATC version, printed on the back of standard form tickets in general use by airlines in the United States). No doubt, the majority of the Arizona Supreme Court would be taken aback by the unanimous opinion of the United States Supreme Court denying an injured, international passenger recovery as a matter of law, based upon its interpretation of the limitations of article 17 of the Warsaw Convention, reached by considering the *Grand Larousse de La Langue Française*, the *travaux préparatoires* of the drafters, the Guatemala City Protocol of 1971 and the Montreal Protocols Nos. 3 and 4 of 1975. *See* Air France v. Saks, 105 S. Ct. 1338 (1985).

254. In an important footnote that revealed the true import of the decision, the Arizona Supreme Court in *Darner* strongly suggested that its expectations analysis should also apply to "contracts for transport by rail, airline or bus; for rental of cars, trucks and other equipment; credit card and charge account 'rules' and terms; bills of lading, invoices and many other commercial documents [which] are 'sold' or 'made' in the same manner as most insurance policies." 140 Ariz. at 392 n.8, 682 P.2d at 397 n.8. Recently, the expectations analysis was applied in a non-insurance context. *See* Huff v. Bekins Moving & Storage Co., No. 2 CA-CIV 5000, slip op. at 4-6 (Ariz. Ct. App. Jan. 25, 1985) (reversing summary judgment in favor of common carrier on bill of lading because of factual issue as to reasonable expectations of consignees who may not have seen conditions set in small print); Nastri v. Wood Bros. Homes, Inc., 142 Ariz 439, 441-42, 690 P.2d 158, 160-61 (Ct. App. 1984) (citing *Darner* and suggesting that provisions of a construction contract might be unenforceable depending on "the real agreement of the parties").

mail.[255] Professor Keeton has observed that the normal process for marketing life insurance does not place the detailed policy terms in the hands of the policyholder until the contract has been made.[256]

Should the non-drafting party be bound by the terms of an agreement he has not received? Let us examine the alternatives. If the law seeks to honor the subjective expectations of the non-drafting party in these circumstances, then the potential liability of the drafting party will be, for at least a time, unlimited and absolute.[257] We predict with some confidence that few insureds who suffer an excluded loss prior to receipt of their policy will subsequently acknowledge that they expected the loss to be beyond the scope of the coverage afforded by the policy. Few passengers who have lost their baggage will acknowledge that a contractual limitation of liability was within their conscious expectation at the time they purchased their tickets. Subjectivity, in this context, means absolute liability for the drafting party.

Honoring the objective expectations of the public at large is likewise undesirable since it may eliminate altogether certain contractual liability limitations (for example, the Warsaw Convention), which are necessary for the efficient or profitable operation of certain industries. As noted earlier, objectivity and freedom of contract are simply incompatible concepts.

There are other practical reasons for rejecting these alternatives. Adoption of either a subjective or objective expectations standard in the "undelivered contract" case is likely to deter the making of such contracts or increase substantially the risks to the drafter and thus, ultimately, the cost to the non-drafting consumer.[258] For example, during the "binder" period, insurers would often have to recognize liability well beyond that envisioned in the written policy.[259] The inevitable result will be increased costs and/or decreased availability of insurance.[260]

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255. Similarly, package policies, which include homeowners' and automobile insurance, are often ordered by telephone. *See* R. KEETON, BASIC TEXT ON INSURANCE LAW 352 (1971).

256. Keeton, *supra* note 29, at 968. In fact, unless a specimen policy is requested, the policyholder does not actually see its terms until he has signed an application and paid a premium, the insurer has reviewed and approved the application, and the policy is issued.

257. The term "absolute" liability is used in the practical sense, not the technical legal sense. If the subjective expectations of the non-drafter determine the terms of agreement, all questions regarding the "true" terms of the contract must be resolved in favor of the construction urged by the non-drafter. In this sense, the "liability" of the drafter is "absolute."

258. If the insurer can spread its losses among all policyholders through an incremental increase in premiums, this is likely to occur. If, on the other hand, the insurer, for economic reasons (e.g., to remain competitive with an insurer which is unwilling to bind coverage), cannot pass on the loss to the consumer, then such rules would deter insurers from engaging in this type of transaction in the first instance. To the extent the public desires and needs to bind coverage immediately, an important consumer benefit may be lost.

259. This is a necessary consequence of an expectations rule since the non-drafter's expectations will often provide the terms of the contract prior to actual delivery of a written agreement. Under some formulations of the expectations rule, delivery of a specimen policy would limit coverage to the clear and unambiguous terms actually set forth in the specimen.

260. For an example of how a court can use an expectations analysis to justify a result, see generally Statewide Ins. Corp. v. Dewar, __ Ariz. __, 694 P.2d 1167 (1984) (Feldman, J.). *Dewar* held that coverage existed for an accident occurring between the time coverage was bound and the application for insurance was rejected, despite the fact that payment was made with an "uncollected funds" check. The court noted that the date on which coverage was bound was filled in on the preprinted binder agreement, and the requirement of payment was not expressly stated. *Dewar* has a surface appeal until one focuses upon the fact that the insurer agreed to issue the binder in exchange for payment of the required premium and the fact that payment was made by check—a conditional

The objective unreasonableness standard provides all the protection the law should afford in this class of cases. A non-drafting contracting party is bound by the terms of the unreceived contract unless such terms are objectively unreasonable or the non-drafting party was induced to believe that the terms of the written agreement would differ materially from those which actually appear in the agreement.[261]

Only a strained economic analysis could justify the invalidation of objectively reasonable standardized contract clauses simply because the actual contract was unavailable at the time of agreement.[262] If the non-drafting party is misled by the drafter, then the inducement principle will protect his right to establish terms at variance with the written agreement. If that agreement contains oppressive terms or terms which defeat the dominant purpose of the transaction, then the doctrine of "objective unreasonableness" provides sufficient protection for the non-drafter. In all other circumstances, the actual terms of the standardized contract should be given effect. In many cases this view is mandated by statute, a fact which the proponents of expectations analysis sometimes ignore.[263]

Most of the cases which purport to honor the "reasonable expectations" of the parties can be classified as either "inducement" or "objective unrea-

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instrument that does not act as payment unless and until honored by the bank. *See* U.C.C. § 2-511(3) (1972). In view of the failure of consideration, one wonders whether the public at large or a reasonable person would really expect coverage under such circumstances; we suspect not.

