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NOTES AND COMMENTS

THE ADHESION CONTRACT OF INSURANCE

Adhesion contracts are acknowledged in both civil and common law jurisdictions but the consonance of effect is questionable. A California court defines them as:

. . . [A] standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject. . . . Such an agreement does not issue from that freedom in bargaining and equality of bargaining which are the theoretical parents of the American law of contracts.¹

It is the lack of equality in bargaining power that distinguishes adhesion contracts from the traditional agreement.² While the term has not yet found general recognition in our legal vocabulary, its introduction into American jurisprudence³ in 1919 was followed by favorable reaction from commentators and an increasing use by the courts. By other reasoning, the common law judges have adopted some of the effects of adhesion contract doctrine, particularly in the field of insurance. Unfortunately the position of the California courts is not clear.

ORIGIN OF THE CONCEPT

In France during the eighteenth and nineteenth centuries, natural law theory and church teaching imposed upon the Roman *causa civilis* an additional *causa* based on intent to gratuitously benefit another. This religious influence on enforcement of promises is also present in the Hindu system in which a man is bound *in law to the extent he is bound in religion*. Extrinsic to this moral basis of enforceability was the development of the common law of Contract based to a large extent on procedure and the almost magical quality of Forms. International trade aided the intermixing of these two bases of enforceability and each acquired some of the aspects of the other. The civil law countries, while recognizing that some promises were unenforceable, held that promises *intending* a legal transaction

¹ Neal v. State Farm Ins. Co., 188 Cal. App. 2d 690, 694, 10 Cal. Rptr. 781, 784 (1961).

² See Shuchman, *Consumer Credit by Adhesion Contract*, 35 TEMP. L.Q. 125 (1962).

³ Patterson, *The Delivery of a Life-Insurance Policy*, 33 HARV. L. REV. 198, 222 (1919) citing the use of the term in foreign Jurisprudence. E.g., 2 PLANIOL, TRAITÉ, ÉLÉMENTAIRE DU DROIT CIVIL, § 972, 1 OPPENHEIM, INTERNATIONAL LAW §§ 532, 533.

would be enforced. Under the common law, as modified by natural law concepts, the theory of equivalents provided the basis of enforceability. Consideration was generally separate from the Form, but the sealed instrument was still valuable for its form alone and this was enough to support enforcement. Through a period of great industrial expansion and emphasis on freedom, the reverence of form in contract remained in the common law system. Even today, resistance to change, a lingering fear of magisterial caprice, and a lack of a definition of *nudum pactum* result in the court's reworking the old forms by restatement, reinterpretation, and reconstruction. Agreements between parties which are legally enforceable are said to be like private legislation, and the courts can no more change the terms of this "legislation" than they can the enactments of elected bodies. This idea was put in the Constitution of the United States⁴ but has been disappearing all over the rest of the world.

The civil law countries, on the other hand, have developed two significant views which are the foundation of the true adhesion contract. In France, by what Jossérand⁵ calls "contractual dirigism," the state makes the contract for the people. The judges have the power to suspend, rescind, or even change the conditions of the contract. The parties no longer make "private law." Planiol⁶ notes that if the state undertakes to direct the economy itself, it cannot admit the maintenance of contractual relations contrary to those it envisages. A second concept is the humanitarian idea⁷ of protecting debtors by lifting or shifting burdens or losses, and hence the burden of promises, so as to put them upon those "better able to bear them." Friedmann⁸ contends that the lack of equality between contracting parties, and the necessity of standardization in a complex society, requires the state to prescribe rather than merely enforce contracts. Compared with this social control view, the common law does not try to anticipate the terms of an infinite number of varied transactions which is the typical condition in an expanding, free enterprise system. By our traditional thinking, the courts only interpret contracts, not make them for the parties; a person is supposed to know the contract he makes.⁹ Where a contract is the result of bargaining within the play of the market, "there

⁴ U.S. CONST. art. 1, § 10.

⁵ 2 JOSSERAND, COURS DU DROIT CIVIL POSTIF FRANÇAIS §§ 402-405 (3d ed. 1939).

