

REFERENCE GUIDE TO  LAW

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Our Reference Guide covers many areas of Arizona law, highlighting the most common issues associated with civil litigation. This resource is intended to provide a general overview of the subject matter, and is a supplement to the personal service we provide to our clients. It should not be relied upon as the sole source of information, and should not be substituted for competent professional legal advice for a particular situation. Should you have any questions, we encourage you to contact the authors listed at the end of each chapter or any JSH attorney.

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CHAPTER 1: GENERAL TORT LIABILITY

To pursue a tort claim against a defendant, a plaintiff must prove the defendant (a) owed plaintiff a duty of care, (b) breached that duty (acted unreasonably or fell below the applicable standard of care), (c) caused plaintiff harm, and (d) plaintiff's damages. **Lorenz v. State**, 238 Ariz. 556, 558, 364 P.3d 475, 477 (Ct. App. 2015). Generally, a defendant will owe a duty to a plaintiff only if they had a relationship (for example, innkeeper/guest), if the defendant undertook such a duty, if a statute created a duty between them (such as dog owner/invitee), or if public policy recognizes a duty imposed on one to act reasonably towards another (such as driver/other drivers on the road). **Quiroz v. ALCOA Inc.**, 243 Ariz. 560, 416 P.3d 824 (2018). Whether the defendant owes the plaintiff a duty of care is a threshold issue of law for the court. **Gipson v. Kasey**, 214 Ariz. 141, 150 P.3d 228 (2007). Finally, courts cannot consider foreseeability when making determinations of duty. **Cal-Am Properties Inc. v. Edais Eng'g Inc.**, 509 P.3d 386, 389 (Ariz. 2022).

The other elements of a tort claim—breach, causation, and damages—are usually factual issues for the jury. *Id.* at 143, 150 P.3d at 230. But summary judgment can be appropriate on these issues if no reasonable juror could conclude on the record presented by the plaintiff that the defendant breached the standard of care or proximately caused the claimed damages. *Id.*

INTENTIONAL TORTS

Conduct can be considered an intentional tort only "if the actor desired to cause the consequences and not merely the act itself, or if he was certain or substantially certain that the consequences would result from the act." **Mein v. Cook**, 219 Ariz. 96, 193 P.3d 790 (Ct. App. 2008). *See also* RESTATEMENT (THIRD) OF TORTS: Phys. & Emot. Harm § 1. Types of intentional torts include assault, battery, false imprisonment, malicious prosecution (wrongful institution of civil proceedings in the civil context), and intentional infliction of emotional distress. It is beyond this Chapter's scope to address all intentional torts, but intentional infliction is a claim that plaintiffs routinely allege.

Intentional Infliction of Emotional Distress

A plaintiff claiming intentional infliction of emotional distress must prove (a) defendant's conduct was extreme and outrageous, (b) the defendant either intended to cause emotional distress or recklessly disregard the near certainty that such distress will result from his/her conduct; and (c) the distress was severe. **Mintz v. Bell Atl. Sys. Leasing Intern, Inc.**, 183 Ariz. 550, 562-63, 905 P.2d 559, 553-54 (1995); **Ford v. Revlon, Inc.**, 153 Ariz. 38, 43, 734 P.2d 580, 585 (1987). The trial court determines whether the defendant's conduct is sufficiently extreme and outrageous to state a claim for intentional infliction. *Mintz*, 183 Ariz. at 563, 905 P.2d at 554. The plaintiff must show that the defendant's acts were "so outrageous in character and so extreme in degree, as to go beyond all possible bounds of decency, and to be regarded as atrocious and utterly intolerable in a civilized community." *Id.* Only when reasonable minds can differ in determining whether

conduct is sufficiently extreme or outrageous does the issue go to the jury. *Id.* Conduct that is callous and insensitive, and certain to cause emotional distress, but is merely a defendant's insistence upon his/her legal rights in a permissible way, does not rise to the level of extreme and outrageous. *See Mintz*, 183 Ariz. at 564, 905 P.2d at 555.

