

2015 WL 11004179 (D.Ariz.) (Expert Report and Affidavit)
United States District Court, D. Arizona.

AMERICAN FAMILY MUTUAL INSURANCE COMPANY,

v.

Bruno CHAVEZ and Lisa Palomar, husband and wife, and Marina Anaya.

No. 2:14-cv-00411-SPL.

May 29, 2015.

Expert Report of Professor Daniel Schwarcz

Name of Expert: Daniel Schwarcz

Area of Expertise: Legal & Insurance >> Insurance Practices & Standards

Representing: Defendant

Jurisdiction: D.Ariz.

1. I am currently an Associate Professor of Law and Solly Robbins Research Fellow at the University of Minnesota Law School. I have been in this position since 2007, and was granted tenure in 2012. I was recently promoted to full professor, to take effect in May of 2015. I am widely recognized as one of the leading experts on insurance law and regulation in the country. I am a co-editor of the sixth edition of the leading insurance law casebook in the country, *Insurance Law and Regulation*, which has been used as the principal text in courses on insurance law in more than 100 American law schools. I have testified to U.S. Congressional committees on matters concerning insurance law and regulation four times, and have also testified and/or presented on numerous occasions to state and federal regulators. I was elected as a member of the American Law Institute (ALI) and am currently an advisor on the ALI's Restatement of Liability Insurance Law project. I have taught insurance law and regulation numerous times at the University of Minnesota Law School, as well as at UCLA Law School. I have written numerous articles on insurance law and regulation, which have appeared in many of the nation's top law reviews, including the *University of Chicago Law Review*, *Virginia Law Review*, *UCLA Law Review*, *Southern California Law Review*, *North Carolina Law Review*, and *William and Mary Law Review*. My scholarship has also appeared in various peer-reviewed journals, including the *Risk Management and Insurance Review*, *Journal of Consumer Affairs*, and *Connecticut Insurance Law Journal*. I served as a consumer representative to the National Association of Insurance Commissioners for six years, from 2008 to 2014. I have served as a consultant or expert witness in a wide range of cases implicating insurance law and regulation. I received a B.A. from Amherst College, *magna cum laude*, in 2000 and a J.D., *magna cum laude*, from Harvard Law School in 2003. I was an Articles Editor on the Harvard Law Review and was appointed as the Olin Fellow in Law and Economics.

2. I have extensively studied the content of homeowners insurance policies in connection with both my legal scholarship and my consumer advocacy at the National Association of Insurance Commissioners. In 2011, I published the article [Reevaluating Standardized Insurance Policies](#), 78 *University of Chicago Law Review* 1263 (2011), which included a study of the content of different homeowners insurance policies. I conducted this study and wrote the associated article entirely in my role as a legal academic without the expectation that it would generate consulting work in any particular case. The article has received substantial recognition from numerous sources: it was awarded the 2011 Liberty Mutual Prize for an exceptional article on the law of property/casualty insurance, has been the basis of articles in newspapers including the New York Times and Wall Street Journal, and has prompted numerous regulatory and legislative reforms and initiatives.

3. In mid-2014, Kyle Hallstrom, then of Benedetto Torgenson Maurer LLC, contacted me via telephone to discuss my interest in serving as a consultant and possible expert witness in the present case. Mr. Hallstrom explained that the case involved the

enforceability of an exclusion in a homeowners policy for liability arising out of the knowing illegal consumption of alcohol. He told me that he had identified me as a potential expert witness as a result of my article *Reevaluating Standardized Insurance Policies*. On October 16, 2014, I agreed to serve as a consultant and possible expert witness in connection with this case. I am charging my normal hourly rate for of \$500 an hour.

4. In connection with this assignment, I have reviewed and considered the following documents: (1) American Family Mutual Insurance Company's ("American Family") Complaint in the above-titled action; (2) the Answer and Counterclaim of Defendants Bruno Chavez and Lisa Palomar ("Answer"); (3) Exhibit 1 to the Answer; (4) Marina Anaya's American Family homeowners insurance policy, Chavez/AF000116-Chavez/AF000142; (5) American Family's claim file in the present action, Chavez/AF000254- Chavez/AF000450; (6) Excerpted pages from American Family's Changes to its Homeowners Insurance Program, Chavez/AF001341-Chavez/AF001343; and (7) Marina Anaya's American Family insurance application, Chavez/AF001344-Chavez/AF001345.