⁶ 2 PLANIOL, TRAITÉ ÉLÉMENTAIRE DU DROIT CIVIL §§ 443-480 (revised by Ripert & Boulanger) (4th ed. 1952).

⁷ The homestead exemptions and bankruptcy discharges provide examples of this concept in common law.

⁸ FRIEDMANN, LAW AND SOCIAL CHANGE IN CONTEMPORARY BRITAIN (1951).

⁹ VANCE, INSURANCE (3d ed. 1951). ". . . [U]pon accepting it (the insurance policy) the insured is conclusively presumed, in the absence of fraud, to have given his assent to all of its terms." At 241.

is no danger that freedom of contract will be a threat to the social order as a whole."¹⁰ But the development of large scale enterprise with mass production and mass distribution made a new type of contract inevitable—the standardized mass contract.¹¹

The insurance industry was the first to acknowledge the hazard of "judicial risk,"¹² and in an effort to minimize this effect, utilized standardized contracts which had been interpreted in the courts and tested in the market place. Uniform provisions, actuarial tabulations, and consistent court interpretations are important facts in the creation of stable and more exact premium rates. But accompanying the benefits of mass merchandising with standardized contracts, there was a decline in the relative bargaining power of the insurance buyer. When the same provisions were universally used by all competitors, the weaker party to the agreements had little or no choice but to accept or reject *in total*. The effect of this type of contract has been likened to statutes which are *unilaterally* imposed. The adhesion contract amounts to government by private law of business enterprise over a mass of individuals.¹³ The courts recognized the problems created by standardization and, while trying to keep the elementary rules of contract law intact, have resorted to interpretation of "ambiguities" to serve the ends of justice.¹⁴ Insurance policy terms clearly labeled warranties would be interpreted as representations, which would be followed by even stricter policy language, in turn followed by other interpretations. In some cases the evil of harsh warranties has only been corrected by statute.¹⁵ The doctrine of Adhesion Contract may provide for a more orderly resolution of the conflict between freedom of contract and the social harm inherent in inequality of bargaining power.

One of the earliest uses of this new term was in *Bekken v. Equitable Life Assur. Soc. of U.S.*¹⁶ where the issue was the effectiveness of coverage twenty five days after a life insurance applica-

¹⁰ Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 630 (1943).

¹¹ Llewellyn, Book Review, 52 HARV. L. REV. 700 (1939).

¹² The danger that the court or jury may be swayed by "irrational factors" to decide against a powerful defendant.

¹³ Llewellyn, *What Price Contract?—An Essay in Perspective*, 40 YALE L.J. 704 (1931). However, the feeling of security which a standard contract imparts to the weaker party may be more desirable than the suspicions and fears generated when negotiating with a professional.

¹⁴ VANCE, INSURANCE (3d ed. 1951). "To hold the insured strictly to terms in the choosing of which he had no part, and the meaning of which he often cannot understand, would often work gross injustice which the courts are loath to inflict." At 243.

¹⁵ CAL. INS. CODE § 10113. ". . . [A]ll statements purporting to be made by the insured shall, in the absence of fraud, be representations and not warranties."

¹⁶ 70 N.D. 122, 293 N.W. 200 (1940).

tion was taken but before the company had acted either to accept or to reject the application and return the pre-paid premium.¹⁷ The court stated:

It has been said that "life insurance contracts are contracts of 'adhesion.' The contract is drawn up by the insurer and the insured, who merely 'adheres' to it, has little choice as to its terms." [citations omitted] He has little or nothing to say as to the terms of the offer which he will submit in his application or the contract which eventually will be made.¹⁸

In the dissent in *Siegelman v. Cunard White Star*,¹⁹ Justice Frank called a passenger ticket a contract of adhesion, or a "take-it-or-leave-it" contract.²⁰ "In such a standardized or mass-production agreement, with one-sided control of its terms, when the one party has no real bargaining power, the usual contract rules, based on the idea of 'freedom of contract,' cannot be applied rationally."²¹ While stating that insurance contracts are outstanding examples, he indicated there are many others. ". . . [T]he courts will do justice better by forthrightly, not obliquely, articulating important doctrines of public policy."²² Although the term Adhesion Contract was not used, the concept was clearly formulated in *Henningsen v. Bloomfield Motors, Inc.*,²³ which was essentially a tort action involving breach of warranty of merchantability.