261. This approach, which is consistent with the rule of law generally applied throughout the United States, has certain practical benefits. For example, it would seem to be unfair (and expensive) to require airlines to distribute copies of the Warsaw Convention, car rental companies to distribute copies of their underlying fleet insurance policies, and financial institutions to provide copies of all of the consumer credit, truth-in-lending, and non-discrimination regulations incorporated in their loan documents. In these circumstances, the marginal social benefit realized by imposing upon the drafter a duty to produce the information in every instance might in fact pale when compared to the marginal cost of producing each unit of information. *See* Abraham, *supra* note 32, at 1171-72 n.78.

We recognize that a reasonable alternative approach would place the burden of providing a specimen contract on the drafting party. The non-drafting party's "duty to read" (and thus his risk of loss) would arise only after the drafter had provided all necessary information upon which to base a decision. The insurance industry, in response, would likely devise a "receipt" to demonstrate that a specimen policy had been delivered. If, as some courts contend, the contract is seldom read anyway, one wonders what would really be gained by delivering two copies, rather than one. Of course, administrative expense would increase marginally to reflect the cost of producing and distributing the specimen policy and receipt. One commentator, Professor Abraham, appears to advocate this allocation of risks. *See* Abraham, *supra* note 32, at 1170-72 nn.77-78, 1173 n.81.

262. Stated differently, the drafter of a contract has the right to assume that all objectively reasonable provisions of the actual agreement are within the reasonable expectations of the non-drafter. In the insurance context, Professor Abraham has observed: "[T]he insurer cannot be the appropriate focus of liability if it has no way of anticipating the insured's expectations. This would be true in the case of an entirely 'unreasonable' expectation." Abraham, *supra* note 32, at 1172 n.78.

263. For example, the Uniform Commercial Code contains a formulation of the parol evidence rule which would appear to preclude ignoring the unambiguous terms of a sales contract in favor of the unexpressed expectations of a contracting party. U.C.C. § 2-202 (1972) provides:

> Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respects to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented
>
> (a) by course of dealing or usage of trade (Section 1-205) or by course of performance (Section 2-208); and
>
> (b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

sonableness" decisions. Those cases which recognize rights at variance with terms of a written agreement and which cannot be reconciled with these principles should be rejected as unwarranted exercises in judicial legislation.[264] The sanctity of the written agreement can and should be preserved. Recognition of the "inducement" and "objective unreasonablness" principles, as defined in this article, prevents overreaching and deters pernicious trade practices, while still maintaining the integrity of written documents. Practical application of these rules is not a complex task.

V. ESTABLISHING A NEW STANDARD: DISCERNING ORDER IN THE CHAOS

The parol evidence rule, the objective unreasonablness standard, and the inducement principle should be applied serially. The following four-step analysis may be applied to every standardized contract dispute.

1. The court should first determine whether the agreement in question is fully integrated and unambiguous.

Traditional rules of construction apply to partially integrated and ambiguous agreements.[265] Parol evidence is admissible to establish integration,[266] and ambiguous contract provisions are construed against the drafter[267]—the party in the best position to avoid the ambiguity[268] and, only incidentally, to absorb and spread any resultant loss.[269] But ambiguity should not be found nor created for the purpose of achieving a desired result.[270] To the contrary, most standardized contract terms are unambiguous (and are often required by law)[271] and should be treated as such. Rules which find ambiguity based solely upon the existence of differing judicial constructions[272] are both an abandonment of judicial responsibility and an unintended perpetuation of past decisions which all too often were unprincipled and result-oriented.[273] Such rules should be uniformly rejected.

The Uniform Commercial Code parol evidence rule has been legislatively adopted in most states with respect to transactions involving the sale of goods. *See, e.g.*, ARIZ. REV. STAT. ANN. § 47-2202 (Supp. 1984).

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

265. As noted at the outset, this discussion is limited to completely integrated agreements.

266. *See* RESTATEMENT (SECOND) OF CONTRACTS § 214(a) (1981).

267. *See id.* § 206.

268. *Cf.* G. CALABRESI, THE COSTS OF ACCIDENTS 68 (1970) ("[T]he primary way in which a society may seek to reduce accident costs is to discourage activities that are 'accident prone' and substitute safer activities as well as safer ways of engaging in the same activities."). The rule of construction against the draftsman has a "deterrent" effect and should, in theory, reduce the number of ambiguously drawn agreements.

269. Whether loss spreading is a proper goal of contract law is an issue which we do not address at this juncture. *Cf.* G. CALABRESI, *supra* note 268, at 39-67 (discussion of loss spreading as a goal of accident law). With respect to standardized agreements, it is an incidental effect of the rule of construction against the draftsman.

270. For a criticism of the tendency of some courts to create false ambiguities, see Keeton, *supra* note 29, at 972, *quoted infra* at note 326.