"A line of demarcation should be drawn between conduct likely to cause mere 'emotional distress' and that cause 'severe emotional distress.'" *Midas Muffler Shop v. Ellison*, 133 Ariz. 194, 199, 650 P.2d 496, 501 (Ct. App. 1982) (citation omitted); *see also* RESTATEMENT (THIRD) OF TORTS § 46 cmt. j (1965) (liability only arises when emotional distress is extreme; "Complete emotional tranquility is seldom attainable in this world, and some degree of transient and trivial emotional distress is a part of the price of living among people."). Thus, crying, being stressed and upset, and occasional trouble sleeping are typically not enough to establish severe emotional distress. *Midas*, 133 Ariz. at 199.

NEGLIGENT TORTS

Negligence is the failure to exercise reasonable care under all the circumstances. RESTATEMENT (THIRD) OF TORTS: Phys. & Emot. Harm § 3 Negligence. A plaintiff can claim the defendant was negligent in any number of ways. It is beyond this Chapter's scope to discuss every way in which a plaintiff can claim a defendant was negligent. But particular negligence claims are discussed below.

There can be no claim for negligent use of intentional force. *Ryan v. Napier*, 245 Ariz. 54, 425 P.3d 230, 236 (2018).

Negligent Infliction of Emotional Distress

A claim for negligent infliction of emotional distress requires the plaintiff to witness an injury to a third person, resulting in plaintiff's shock or mental anguish. Plaintiff must prove that the defendant's negligence caused the third person's bodily harm; that plaintiff directly observed the event; and that plaintiff had a close personal relationship with the person injured. *Keck v. Jackson*, 122 Ariz. 114, 593 P.2d 668 (1979). While damages are recoverable for emotional distress caused by witnessing injury to another, the emotional distress "must be manifested as a physical injury" and the damages must be caused by "the emotional disturbance that occurred at the time of the accident, and not thereafter." *Id.* The law also requires that plaintiff be within the "zone of danger" (i.e., in proximity to the injury-causing event). The zone of danger is usually established as a matter of law by the court, and is rarely an issue for the jury.

With respect to the "close personal relationship" factor, the plaintiff bystander must have a family relationship, or something closely similar, to the victim in order to pursue this claim. *Hislop v. Salt River Project Agr. Imp.*, 197 Ariz. 553, 5 P.3d 267 (Ct. App. 2000). A co-worker or friend relationship is not sufficient. Allowing recovery for witnessing injury to a co-worker or friend would be out of proportion to the culpability inherent in conduct that is merely negligent. *Id.* However, in the case of *Ball v. Prentice*, 162 Ariz. 150, 781 P.2d 628 (Ct. App. 1989), the court created an exception to this general rule. In *Ball*, one party was involved in an accident and saw

the culpable driver of the other car killed as a result of the accident. The party sued for negligent infliction of emotional distress and the court of appeals ruled that because the party was a participant and victim, and not bystander, he could seek to recover damages for negligent infliction of emotional distress even though he was not acquainted with the driver who was killed.

Unlike a loss of consortium claim, in Arizona a claim for negligent infliction of emotional distress is not subject to the “each person” limitation often found in insurance policies. In a loss of consortium claim, a tortfeasor’s injury to one person indirectly affects another person by affecting the relationship between the injured party and the plaintiff; but in a negligent infliction of emotional distress claim, the plaintiff directly experiences the tortfeasor’s negligence, and that negligence causes the plaintiff to suffer such severe emotional distress that physical injury results. ***State Farm Mut. Auto. Ins. Co. v. Connolly ex rel. Connolly***, 212 Ariz. 417, 132 P.3d 1197 (Ct. App. 2006). Thus, a claim for negligent infliction of emotional distress constitutes a separate “bodily injury” arising from the “same accident” as the other injured party, and the separate “each person” coverage limits would apply to compensate each person for his/her respective bodily injuries, up to the aggregate “each accident” coverage limits provided in the policy. *Id*