Although the courts, with few exceptions, have been most sensitive to problems presented by contracts resulting from gross disparity in buyer-seller bargaining positions, they have not articulated a general principle condemning, as opposed to public policy, the imposition on the buyer of a skeleton warranty as a means of limiting the responsibility of the manufacturer.²⁴

And in a clear recognition of the changing social demands:

The traditional contract is the result of free bargaining of parties who are brought together by the play of the market, and who meet each

¹⁷ There was a conflict in evidence as to whether the deceased was an insurable risk, the company maintaining that information was received indicating a moderately serious drinking habit. In the opinion, the court examines at great length the various holdings recognizing that the business of insurance is quasi-public in character and indicates the various areas of control exercised by the state over the insurance carriers.

¹⁸ *Bekken v. Equitable Life Soc. of U.S.*, 70 N.D. 122, 293 N.W. 200, 212 (1940).

¹⁹ 221 F.2d 189 (2d Cir. 1955). In this case the subject of the action was a suit for damages for injuries sustained on the high seas by the deceased wife of the plaintiff when she was a passenger on a ship owned by the defendant. The ticket for the passage contained several contractual terms, one of which was that any suit or action against the company must be commenced within one year after the termination of the voyage notwithstanding any provisions of law of any country or state to the contrary. The suit was not in fact brought within such a time.

²⁰ *Id.* at 204.

²¹ *Ibid.*

²² *Id.* at 205.

²³ 32 N.J. 358, 161 A.2d 69 (1960).

²⁴ *Id.* 32 N.J. 358, 161 A.2d 69, 87 (1960).

other on a footing of approximate economic equality. In such a society there is no danger that freedom of contract will be a threat to the social order as a whole. But in present-day commercial life the standardized mass contract has appeared. . . . Such standardized contracts have been described as those in which one predominant party will dictate its law to an undetermined multiple rather than to an individual.²⁵

THE APPLICATION OF ADHESION THEORY IN CALIFORNIA

The California insurance decisions have reflected the conflict between the strict view of the older common law, and the more liberal view based on equity and public policy. As early as 1910, the philosophy of Adhesion Contract was announced:²⁶

. . . [T]he rule (referring to the presumption of knowledge of terms in a written contract) should not be strictly applied to insurance policies. It is a matter almost of common knowledge that a very small percentage of policy-holders are actually cognizant of the provisions of their policies and many of them are ignorant of the names of the companies issuing the said policies. The policies are prepared by the experts of the companies, they are highly technical in their phraseology, they are complicated and voluminous . . . and in their numerous conditions and stipulations furnishing what sometimes may be veritable traps for the unwary. . . . "The courts, while zealous to uphold legal contracts, should not sacrifice the spirit to the letter nor should they be slow to aid the confiding and innocent. . . ."²⁷

Later decisions, announcing what Vance²⁸ cites as the growing view, apply the strict rule that a bargain in writing raises a conclusive presumption (in the absence of fraud or mistake) of knowledge of the terms and brings binding force to the provisions.²⁹ While both positions continue to be held, it would now seem that the more liberal view is gaining favor.

The most consistent pattern emerging from the decisions is the importance of determining ambiguity (or lack of it) in the insurance contract. The strict view is that where provisions are definite and certain there is no room for interpretation and the courts will not indulge in a forced construction in order to cast a

²⁵ *Id.* 161 A.2d at 86. Cf. *Fricke v. Isbrandtsen Co.*, 151 F. Supp. 465. "A contract of the type in this case is not formulated as a result of the give-and-take of bargaining where the desires of one party are balanced by those of the other." At 467.

²⁶ *Raulet v. Northwestern Nat. Ins. Co.*, 157 Cal. 213, 107 Pac. 292 (1910).

²⁷ *Id.* at 230, 107 Pac. at 298.