271. For example, the terms of consumer credit agreements are, in large part, prescribed by federal regulations. *See, e.g.*, 15 U.S.C. §§ 1601-1693 (1982).

272. *See, e.g.*, Federal Ins. Co. v. P.A.T. Homes, Inc., 113 Ariz. 136, 138, 547 P.2d 1050, 1052 (1976).

273. Darner Motor Sales, Inc., v. Universal Underwriters Ins. Co., 140 Ariz. 383, 389, 682 P.2d

2. The court should determine, as a matter of law, whether the contract term in question is "objectively unreasonable."

In making this determination, the court should determine whether the clause in question is oppressive, whether it eviscerates the "dickered" terms of the agreement, whether it eliminates the dominant purpose of the transaction, or whether it places a truly unreasonable burden upon the non-drafting party. The adhesive nature of the contract should be considered, but it is in no sense controlling. Terms which are reasonable—even though restrictive, narrowly drawn, or unfavorable to the non-drafting party—should be given effect. The one-year limitations period in the standard fire insurance policy is a classic example. Standardized terms which are objectively unreasonable do not constitute terms of the "true agreement" between the contracting parties. Finally, we note again that questions of objective unreasonableness are questions of law to be determined by the court. The subjective expectations of the contracting parties are irrelevant unless the expectation of the non-drafter has been "induced" by the drafter.

3. If an unambiguous term of an integrated agreement is not objectively unreasonable, then the term will be enforced unless the non-drafting party has been induced by the drafting party to believe that the written agreement embodied a different term.

Allegations of inducement generally involve questions of fact and may be established by parol and extrinsic evidence.[274] However, while the subjective expectation of the non-drafting party is an element of an inducement case, it is not the pivotal element. A party seeking to invoke the inducement principle to establish a right at variance with a written contract term must establish both an act constituting inducement and detrimental reliance upon that act; that is, the party must establish the pre-contract formation of an induced expectation.[275] An affidavit stating that an insurance agent delivered a policy with an unambiguous coverage exclusion without noting the existence of a particular policy term is not sufficient to establish inducement even though the insured may have expected coverage for the excluded risk.[276]

388, 394 (1984) criticizes the rule of construction that finds an ambiguity simply because different courts have reached different conclusions regarding the meaning of a provision.

274. *See* RESTATEMENT (SECOND) OF CONTRACTS § 214(d) (1981). For example, the parol evidence rule does not bar extrinsic evidence of fraud. 3 A. CORBIN, *supra* note 11, § 580, at 431. *But see* E. FARNSWORTH, *supra* note 11, § 7.4 at 465-66 (1982) (stating that the parol evidence rule does bar extrinsic evidence of promissory fraud).

275. Guardian Life Ins. Co. of Am. v. Zerance, —Pa.—, 479 A.2d 949 (1984). *See also* Keeton, *supra* note 29, at 977-78.

276. While we leave open certain important questions regarding the scope of the inducement principle, the majority rule is that the drafting party does *not* have an affirmative duty to describe the contents of the contract. To the contrary, the non-drafter has a duty to read the agreement. *See supra* note 111.

4. In the absence of inducement or an objectively unreasonable term, a fully integrated, unambiguous writing constitutes the agreement between the parties.

This is the modern form of the parol evidence rule. Absent evidence of inducement, a fully integrated, non-ambiguous written agreement may not be contradicted by parol or extrinsic evidence. While technically the writing is only evidence of the actual agreement, it is uncontrovertible evidence of that agreement.[277] Principled application of this rule assures the necessary degree of consistency and predictability in contract interpretation cases.

VI. APPLYING THE NEW RULES TO STANDARDIZED CONTRACT DISPUTES.

Having developed a discrete set of rules, the application of these rules to real-life situations should be explored. The following case studies illustrate the application of the proposed standards in certain difficult cases in which courts have been prone to engage in a somewhat unstructured, if not unprincipled, expectation analysis for the apparent purpose of achieving what they believe to be a socially desirable result. As will be seen, application of these rules would change few results. This stems in part from the rules' embodiment of an expectations principle and in part from the fact that the principles and rules outlined in this article, though often unspoken, have always formed the true basis of most standardized contract decisions.

Illustration No. 1: The "Mandated Coverage" Case[278]

Gray was insured under a comprehensive personal liability policy issued by Zurich Insurance Co. The policy insured against liability for bodily injury and property damage. The policy expressly excluded coverage of claims for "bodily injury or property damage caused intentionally by or at the direction of the insured." When Gray was sued for "wilfully, maliciously, brutally and intentionally" assaulting the plaintiff, the insurer refused to defend on the grounds that the suit did not seek damages for an act covered by the policy. The insured then defended himself and contended that he had acted in self-defense. The jury rejected the defense and assessed damages against the insured.[279]

Analysis of the *Gray v. Zurich Insurance Co.* decision within the framework previously established is not difficult.[280] The real issue is whether the

277. Professor Murray refers to this as "one of the unassailable rudiments of contract law." Murray, *The Parol Evidence Process and Standardized Agreements Under the* Restatement (Second) of Contracts, 123 U. PA. L. REV. 1342 (1975).

278. The term "mandated coverage case" was coined by Professor Abraham. *See* Abraham, *supra* note 32, at 1162. He suggests that although these cases often pay lip service to the expectations principle, they are actually premised upon the desire to provide insurance coverage that is otherwise unavailable at the time of decision. *Id.* at 1163. While we concur that this may be one of the conceptual bases for these difficult to classify decisions, the issue addressed in the text is principally one of institutional competence: Is it the role of the courts to provide insurance coverage when the market does not and the legislature has not required it?