Negligence *Per Se*

Some statutes, ordinances and regulations are passed to protect a certain class of persons from unreasonable risk of harm. A violation of such a statute, ordinance or regulation would be deemed negligence per se (in and of itself) and below the standard of care. ***Deering v. Carter***, 92 Ariz. 329, 333, 376 P.2d 857, 860 (1962). For a plaintiff to use negligence per se, the statute must have been designed to protect the plaintiff from the harm of which he complains. The plaintiff must also be in the class of persons that the statute is intended to protect. See RESTATEMENT (THIRD) OF TORTS: Phys. & Emot. Harm § 14.

COMPARATIVE NEGLIGENCE IN ARIZONA

Fault Allocation

Arizona follows the doctrine of pure comparative negligence. A.R.S. § 12-2501 *et seq.* Except for three circumstances discussed below, joint and several liability is abolished. Thus, a defendant only minimally at fault will not have to pay the full amount of damages where the rest of the fault is apportioned to others. ***Piner v. Superior Court***, 192 Ariz. 182, 962 P.2d 909 (1998); see A.R.S. § 12-2506 through § 12-2509. Each defendant is liable for only that amount of the plaintiff’s damages that is directly proportional to the percentage of fault the jury allocates to that defendant. A.R.S. § 12-2506(A). In assessing percentages of fault, the trier of fact considers the fault of all persons who contributed to the injury, regardless of whether the person was, or could have been, named as a party to the suit. A.R.S. § 12-2506(B). Fault is apportioned regardless of whether each person’s conduct was negligent or intentional; the jury need not apportion a certain amount of fault to intentional conduct as compared to negligent conduct. ***Hutcherson v.***

City of Phoenix, 192 Ariz. 51, 55, ¶ 20, 961 P.2d 449, 453 (1998), *abrogated in part on other grounds, State v. Fischer*, 242 Ariz. 44, 392 P.3d 488 (2017).

Defendants can still be jointly and severally liable in three circumstances. The first is for defendants who are “acting in concert.” A.R.S. § 12-2506(D)(1). “Acting in concert” means “entering into a conscious agreement to pursue a common plan or design to commit an intentional tort and actively taking part in that intentional tort.” A.R.S. § 12-2506(F)(1). Defendants cannot negligently act in concert; the term applies to intentional conduct only. The second joint and several circumstance occurs where one person “was acting as an agent or servant of the party.” A.R.S. § 12-2506(D)(2). For example, an employer can be jointly and severally liable for the employee’s actions if the employee was acting within the scope of his/her employment. The third joint and several circumstance is where “[t]he party’s liability for the fault of another person arises out of a duty created by the Federal Employers’ Liability Act, 45 United States Code § 51.” A.R.S. § 12-2506(D)(3).

Non-Parties at Fault

A.R.S. § 12-2506 states that when assessing the percentage of each defendant’s fault, the fact finder “shall consider the fault of all persons who contributed to the alleged injury ... regardless of whether the person was, or could have been, named as a party to the suit.” A.R.S. § 12-2506(B). The percentages of fault assessed against such non-parties “are used only as a vehicle for accurately determining the fault of the named parties.” *Id.* Assessment of fault against a non-party does not require the non-party to pay any damages to the plaintiff. *Id.* Assessment of fault against a non-party effectively reduces the amount of damages the plaintiff will recover. For instance, if a jury awards the plaintiff \$10,000 in damages and finds a defendant 20% at fault and the non-party 80% at fault, the plaintiff will recover \$2,000 from the defendant.