²⁸ VANCE, *INSURANCE* 259 (3d ed. 1951).

²⁹ *Madsen v. Maryland Casualty Co.*, 168 Cal. 204, 142 Pac. 51 (1914); *Porter v. General Acc., Fire & Life Assur., Corp.*, 30 Cal. App. 198, 157 Pac. 825 (1916); *Layton v. N.Y. Life Ins. Co.*, 55 Cal. App. 202, 202 Pac. 958 (1921); *Telford v. N.Y. Life Ins. Co.*, 9 Cal. 2d 103, 69 P.2d 835 (1937).

liability upon an insurer which is not assumed.³⁰ The principle is that the parties may contract as they please so long as they do not violate law or public policy.³¹ The more liberal view appears to rely on ambiguity to justify sweeping alterations of the contracts. In a "moderate" case³² the insurer denied liability for a fire loss to the plaintiff's home which occurred on the thirteenth day of his absence on vacation. The *standard form*³³ policy excluded liability after unoccupancy for ten days. The court stated that the effect of the exclusion clause was to shift the risk back onto the insured and after rejecting the company's definition of "unoccupied," found the company liable. The finding of ambiguity concerning the term "unoccupied" seemed to be necessary to the decision.

The first use of the term Adhesion Contract was in *Neal v. State Farm Ins. Co.*³⁴ where a contract of employment between the company and one of its agents was called a contract of adhesion.³⁵ "Here the party of superior bargaining power not only prescribes the words of the instrument but the party who subscribes to it lacks the economic strength to change such language."³⁶ The court found that there was no ambiguity in the contract so that the rules applicable to adhesion contracts would not come into play. This decision seems to hold that ambiguity is necessary to enable the operative doctrines of adhesion contracts to attach. Attention should again be called to the reasoning in the French civil law from which the term came. An Adhesion Contract is a *type* of contract where lack of freedom and equality in bargaining raises sufficient justification for the courts to modify its effect.

Nearly two years later Justice Tobriner (who wrote the *Neal* decision) again announced the doctrine in *Steven v. Fidelity and Casualty Co. of New York*.³⁷ This case involved a purchase of a "trip accident policy" from a vending machine. The insured was killed during the course of the trip and the company denied liability

³⁰ *National Automobile Ins. Co. v. Industrial Acc. Comm.*, 11 Cal. 2d 689, 691, 81 P.2d 926, 927 (1938). Accord, *McMillan v. State Farm Ins. Co.*, 211 Cal. App. 2d 58, 27 Cal. Rptr. 125 (1962), (courts are not to put strained construction on policy in order to create ambiguity); *General Casualty Co. of America v. Azteca Film, Inc.*, 278 F.2d 161 (1960), (reaching a strained interpretation of a contract is tantamount to rewriting it, which the courts cannot do).

³¹ CAL. INS. CODE § 381; *Linnastruth v. Mutual Benefit Health & Accident Ass'n.*, 22 Cal. 2d 216, 137 P.2d 833 (1943).

³² *Foley v. Sonoma Ins. Co.*, 18 Cal. 2d 232, 115 P. 2d 1 (1941).

³³ This type of policy is a statutory creation from which the companies cannot deviate. If it is construed as ambiguous, the companies are caught between the legislature on one hand and the courts on the other.

³⁴ 188 Cal. App. 2d 690, 10 Cal. Rptr. 781 (1961).

³⁵ *Id.* at 692, 10 Cal. Rptr. at 782.

³⁶ *Id.* at 695, 10 Cal. Rptr. at 784.