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

280. *Gray* is often mischaracterized as primarily a "coverage" case. In fact, the principal issue in *Gray* was not whether the policy covered losses arising out of intentional acts, but whether the policy

exclusion in question is ambiguous, and the courts are divided on this point.[281] If the exclusion is ambiguous, an expectations analysis is unecessary. If the provision is unambiguous, expectations analysis provides a convenient fiction which has permitted certain courts to sidestep the lack of ambiguity and justify a desired result. While exclusion of coverage for (and a duty to defend) claims based upon allegedly intentional acts may or may not be generally desirable, there is nothing unreasonable about this provision. Insurers have the right to exclude such risks from coverage; the public policy which favors deterrence of violent behavior and self-help justice would also seem to favor such an exclusion.[282] Surely the legislature could require intentional act coverage[283] and arguably an insured could bargain for such coverage,[284] but the courts should not legislate such coverage where it is not provided in an unambiguous contract. The exclusionary clause is not oppressive; it does not defeat the dominant purpose of the transaction or contradict a freely negotiated term; nor does it impose an undue burden upon any contracting party. In the absence of evidence that the insurer affirmatively induced Gray into believing that the policy provided intentional act coverage, the policy provision should be given effect as drawn and as obviously intended by its drafter. Indeed, on the facts presented, *Gray* would appear to present a case for summary disposition in favor of the insurer.[285]

The fact that the California Supreme Court reached precisely the oppo-

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required the insurer to defend claims which alleged intentional conduct. This is a distinction of substance since the law has long recognized that a duty to defend may exist even though the insurer may not be bound to pay the loss if a judgment ultimately results from the litigation. In practice, insurers often defend claims like the one in *Gray* under a full "reservation of rights" permitting subsequent denial of the claim if a judgment is obtained. In any event, focusing solely upon the duty to defend, the *Gray* decision may be explained under traditional rules relating to ambiguous agreements. *See id.* at 268, 419 P.2d at 171, 54 Cal. Rptr. at 107. It appears, however, that had the primary issue in *Gray* been one of coverage rather than the duty to defend, the California court, applying the expectations principle, would have reached precisely the same result. *Id.*

281. *See, e.g.*, Annot., *Construction and Application of Provision of Liability Insurance Policy Expressly Excluding Injuries Intended or Expected by Insured*, 31 A.L.R. 4TH 957, 978 (1984). A reasonable insured is not likely to assume that his homeowners' liability policy provides coverage if he intentionally assaults another customer in a bar or intentionally drives his car through the door of his neighbor's garage. *Accord* Abraham, *supra* note 32, at 1165 (opining that a reasonable insured would not expect coverage to include the defense of claims based upon assault and battery). Moreover, the availability of such coverage is more likely to encourage than deter such conduct. On the other hand, a defensive reaction to an unprovoked attack by another may not be an "intentional act." Transamerica Ins. Group v. Meere, __ Ariz. __, 694 P.2d 181 (1984); Fire Ins. Exch. v. Berray, __ Ariz. __, 694 P.2d 191 (1984).

282. The defendant-insurer in *Gray* did argue that, if the policy required the defense of an intentional tort claim, then it violated public policy and, further, that the judgment against the insured on the injured party's claim of intentional bodily injury created an estoppel preventing the insured from recovering against his insurer. 65 Cal.2d at 268, 419 P.2d at 170, 54 Cal. Rptr. at 106.

283. The legislature often prescribes the terms of insurance policies in certain contexts. *See, e.g.*, ARIZ. REV. STAT. ANN. § 20-1503 (1975) (fire insurance); ARIZ. REV. STAT. ANN. § 20-259.01 (Supp. 1984-85) (uninsured motorist insurance).

284. Even the *Darner* court recognized that some insurance transactions are the product of negotiation. *See* Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 392 n.8, 682 P.2d 388, 397 n.8 (1984).

285. If *Gray* is not an appropriate case for summary disposition in favor of the insurer, it is because a court reviewing the insurance contract as a whole could find either the coverage clause or the defense clause to be ambiguous; it is not because the insured expected a defense or anticipated coverage for his intentional torts.

site conclusion in *Gray* illustrates the mischief which can be perpetrated in the name of the "expectations principle."[286] The court found that a duty to defend existed because the policy contained a supposedly unqualified defense clause and because the relationship between the defense clause and the liability coverage provisions was supposedly unclear.[287] The court thus concluded that the insured could "reasonably expect" a defense to be provided in the situation presented.[288] The court also held that the policy exclusion would "defeat the basic reason for the purchase of insurance."[289]

The *Gray* decision has been subject to criticism on a variety of grounds.[290] For present purposes, however, it is most important to note that the court's actual decision in *Gray* furthers none of the goals underlying either the parol evidence rule or the expectations principle.[291] Recognizing this fact, Professor Abraham has classified this case as one which illustrates a "mandated coverage theme"—that is, the court found that coverage existed because it thought coverage was desirable and might not be available in the marketplace.[292] However, Professor Abraham fails to address the question of institutional competence[293] and it is here that the *Gray* decision is subject to the most pointed criticism. Establishing mandatory insurance policy provisions is a matter for legislative and not judicial consideration. The exclusionary clause in *Gray* did not eliminate the basic purpose of the transaction. To the contrary, liability coverage was provided by the policy purchased and, to the extent the exclusionary clause did limit that coverage, it did so "only tangentially."[294]

The *Gray* decision illustrates the importance of having a properly defined, "objective unreasonableness" standard for use in non-inducement

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286. In a footnote, the *Gray* court cites with apparent approval a law review comment which recognizes some of the problems encountered in attempting to apply the expectations doctrine:

> As to the insured's expectations, it is safe to assume that if the ordinary insurance consumer had thought about them, his expectations would be that the insurer would defend him whenever there was a threat of liability to him and the threat was based on facts within the policy. The insured probably would be surprised at the suggestion that defense coverage might turn on the pleading rules of the court that a third party chose or on how the third party's attorney decided to write the complaint.