5. Homeowners insurance policies have long been understood by most insurance consumers, agents, and analysts to be completely standardized across different insurance carriers. In other words, conventional wisdom in insurance markets is that all homeowners insurance carriers sell essentially the exact same insurance product, such that consumers should shop for coverage on the basis of price, service, and carriers' financial strength, but not on the basis of differences in carriers' terms of coverage. This standardized coverage, according to conventional wisdom, is based on the Insurance Services Office's ("ISO") "HO3" policy form. The ISO drafts numerous form insurance policies, which are then made available to member-companies. In general, the ISO secures regulatory approval of these policies in each state, monitors judicial opinions for precedents that might impact policy meaning and, most importantly, aggregates and makes available to member companies data on policyholder losses. Historically, insurance companies were practically compelled to use ISO policy forms (or the nearly identical forms of ISO competitors), because their own data was not sufficiently robust to allow them to reliably predict policyholder losses. Instead, they were only able to accurately predict losses by aggregating data across different companies. To do so, they had to use the same policy forms, as pooling data on policyholder claims stemming from different insurance policies would produce unreliable data.

6. The ISO maintains several different types of standardized homeowners policies, but by far the most important for stand-alone structures is the "HO3" policy. This policy is often referred to as the "standard" homeowners policy in the insurance industry. The ISO has periodically updated its HO3 policy. Additionally, the ISO maintains numerous endorsements that companies can add to the HO3 policy to alter the coverage it provides.

7. In my 2011 article *Reevaluating Standardized Insurance Policies*, *supra*, I reexamined the conventional wisdom that homeowners insurance policies are essentially homogeneous across different insurance carriers. To do so, I systematically studied the content of homeowners policies issued by the top ten insurance groups by premium volume in six states: North Dakota, South Dakota, Pennsylvania, Illinois, California, and Nevada. I focused on these six states because these were the only states in which state regulators were willing to issue a data call to the top ten insurance groups in the states requesting complete copies of their "standard"¹ homeowners policy, including all mandatory endorsements. Alternative methods for systematically acquiring complete and accurate copies of homeowners' insurance policies proved impractical for several reasons. First, the vast majority of insurers did not make copies of their homeowners policies available to prospective policyholders or otherwise publicly accessible on a pre-sale basis. Second, state regulatory records in all states examined did not include complete and reliable copies of most carriers' homeowners insurance policies despite the requirement in the vast majority of states that such policies be filed with and reviewed by state regulators. The reason, in short, was that carriers typically submitted policies for regulatory review when they were altered, and then generally submitted only the specific text that was altered rather than the entire policy. At the same time, regulatory records only dated back several years, making it impossible in most instances to piece together a complete picture of each carrier's coverage on the basis of regulatory records. An additional impediment to acquiring complete and accurate copies of different carriers' policies using regulatory records was that almost all state insurance regulators did not make their records easily public accessible, frequently necessitating a Freedom of Information Act request or similar procedure to even gain access to their records.

8. One approach I used to compare different carriers' homeowners policies was to identify specific types of exclusions or provisions that figured prominently in coverage litigation or where preliminary review of policy language suggested heterogeneity in policy language. One term that I isolated for review was an exclusion for coverage of liability arising out of the illegal consumption of alcohol. I identified this clause for review because the exclusion was not contained in the ISO HO3 policy, even though I noticed it in at least one carrier's policy. Additionally, liability arising from the illegal consumption of alcohol is an important risk facing homeowners with teenage residents. Moreover, it would generally fall within the scope of the liability coverage provided by a standard homeowners policy, as the illegal consumption of alcohol can obviously result in potential damages due to bodily injury or property damage caused by an occurrence.

9. The results of my study's findings on exclusions for liability arising out of the illegal consumption of alcohol are contained in Figure 1, below. The figure indicates that none of the examined carriers in California or Pennsylvania excluded coverage for liability arising out of the illegal consumption of alcohol. In two of the examined states - Nevada and Illinois - only one company excluded coverage for liability arising out of the illegal use of alcohol. They were both American Family insurance companies. In the final two states - North and South Dakota - two examined carriers excluded coverage for liability arising out of the illegal consumption of alcohol. In both instances, American Family companies issued one of the two policies excluding coverage for liability stemming from the illegal consumption of alcohol. The second policy with such an exclusion was, in both North and South Dakota, issued by a small, regional insurance group (North Star Mutual Insurance Co.). In other words, only two (American Family and North Star Mutual) of the twenty-four insurance groups examined excluded coverage for liability arising out of the illegal consumption of alcohol, and only one (American Family) of the top thirteen insurance groups writing homeowners insurance excluded coverage for liability arising out of the illegal consumption of alcohol.

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

10. Despite the highly unusual character of American Family's exclusion of coverage for liability associated with the illegal use of alcohol, nothing on American Family's website alerted prospective or current policyholders to the presence of this exclusion at the time of my study. As I wrote in 2011, the American Family website described the scope of its liability coverage in its homeowners policy only by noting that: "If you are legally responsible for a covered accident that injures another person or damages someone else's property, your policy will provide liability coverage up to the amount specified in your policy. We are also required to defend you against a suit for damages payable under the policy until your liability limit has been offered or paid." See American Family Insurance, Learn & Plan: Coverage Options, online at <http://www.amfam.com/learn-and-plan/learning-center/tours-of-insurance/homeowners-tour/coverageoptions.asp> (visited May 4, 2011). The "Liability" tab also provided several examples of losses that liability coverage "may" protect the insured against, including "[l]iability to others such as sports activities" and "[a]cts of pets." See *Reevaluating Standardized Insurance Policies*, *supra*, at 1333 n. 281.