³⁷ 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 168 (1962).

relying on terms in the exclusion clause.³⁸ The court found ambiguity, interpreted the contract strictly against the company, and found liability. The ambiguity was not so much in the meaning of the terms used, but in the failure to clearly indicate all areas of non-coverage. Since an insurance policy may be written to cover a variety of risks, this reasoning would make it extremely difficult for any insurance company to define the actual risk undertaken.³⁹ The court then considered the policy as an adhesion contract and supported the decision on this theory. “. . . [C]ases have held that in such contracts the *expected* coverage of the policy can only be defeated by a provision for limitation which has been plainly brought to the attention of the insured.”⁴⁰ “If it (the company) deals with the public on a mass basis, the notice of non-coverage of the policy . . . must be conspicuous, plain, and clear.”⁴¹ The court made the following statement, which on its face seems to impose a limit on the effect of adhesion contracts:

In standardized contracts, such as the instant one, which are made by parties of unequal bargaining strength, the California courts have long been disinclined to effectuate the *clauses of limitation* of liability which are unclear, unexpected, inconspicuous, or unconscionable.⁴²

³⁸ One of the provisions of the policy provided for an extension of coverage to include injuries sustained “while riding in or on a land conveyance provided or arranged for, directly or indirectly, by such scheduled air carrier . . . for the transportation of passengers necessitated by an interruption or temporary suspension of such scheduled air carrier’s service.” The insured was left stranded on one part of the trip because the carrier’s plane was grounded. The agent for the airline, after unsuccessfully trying to arrange ground transportation, *introduced* the deceased to a charter flying service with whom he and two others contracted for a flight to Chicago. The insured was killed in the crash of the charter flight. The court states that the crucial issue resolves into whether the limitation to substitute land conveyances will prevail over the normal expectation that coverage would extend to any reasonable form of substitute conveyance. “While the policy specified coverage for injuries suffered in a *land* conveyance provided by the scheduled carrier, it contained no statement whatsoever as to such substituted *air* conveyance. We do not see how such verbal vacuity can serve as clear and plain notice to the insured of noncoverage.” *Id.* at 872, 377 P.2d at 290.

³⁹ There are two methods of defining the risk undertaken. The “named peril” approach seeks to specify all losses for which protection is given. Anything not included is by inference intended to be excluded. The policy in *Steven* was of this type, and the court in effect said that because they did not also exclude specific “close” risks, the policy was ambiguous. The other method is to issue an “all risk” policy and limit the coverage by the terms of the exclusion clause. By this method all related risks are assumed to be included and the company has the duty of clearly calling to the insured’s attention any “subtraction” from his rights. The courts attack these policies also on the basis of ambiguity, but here it is ambiguity of the words used, instead of words not used.

⁴⁰ *Steven v. Fidelity & Casualty Co. of N.Y.*, 58 Cal. 2d 862, 877, 377 P.2d 284, 293 (1962). (Italics added.)

⁴¹ *Id.* at 878, 377 P.2d at 294.

⁴² *Id.* at 879, 377 P.2d at 295. (Italics added.)

The court cited *Raulet v. Northwestern Etc. Inc. Co.*⁴³ and several other California cases⁴⁴ to support this position. In calling attention to the fact that the policy was only available for examination after the completion of the purchase, the court in *Steven* stated that the disparity in bargaining power was so great that the company had adopted methods making bargaining impossible.⁴⁵

Steven provided a nearly perfect illustration of the doctrine of adhesion contract: It was an *insurance* case; the sale agent was a *machine*; all contract terms except the face amount (and the designation of beneficiary) were determined solely by the company; circumstances militated against reading the policy after purchase because of directions to mail it immediately to the beneficiary; the death was due to a cause clearly outside the intended risk assumption.⁴⁶ In addition the opinion was written by the only justice who had used the term Adhesion Contract in a California decision. Why was the contract wording in *Steven* twisted and tortured to develop an ambiguity? Is the term only a convenient label, while the enforcement of such a contract remains within the rules of common law "interpretation"? If so, the social policy underlying adhesion contracts will not find the same expression that exists within the civil law. The old "battleground" of ambiguity would have served the decision without mentioning adhesion contracts, but perhaps these are the first tentative excursions with a doctrine well established in the civil law.⁴⁷

⁴³ *Raulet v. Northwestern Nat. Ins. Co.*, 157 Cal. 213, 107 Pac. 292 (1910).