65 Cal. 2d at 275 n.14, 419 P.2d at 175 n.14, 54 Cal. Rptr. at 111 n.14 (quoting Comment, *The Insurer's Duty to Defend Under a Liability Insurance Policy*, 114 U. PA. L. REV. 734, 748 (1966)).

287. 65 Cal. 2d at 275, 419 P.2d at 174-75, 54 Cal. Rptr. at 110-11.

288. *Id.* at 268, 419 P.2d at 171, 54 Cal. Rptr. at 107.

289. *Id.* at 278, 419 P.2d at 178, 54 Cal. Rptr. at 114.

290. *See, e.g.*, Abraham, *supra* note 32, at 1165-66.

291. A parol evidence rule analysis would have concluded that either (1) the policy was unambiguous and no duty to defend intentional acts was imposed, or (2) the scope of the coverage and/or defense clauses was ambiguous and should be construed in favor of the insured. Professor Abraham notes that the opinion in *Gray* is really more concerned with the substance of coverage than with the expectations of the insured. He suggests that if the insured had read the exclusionary clause in *Gray*, he would have understood it and that, in the absence of such a reading, it is unlikely that the insured expected his policy to include a defense of assault and battery claims. Abraham, *supra* note 32, at 1165.

292. Abraham, *supra* note 32, at 1166.

293. The term "institutional competence" refers to the distinction between the appropriate functions of the courts and the legislature. Specifically, it refers to the principle that courts are not supposed to "make contracts" and that it is generally the function of the legislature, not the courts, to proscribe contract terms which are contrary to public policy, and to mandate other terms when required by public policy considerations.

294. Abraham, *supra* note 32, at 1165-66.

cases. Absent such a well defined standard, the courts are free to legislate at will, the written agreement loses all relevance, and the true expectations of the parties, actual or imagined, are important only to the extent that they may provide the court with an acceptable conceptual basis for decisions which would otherwise be characterized as judicial excess and usurpation of the prerogatives of the legislature.[295]

Illustration No. 2: Avoiding False Ambiguities

Gyler v. Mission Insurance Co.[296] demonstrates that the judicial activism of *Gray* is not an isolated event. *Gyler* involved a malpractice insurance policy issued by Mission Insurance to a group of attorneys covering the period 1964 to 1967. A suit was filed in 1969 against the attorneys alleging malpractice in 1966. The policy covered claims which "may be made against" the insured during the policy period. Mission argued that the policy covered only claims made during the policy period. The insured-attorneys argued that the policy provided coverage for any claim which "may" have been asserted during the policy period.[297]

Again, this is not a difficult case. The policy provision is, in reality, quite clear. The limitation on covered claims is both common and fair and there was no evidence of an induced belief at variance with the terms of the policy. Particularly, if "tail" coverage[298] was available, there was no basis for creating an "ambiguity" in an otherwise unambiguous policy; the insureds should not have expected their policy to provide post-policy period coverage without an express tail provision and a corresponding increase in

295. In his conclusion regarding the *Gray* case, Professor Abraham also suggests that, at least in certain cases, the expectations principle is merely a conceptual rationale for what might otherwise be condemned as "judicial legislation."

> This analysis suggests that in the duty-to-defend cases, the courts are concerned much more with the substance of coverage than with the expectations of the insured. Where they find excluded coverage desirable, they may mandate such coverage, regardless of the insured's reasonable expectations. Indeed, the coverage mandated in *Gray* might well be thought desirable. The cost of defending totally groundless claims of intentional tort could be so significant that in spite of victory in the underlying lawsuit, the insured will have suffered a catastrophic loss. Yet, insurance against these costs is not independently available. *Gray* and the cases that follow it remedy that situation by tacking such coverage onto the duty of defense contained in the typical liability policy. The rationale for such judicial action seems to be that regardless of whether anyone actually expects such coverage, people have a "right to expect" it from some source, and that it is most appropriately provided by primary liability insurers.

Abraham, *supra* note 32, at 1166 (footnotes omitted).

296. 10 Cal. 3d 216, 514 P.2d 1219, 110 Cal. Rptr. 139 (1973).

297. Another provision in the policy provided that: "If during the subsistence hereof the firm shall become aware of any occurrence which may subsequently give rise to a claim against them . . .," the attorneys were required to give notice to the insurer and then any claim subsequently filed would be deemed made during the policy period. *Id.* at 218, 514 P.2d at 1220, 110 Cal. Rptr. at 140 (quoting insurance policy). In an act of legal legerdemain, however, the court found that this provision applied only to negligent acts which occurred during the policy period but which did not cause injury until after the policy had expired—that is, it covered claims which could not be brought within the policy period. *Id.* at 220, 514 P.2d at 1221, 110 Cal. Rptr. at 141. *See* Abraham, *supra* note 32, at 1167.

298. "Tail" coverage is a phrase used to refer to an endorsement that can be added to claims-made policies for an additional premium; the endorsement provides coverage for claims asserted after the basic policy period so long as they relate to acts which occurred during the policy period.

premium.[299] In short, *Gyler*, like *Gray*, was a case in which summary disposition in favor of the insurer was appropriate.

