

Morgan v. American Family Mutual Insurance Co., No. 07-16278 JUN 18 2009

TYMKOVICH, Circuit Judge, dissenting:

MOLLY C. DWYER, CLERK
U.S. COURT OF APPEALS

Arizona law places important limitations on the reasonable expectations doctrine that apply in this case. Most importantly, the reasonable expectations doctrine does not operate as a per se bar against named-insured exclusions. *State Farm Mut. Auto. Ins. Co. v. Falness (Falness I)*, 872 P.2d 1233, 1234 (Ariz. 1994) (holding that a named-insured exclusion “is not invalid on its face”). But a rigid application of this circuit’s follow up decision in *State Farm Mut. Auto. Ins. Co. v. Falness (Falness II)*, 39 F.3d 966, 968 (9th Cir. 1994), will lead to just such a per se rule.

As is clear from the case law, Arizona courts disavow a categorical application of the reasonable expectations doctrine. They instead examine evidence of (1) the policyholder’s intent in acquiring an insurance policy and (2) the insurance company’s belief about the policyholder’s reasonable expectations. *See, e.g., Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co.*, 682 P.2d 388, 396–97 (Ariz. 1984) (holding that the doctrine of reasonable expectations applies when “the [insurer] has *reason to believe* that the [insured] would not have accepted the agreement if he had known

that the agreement contained the particular term” (quoting Restatement (Second) of Contracts § 211 cmt. f (1981) (emphasis added))).¹

The only Arizona case (other than *Falness II*) that appears to rely solely on the language of an insurance policy to invalidate a policy exclusion is *State Farm Mutual Automobile Insurance Co. v. Dimmer*, 773 P.2d 1012 (Ariz. Ct. App. 1988). That case is not persuasive here.

Although we have noted *Dimmer* relied primarily on an examination of the “form and clarity of the policy,” see *Falness II*, 39 F.3d 966, 968 (9th Cir.

¹ See also *Phila. Indem. Ins. Co. v. Barerra*, 21 P.3d 395, 404 (Ariz. 2001) (finding that an insured reasonably believed he would be covered by an insurance policy when driving under the influence in part because the car rental company who sold him the insurance knew he had been in a DUI-related accident two weeks before); *Averett v. Farmers Ins. Co. of Ariz.*, 869 P.2d 505, 508 (Ariz. 1994) (concluding summary judgment for the insurance company was unwarranted because the insured testified he was particularly concerned about coverage for his family due to his wife’s health problems, and the insurance agent allegedly knew of these health problems); *Do v. Farmers Ins. Co. of Ariz.*, 828 P.2d 1254, 1257–58 (Ariz. Ct. App. 1991) (finding the insured’s expectations that his children were covered under a policy were “not unreasonable” because an insurance agent told the insured his family would be covered up to the policy’s limits); *State Farm Fire & Cas. Co. v. Powers*, 786 P.2d 1064, 1067 (Ariz. Ct. App. 1989) (explaining that though the insured testified at trial she thought she and her family were covered under an insurance policy, “[t]here was no evidence that the insurance company had reason to believe that [the insureds] would not have accepted the insurance policy if they had known of the exclusion”); cf. *Shade v. U.S. Fid. & Guar. Co.*, 801 P.2d 441, 443 (Ariz. Ct. App. 1990) (“The record is devoid of any evidence supporting the [plaintiff’s] theory of reasonable expectation.”).

1994), the resolution of the case turned on at least some evidence that the policyholder expected coverage—the policyholder testified and submitted an affidavit to that effect. *Dimmer*, 773 P.2d 1014–15.

Furthermore, because our decision in *Falness II* relied almost exclusively on *Dimmer*, *Falness II* is likewise unpersuasive where, as here, a different policy is at issue and the record contains no evidence of the insureds’ reasonable expectations. In *Falness II*, we invalidated a named-insured exclusion that was “basically the same” as the exclusion in *Dimmer*. *Falness II*, 39 F.3d at 968. Indeed, we noted that “[t]he portion of the exclusion quoted in *Dimmer* is identical to the same portion of the exclusion in the Huggs’ policy.” *Id.* at 967 n.1. We also noted that an average consumer would have trouble understanding the named-insured exclusion at issue, and “[e]ven a law degree” might not have enabled the average insured to understand the exclusion. *Id.* at 968 n.2.

In my view, the intra-insured suits exclusion at issue in this case is distinguishable from the exclusions in *Dimmer* and *Falness II*. The basis of the Arizona doctrine of reasonable expectations is Restatement (Second) of Contracts, § 211. Section 211 allows courts to infer a consumer lacked a reasonable expectation of a contract term if the term is (1) “bizarre or

oppressive,” (2) “eviscerates the non-standard terms explicitly agreed to,” or (3) “eliminates the dominant purpose of the transaction.” Restatement (Second) of Contracts, § 211 cmt. f; *see also Darner*, 682 P.2d at 397 (adopting section 211 and comment f as the law of Arizona). None is true here. Intra-insured exclusions are standard in modern liability insurance policies and further the goal of preventing collusive suits among family members. *See* 2-9 HOLMES’ APPLEMAN ON INSURANCE § 9.3 (2d ed. 2009) (“The ability of family members to sue each other and collect insurance proceeds presents significant opportunities for fraudulent and collusive suits.”).

The exclusion here, moreover, is not excessively prolix or confusing, nor is it couched in legalese beyond the understanding of an ordinary consumer. It simply states, “**We** will not cover **personal injury** to the **named insured**.” In turn, the declarations page of the Policy states that Geri Morgan is a “named insured.” It is reasonable to assume she would have understood the intra-insured exclusion applied to her if she had read the Policy and “checked on her rights.” *See Gordinier v. Aetna Cas. & Sur. Co.*, 742 P.2d 277, 284 (Ariz. 1987). Furthermore, the exclusion’s location within the Policy cannot be characterized as “inconspicuous.” *Falness II*,

39 F.3d at 968 (quoting *Dimmer*, 773 P.2d at 1021). It is within a section of the Policy boldly entitled “**EXCLUSIONS.**” That section would have placed the Morgans and any reasonable policyholder on notice that the Policy had numerous limits, ranging from intentional damage caused by the insured to the insured’s use of an aircraft. Though I agree we are bound by *Falness*, I do not agree it requires us to invalidate the particular named-insured exclusion at issue in this case. To do so erects a per se rule against such insurance exclusions, contrary to Arizona law.

In sum, because there is no evidence the intra-insured suits exclusion supplanted the Morgan’s reasonable expectations, we should uphold it for numerous reasons: (1) the exclusion is understandable to a reasonable insured; (2) the exclusion is not unusual in an automobile or umbrella liability policy; (3) the exclusion does not emasculate coverage or undermine the policy’s dominate purpose; (4) no evidence suggests the exclusion was misleading to an average policyholder or misled the Morgans in particular; (5) there is no evidence the Morgans lacked notice of the exclusion; and (6) the term was not unfairly hidden within the Policy, but was among other standard exclusions in a section conspicuously marked “Exclusions.”

For the above reasons, I respectfully dissent.