⁴⁴ *Coniglio v. Connecticut Fire Ins. Co.*, 180 Cal. 596, 182 Pac. 275 (1919); *Sharp v. Scottish Union Co.*, 136 Cal. 542, 69 Pac. 253 (1902); *Brubaker v. Beneficial etc. Life Ins. Co.*, 130 Cal. App. 2d 340, 270 P. 2d 966 (1955); *Glickman v. New York Life Ins. Co.*, 16 Cal. 2d 626, 107 P. 2d 252 (1940).

⁴⁵ *Cf. Lachs v. Fidelity & Casualty Co. of N.Y.*, 306 N.Y. 357, 118 N.E.2d 555 (1954) also involved a loss after purchase of insurance from a machine. The case for ambiguity is much stronger, however, because the death was in an *excluded* non-scheduled airline, but there was no indication on the machine of this limitation and the machine was placed in front of a counter used by all the non-scheduled airlines operating from that airport.

⁴⁶ As to flying accidents, the company intended to cover a risk involving an accident to a commercial airliner. At that time, the minimum equipment being used by the airlines consisted of twin engined metal, full instrumented planes, flown by a fully rated pilot and co-pilot and generally assisted by an engineer and navigator. The company was held liable for a death in a Piper Tri-Pacer. This airplane is a single engined, fabric covered airplane which can only carry four people including the pilot. It is easily over loaded and is seldom adequately instrumented. While the pilot in this case may have had the highest rating, he was not required to have more than a mere commercial license by applicable Federal regulations.

⁴⁷ In *Walnut Creek Pipe Dist., Inc. v. Gates Rubber Co., Inc.*, 228 A.C.A. 929, 39 Cal. Rptr. 767 (1964), the only decision since *Steven* using the term, the plaintiff wholesaler attempted to bolster his case for an implied term of his contract with the defendant manufacturer, by calling it an adhesion contract. The court rejected the contention stating, "There is no evidence that the parties in the instant case were not bargaining as equals. . . ." at 934, 39 Cal. Rptr. at 771.

CONCLUSION

One conclusion to be derived from the cases is that the only value of the term Adhesion Contract is to raise a series of "well established rules" of construction applicable to insurance contracts.⁴⁸ But a well recognized doctrine of Adhesion Contract would give the courts a framework within which to relieve the harshness of common law contract rules operating on standardized mass forms created by parties in vastly superior bargaining positions. A reasonable measure of certainty could still be achieved if the limits of the use of adhesion contract theory were clearly defined. The insurance cases provide the best opportunity to develop and delineate these limits. Such a doctrine will not emerge, be defined, and limited until the courts direct their attention to the task and stop torturing traditional rules out of recognition. The argument that such an approach is contrary to settled principles of contract law is generally accepted by courts, but ". . . the majority still allows recovery by the back door, so to speak. They regard recovery *ex contractu* as impossible, but at the same time allow recovery *ex delictu*."⁴⁹ Under the guise of tort, the courts are making new law with regard to the formation of insurance contracts.⁵⁰

. . . [T]echnical doctrines of the law of contracts cannot possibly provide the courts with the right answers. . . . (Those) resorted to by the courts in the insurance cases *denying* liability are in the last analysis but rationalizations of the court's emotional desire to preserve freedom of contract.⁵¹

It would seem that a more carefully tailored system of *contract law* would evolve from the frank recognition of the doctrine of Adhesion Contract, followed by a more accurate definition from contract case decisions. In the absence of such recognition, the continued infusion of *tort* "rules" into contract cases can only result in greater uncertainty and capriciousness in the enforcement of these inter-party legal relations.

Allen Reames

⁴⁸ Maxon v. Security Ins. Co. of New Haven, Conn., 214 Cal. App. 2d 603, 29 Cal. Rptr. 586 (1963), lists five such rules as collected from the past authoritative cases at page 611, 29 Cal. Rptr. at 590. See particularly Continental Casualty Co. v. Phoenix Const. Co., 46 Cal. 2d 423, 296 P.2d 801 (1956).

⁴⁹ Kessler, *supra* note 10, at 635.

⁵⁰ Duffie v. Bankers' Life Ass'n, 160 Iowa 19, 139 N.W. 1087 (1913).

⁵¹ Kesler, *supra* note 10, at 639. (Italics added.)