The California Supreme Court again reached the opposite result,[300] relying upon both an alleged ambiguity in the policy and the supposedly "reasonable expectations" of the insureds.[301] Once again, a strained application of the expectations doctrine resulted in a substantial rewriting of the contract and demonstrated how concerns for predictability and consistency in standardized contract interpretation are often at odds with result-oriented applications of the expectations principle. The discrete set of rules proposed in this article provides the necessary consistency while preserving the possibility of utilizing an expectations analysis in those cases where the expectations doctrine may be legitimately employed.

Illustration No. 3: The Inducement Principle

Illustration 8 to section 211 of the *Restatement (Second) of Contracts* [302] offers the following scenario. *A* sells an electric generator to *B* by a written contract which incorporates by reference certain typewritten specifications and pre-printed standard terms. The typewritten specifications include a reference to "1136 kilowatts," but the standard terms disclaim any warranty not set forth in the pre-printed document.

Clearly the standard disclaimer does not impair the typed specification that the generator will produce 1136 kilowatts.[303] Depending upon the specific facts, any of at least three distinct principles can be cited in support of this result: (i) if the typewritten and printed terms are truly conflicting, then the resulting ambiguity should, under traditional rules, be resolved in favor of the non-drafting party;[304] (ii) the typewritten provisions are "dickered" terms of the agreement, and they take precedence over any apparently contrary terms in the standardized provisions;[305] and (iii) the power production

299. The court's analysis was based, in part, upon the contention that an attorney buys malpractice coverage only during the time he is in practice, but reasonably expects coverage against claims which are not asserted until after his retirement. 10 Cal. 3d at 220, 514 P.2d at 1221, 110 Cal. Rptr. at 141. While they may be true in the case of an "occurrence" policy, it is a dubious contention in the context of a "claims-made" policy. Professor Abraham properly criticizes the court's analysis by noting that: "The court gave no indication why attorneys who had not yet retired would also expect such coverage, or even why they would need it." Abraham, *supra* note 32, at 1168 n. 68. We would add that attorneys who are retiring should pay the additional premium and purchase tail coverage if they expect post-retirement coverage.

300. 10 Cal. 3d 216, 514 P.2d 1219, 110 Cal. Rptr. 139 (1973) (reversing a judgment of dismissal entered by the Superior Court, Los Angeles County).

301. *Id.* at 219-20, 514 P.2d at 1221, 110 Cal. Rptr. at 141.

302. RESTATEMENT (SECOND) OF CONTRACTS § 211 comment f, illustration 8 (1981).

303. *See* U.C.C. § 2-316(1) (1972):

> Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this Article on parol or extrinsic evidence (Section 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.

304. "In choosing among the reasonable meanings of a promise or agreement or a term thereof, that meaning is generally preferred which operates against the party who supplies the words or from whom a writing otherwise proceeds." RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981).

305. *See supra* note 201 for a discussion of the rule favoring dickered terms over standardized terms.

"expectation" of *B* is the result of an affirmative act of inducement by *A*.[306] Whether classified as "estoppel,"[307] "waiver,"[308] "misrepresentation,"[309] or otherwise, *A* cannot conclusively rely upon the pre-printed disclaimer when he had induced *B* to expect a certain generating capability which is at variance with that disclaimer. Under any of these theories, extrinsic evidence[310] would be admissible to establish the true terms of the parties' contract.[311]

Illustration No. 4: The Undelivered Contract

Illustration 5 to section 211 of the *Restatement (Second) of Contracts* involves an insurance binder pursuant to which *B* "agrees to insure property as herein described for amounts subscribed" until a policy is issued.[312] The actual policy includes provisions permitting cancellation upon written notice and requiring suit within one year after loss.[313]

The provisions in question are part of the contract.[314] As long as the provisions in question are not "objectively unreasonable," they should be

306. *See* Fairbanks, Morse & Co. v. Consolidated Fisheries Co., 190 F.2d 817 (3d Cir. 1951), the case upon which illustration 8 to § 211 is based, where the court said of the specification: "It represents positive affirmations of fact, the natural tendency of which is to induce the buyer to purchase." *Id.* at 821.

307. The elements of estoppel are "conduct by which one . . . induces another to believe . . . in certain material facts, which inducement results in acts in reliance thereon, justifiably taken, which cause injury . . . ." Sahlin v. American Cas. Co., 103 Ariz. 57, 59, 436 P.2d 606, 608 (1968) (quoting Builders Supply Corp. v. Marshall, 88 Ariz. 89, 94, 352 P.2d 982, 985 (1960)); *see also* Guardian Life Ins. Co. v. Zerance, —Pa.—, 479 A.2d 949 (1984). *Cf.* Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 394-96, 682 P.2d 388, 399-401 (1984); Abraham, *supra* note 29, at 1178-79.

308. The doctrines of waiver and estoppel, at least in this context, are often treated as one. Professor Keeton has noted that the principle of protecting a person who justifiably relies to his detriment upon the representation of another can be used to explain most decisions which have loosely employed the terms "waiver" and "estoppel." Keeton, *supra* note 29, at 978.

309. The concept of "misrepresentation" is also closely tied to the concept of estoppel. (Indeed, the similarity among the various parol evidence rule "exceptions" explains Professor Keeton's preference for a single reliance principle and for our conceptual grouping of these doctrines within the "inducement" principle.) Professor Abraham has explained the relationship between these doctrines as follows:

> A person may be estopped from asserting as a defense the truth of a matter that he has misrepresented to another if the latter has relied on the misrepresentation. Estoppel does not require an intent to deceive. If the misrepresentation is active—involving words or conduct made with reason to believe another would rely—then the misrepresentation alone may be sufficiently blameworthy for estoppel to hold the other responsible. If the misrepresentation is passive—failure to disabuse another of his misconceptions—estoppel requires that his silence at least be negligent. In the latter case, estoppel would require that the offending party have some reason to know of the other party's misconceptions and of his intention to act on them.