11. My current attempts to search the American Family website similarly have failed to turn up any warning that the company's homeowners insurance program does not provide coverage for liability arising out of the knowing illegal consumption of alcohol. In fact, a "Learning Center" Section of the American Family website on "Responsible Party Hosting" indicates that "Homeowners insurance often provides some liquor liability coverage but, depending on the policy, may not be enough." See <http://www.amfam.com/learning-center/my-family/throw-safe-parties.asp#.VGJlePTF8jg> (last visited on November 11, 2014). Despite extensive searching on the American Family website as well as various Google searches, I have been unable to locate any clear notification on the American Family website that its homeowners policies generally exclude liability arising out of the knowing illegal consumption of alcohol.

12. Based on the materials I reviewed, Marina Anaya was not provided with any specific warning that her policy did not cover liability arising out of the knowing illegal consumption of alcohol. Nothing in the declarations page or in the table of contents of Marina Anaya's American Family homeowners insurance policy contains any indication of the exclusion for liability arising out of the knowing illegal consumption of alcohol. Chavez/AF000117-Chavez/AF00018. Instead, the non-standard exclusion is contained on page 11 of the densely written 16 page policy. Chavez/AF00129. Other than this buried text, nothing in the policy itself or in any documentation provided by American Family to Marina Anaya that I reviewed warns the policyholder of the exclusion for liability arising out of the knowing illegal consumption of alcohol or the fact that such an exclusion is

highly unusual in the homeowners insurance marketplace. Much to the contrary, the American Family policy purports to be a “Gold Star Special Deluxe” form of coverage, as stated at the very top of the declarations page of the policy. Chavez/AF000117. Additionally, it is my understanding that Marina Anaya was not specifically warned about this exclusion by her insurance agent, either at the time of purchase or subsequently.

13. I am generally familiar with the “reasonable expectations” doctrine, and have written extensively on the topic. See, e.g., Daniel Schwarcz, *A Products Liability Theory for the Judicial Regulation of Insurance Policies*, 48 *William & Mary Law Review* 1389 (2007). I have also specifically reviewed Arizona law on the doctrine in connection with this case. E.g. *Gordinier v. Aetna Cas. & Sur. Co.*, 742 P.2d 277 (Ariz. 1987); *Philadelphia Indem. Ins. Co. v. Barerra*, 21 P.3d 395 (Ariz. 2001). Of particular relevance here, the *Barerra* case provides that “an exclusion that subtracts from coverage usually provided by insurance should be stated in a conspicuous typeface and placed either on the face of the [relevant] contract or in obvious documentation that would clearly put the [insured] on notice, prior to obtaining the [coverage], that the policy purchased to cover liability for negligent [conduct] does not cover all types of negligent [conduct].” *Id.* at 402.

14. My opinion is that, under Arizona law, an objectively reasonable consumer would not reasonably expect the exclusion for liability stemming from the knowing illegal consumption of alcohol contained in the American Family policy if the consumer was not specifically warned of this exclusion at the time of purchase. Ordinary homeowners policies are meant to provide protection against liability for negligence that results in bodily injury or property damage and which is not associated with the usage of a motor vehicle. Particularly for families with teenagers, the knowing illegal consumption of alcohol poses obvious liability risks associated with the potential failure to use reasonable care in safeguarding alcohol and preventing teenagers from consuming excessive amounts of alcohol. In fact, in a blog post entitled “Underage Drinking Liability for Homeowners,” included as Exhibit 1 to the complaint, American Family acknowledges that this is a common risk to which many of its policyholders are exposed, noting that:

“Some parents enjoy planning celebrations for their high school-aged children, whether it's for a birthday or school-related event like prom or graduation, or a team or club gathering. Unfortunately, these celebrations can also mean underage-drinking. Some adults believe if they supervise drinking of young people in their homes, that it's a better or safer alternative to unsupervised parties.”

To be sure, the blog post does state that “don't assume your policy protects you from losses or civil liability that results from allowing the consumption of alcoholic beverages by an underage person on your property.” But this blog post is, of course, not actually seen or provided to the vast majority of American Family policyholders. Nor does it clearly warn that American Family homeowners policies in fact exclude liability arising from the knowing illegal consumption of alcohol. Finally, the blog post, of course, does not provide any notice that this exclusion is highly unusual in the industry and not consistent with the coverage provided in the “standard” ISO H03 policy form.

Footnotes

- 1 Where insurers maintained multiple forms corresponding to Insurance Services Office (ISO) distinctions, forms corresponding to the H03 form were isolated for review. In some cases, companies maintained multiple forms that did not correspond to ISO distinctions. In those cases, the policy that most closely corresponded to the H03 form was selected.