Abraham, *supra* note 32, at 1178-79 (footnotes omitted).

310. *See generally* RESTATEMENT (SECOND) OF CONTRACTS § 214 (1981).

311. One of the authors, Mr. Stahl, questions whether the illustration is really an appropriate example of the inducement principle since the power specification was actually part of the contract rather than parol or extrinsic evidence offered to vary or contradict the contract. He believes the case should have been decided on traditional grounds (that is, ambiguity or typed terms prevail over pre-printed terms), without reference to inducement or expectations.

312. RESTATEMENT (SECOND) OF CONTRACTS § 211 comment f, illustration 5 (1981). The illustration is based upon the decision in Sherri v. National Sur. Co., 243 N.Y. 266, 153 N.E. 70 (1926).

313. In this respect, the policy is identical to the New York Standard Fire Insurance Policy discussed, *supra* note 241.

314. This is the conclusion reached by the *Restatement (Second) of Contracts* draftsmen as well. *See* RESTATEMENT (SECOND) OF CONTRACTS § 211 comment f, illustration 5 (1981).

given their intended effect. The subjective expectation of *A* (the insured) is irrelevant—in part because an ordered system of law must rely upon the terms of written contracts and, in part, because the law must recognize that subjective expectations are rarely verifiable.[315] As the *Restatement (Second) of Contracts* notes, customers "understand that they are assenting to the terms not read or not understood, subject to such limitations as the law may impose."[316] In the absence of actionable inducement, the objectively reasonable terms of the policy actually issued form the enforceable agreement between the parties.[317]

Illustration No. 5: The "Automated Marketing" Case

When is the evidence of inducement sufficient to require submission of the issue to the trier of fact? The answer to this question is no clearer in the case of a standardized contract dispute than it is in any case in which a party seeks to rely upon doctrines such as waiver or estoppel to avoid summary judgment.[318]

Illustrative of this problem are cases which fall within Professors Abraham's "automated marketing" classification.[319] For example, in *Lachs v. Fidelty & Casualty Co.*,[320] the insured died on a charter flight. The policy of insurance specifically excluded non-scheduled airline flights; a large sign near the charter airline counter designated the flight as "non-scheduled."[321] Nevertheless, the insured had purchased the policy from a vending machine placed directly in front of the charter airline counter.

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315. Recognition of the inherent unreliability of a party's testimony regarding his subjective intent, motive or opinion is a cornerstone of the parol evidence rule. As a result, the courts look to the written agreements as one (and, often, the only) objective manifestation of the parties' intentions. A contract is construed in accordance with the intention of the parties as "judged by objective standards and not by their secret intentions or motives." Franklin Life Ins. Co. v. Mast, 435 F.2d 1038, 1045 (9th Cir. 1970). Arizona courts have held:

> It is not the undisclosed intent of the parties with which we are concerned, but the outward manifestations of assent. This principle of law is expressed well by Justice Holmes: ". . . the making of a contract depends not on the agreement of two minds in one intention, but on the agreement of two sets of external signs . . . ." Holmes, The Path of The Law.

Helena Chem. Co. v. Coury Bros. Ranches, 126 Ariz. 448, 453, 616 P.2d 908, 913 (Ct. App. 1980).

316. RESTATEMENT (SECOND) OF CONTRACTS § 211 comment b (1981).

317. *Id.* at comments b and f.

318. We have attempted in this article to define a "discrete set of rules" to permit consistent, and principled use of the "expectations principle." More work needs to be done in this area. For example, must inducement be proven by clear and convincing evidence? Is recognition of the induced, but unwritten expectations of a party in the nature of equitable relief? If so, does the jury sit in an advisory capacity only? While hoping that we have taken a step on the path charted by Professors Keeton and Abraham, we recognize that these questions and others lie ahead.

319. *See* Abraham, *supra* note 32, at 1155. In these cases, the "principal concern was that the marketing context prevented the insured from determining whether the policy in question actually provided the the expected coverage—a fact that underscored the insurers' responsibility for the mistaken expectations of coverage held by the insureds." *Id.* The two groups of cases which fall within the "automated marketing" classification are those involving flight insurance sold through airport vending machines and those involving accident insurance offered and sold through the mail. *See id.* at 1155-57 and cases cited therein.

320. 306 N.Y. 357, 118 N.E.2d 555 (1954).

321. *Id.* at 363, 118 N.E.2d at 558. A placard near the insurance vending machine also stated that the insurance coverage applied to trips "on any scheduled airline." In addition, certain machines had specimen policies attached. It was not clear whether the machine utilized by the decedent had such a specimen attached. *Id.* at 362, 118 N.E.2d at 557.

The New York court's finding that the policy was "ambiguous" is indefensible.[322] The issue is simply one of inducement. If the placement of the machine induced the insured to believe that the policy would provide coverage for flights offered to the public at the nearby airline counter, then the insurer's actions may have created a right at variance with the written policy provision. Whether the placement of the machine may be a sufficient inducement to give rise to such an expectation should be, in the first instance, a question of law for determination by the court. For example, a court faced with a placard notice, an unambiguous policy exclusion, and an available specimen policy could find as a matter of law that the location of the machine was not a sufficient act of inducement to create a cognizable expectation contrary to the actual terms of the placard, the specimen and the policy actually issued. Likewise, had the vending machine been located one hundred yards away, in front of a major, regularly scheduled carrier's ticket counter, the evidence of inducement may have been insufficient as a matter of law to create a question of fact for submission to the jury.[323] The mere allegation of inducement does not create a question of fact.[324] Thus, some purported inducement cases may be decided by the court in summary proceedings. Creating a false ambiguity to justify a desired result does not permit such judicial "line-drawing."[325] If the policy provision is truly ambiguous, then the ambiguity exists whether or not the vending machine is placed in front of the non-scheduled airline ticket counter. Hopefuly, under the rules outlined above, the search for false ambiguities can be ended.

SUMMARY

These illustrations are designed to demonstrate both the adaptability of the standards proposed and the difficult areas which remain to be explored by the courts and academicians. The objective unreasonableness/inducement standard which we have proposed succeeds in one critical area where adherence to an expectations principle, "objectively" or "subjec-

322. *See id.* at 367, 118 N.E.2d at 560. The court concluded that the phrase "scheduled airline" was ambiguous in the circumstances presented, in part because "we do not know whether the decedent had ever been on a plane before." *Id. But see id.* at 367, 118 N.E.2d at 560 (Fuld, J., dissenting on the ground that "I do not perceive how . . . the word 'scheduled' can mean 'non scheduled' . . .").

323. *Cf. id.* at 371, 118 N.E.2d at 564 (Fuld, J., dissenting) (suggesting that factors such as the location of the machine may not be sufficient in any event to defeat a motion for summary judgment where the policy term is unambiguous).

324. This is simply a restatement of the general rule regarding the quantum of evidence necessary to withstand a motion for summary judgment. Unlike the court in *Darner*, we believe that where, for example, a contract limit is clearly disclosed but the insured simply failed to read the contract, summary disposition is appropriate. *Cf.* Darner Motor Sales, Inc. v. Universal Underwriter Ins. Co., 140 Ariz. 383, 396 n.12, 682 P.2d 388, 401 n.12 (1984). As a matter of law, such cases should be held to involve insufficient evidence to raise a triable issue of fact. *See, e.g.*, Standard Venetian Blind Co. v. American Empire Ins., 503 Pa. 300, 469 A.2d 563 (1983).

325. Courts applying a traditional parol evidence rule analysis to insurance disputes are often fairly criticized for creating false ambiguities to justify desired results. *See, e.g.*, the criticism of that tendency by the court in Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 389, 682 P.2d 388, 394 (1984); Keeton, *supra* note 29, at 972. Of course, the same criticism applies to expectations principle decisions which often "create" uncertainties so as to permit the court to then give effect to the "reasonable expectations" of the non-drafting party, and thereby obtain a desired result at variance with the express terms of the contract.

tively" applied, does not; it preserves the sanctity of the written agreement and thus advances the policies underlying the parol evidence rule. As future cases are decided, the standard to be applied will no doubt be further refined and explained. However, application of the proposed standard, even in its present outline form, will permit courts to decide expectations cases in a relatively consistent and predictable manner without reference to "false ambiguities" or "subjective expectations," and without submission to the jury of cases which should properly be decided by the court. If the standard is properly and consistently applied, criticism of expectations decisions as "unprincipled"[326] and "result-oriented"[327] should eventually disappear from legal commentaries.

VII. CONCLUSION

We have attempted to discern and to formulate principled guidelines for courts seeking to apply the expectations principle to standardized contract disputes, including, but not limited to, those arising in the insurance context. Unlike Professor Keeton, we have not attempted to define all of the policy considerations underlying the expectations doctrine. Unlike Professor Abraham, we have not attempted to catalogue all of the decisions which acknowledge, directly or indirectly, an expectations principle. Rather, we have sought to facilitate the natural evolution of the principle by formulating a discrete set of rules for its application and by then demonstrating the application of those rules to various disputes that commonly arise out of standardized contracts.

In attempting to formulate a new standard, we have discussed certain deficiencies in both the "objective" and "subjective" expectations theories. At the same time, we have reaffirmed the continuing validity of certain principles underlying the parol evidence rule. The standard which we propose is a true hybrid which seeks to accommodate the desire for certainty and predictability in the law of contracts with the often conflicting desire to achieve what is perceived to be a "just" result in a particular case.

Adoption of the expectations principle is an important step in the evolution of contract law. Just as definition of the policies underlying the law of torts has led to new rules governing product cases, further refinements of the expectations principle may lead to a new law of standardized contracts. For the moment, however, our task is to try to accommodate the old and the new

326. *See, e.g.*, Keeton, *supra* note 29, at 972. In referring specifically to the tendency of courts in insurance cases to create false ambiguities to achieve desired results, Professor Keeton has observed:

> [T]he principle of resolving ambiguities against the draftsman is simply an inadequate explanation of the results of some cases. The conclusion is inescapable that courts have sometimes invented ambiguity where none existed, then resolving the invented ambiguity contrary to the plainly expressed terms of the contract document. To extend the principle of resolving ambiguities against the draftsman in this fictional way not only causes confusion and uncertainty about the effective scope of judicial regulation of contract terms but also creates an impression of unprincipled judicial prejudice against insurers.

Id. at 972 (footnotes omitted). *But see* Abraham, *supra* note 32, at 1152 (observing that "[t]he expectations principle is . . . more than an unprincipled judicial preference for the insured. . . .").

327. *See, e.g.*, Abraham, *supra* note 32, at 1151-52, 1155. Cf. Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 140 Ariz. 383, 389, 682 P.2d 388, 394 (1984) (finding the misuse of traditional rules to be result-oriented).

and to formulate substantive and procedural rules which will give meaning and practical effect to the expectations principle. In the process, we must be careful not to lose sight of the basic principles—consistency, predictability and the sanctity of written agreements—upon which the law of contracts is founded.