A defendant can name a non-party at fault even if the plaintiff is prohibited from directly suing or recovering from such party. *See, e.g., Dietz v. General Elec. Co.*, 169 Ariz. 505, 821 P.2d 166 (1991) (employee cannot sue employer directly, but can name employer as non-party at fault); *McKillip v. Smitty’s SuperValu, Inc.*, 190 Ariz. 61, 945 P.2d 372 (Ct. App. 1997) (fault can be allocated to an unidentified customer who dropped slippery wax paper in store); *Smith v. Johnson*, 183 Ariz. 38, 44, 899 P.2d 199, 206 (Ct. App. 1995) (jury could consider fault of unidentified driver who might have flagged another motorist into an accident); *Rosner v. Denim & Diamonds, Inc.*, 188 Ariz. 431, 937 P.2d 353 (Ct. App. 1996) (jury could apportion fault of non-party unidentified assailants). Defendants can offer evidence at trial of a non-party’s negligence and argue that the jury should attribute all or some percentage of fault to the non-party, thereby reducing the defendant’s percentage of fault and consequent liability. From the plaintiff’s standpoint, this designation can result in the named defendants “laying off” their liability on a non-party who can never be a party defendant.

An allegedly negligent defendant may seek to compare the fault of a non-party who commits a criminal/intentional act. *Thomas v. First Interstate Bank*, 187 Ariz. 488, 930 P.2d 1002 (Ct. App. 1996).

Permitting a defendant to name the plaintiff/employee's employer as a non-party at fault creates an inequity when a trier of fact allocates some percentage of fault to the non-party employer. First, the plaintiff's award is reduced by reason of the employer's fault, and second, the plaintiff might have to satisfy a lien against this diminished recovery in favor of the employer and workers' compensation carrier to the extent of workers' compensation benefits provided. To cure this inequity, the Supreme Court has held that a workers compensation carrier may assert a lien on a third party recovery only to the extent the compensation benefits paid exceed the employer's proportionate share of the total damages set by verdict in the underlying action. **Aitken v. Indus. Comm'n of Arizona**, 183 Ariz. 387, 392, 904 P.2d 456, 461 (1995). It has been suggested that this rule unconstitutionally usurps the Legislature's authority, but to date the Aitken rule stands. **Twin City Fire Ins. Co. v. Leija**, 244 Ariz. 493, 497, 422 P.3d 1033, 1037 (2018).

A defendant may name the plaintiff's subsequent treating physician as a non-party at fault despite the "original tortfeasor rule." That rule states that if a negligent actor is liable for another's bodily injury, he is also liable for any additional bodily harm resulting from the normal efforts of third persons in rendering aid, whether negligent or not. **Cramer v. Starr**, 240 Ariz. 4, 8-9, 375 P.3d 69, 73-74 (2016). Although the plaintiff cannot use the original tortfeasor rule to *automatically* impute a medical provider's subsequent negligence to the original tortfeasor, the plaintiff may argue that the original tortfeasor proximately caused the enhanced injury resulting from the provider's negligence. 240 Ariz. at 9-10.

A defendant must give notice within 150 days after filing an answer that it intends to assert a non-party's fault. Ariz. R. Civ. P. 26(b)(5); *see also* A.R.S. § 12-2506(B). If a defendant fails to timely name a non-party at fault, the fact finder cannot allocate any percentage of fault to that non-party except upon the parties' written agreement "or on motion showing good cause, reasonable diligence, and lack of unfair prejudice to all other parties." *Id.* The purpose of this rule is to require defendants to identify for the plaintiff any unknown persons or entities who might have caused the injury in sufficient time to allow the plaintiff to bring them into the action before the statute of limitations expires. **Scottsdale Ins. Co. v. Cendejas**, 220 Ariz. 281, 286, ¶ 18, 205 P.3d 1128, 1133 (Ct. App. 2009). To this end, Rule 26(b)(5), Ariz. R. Civ. P. requires the defendant to "provide the identity, location, and the facts supporting the claimed liability" of the non-party at fault. It is insufficient, for example, to give the name and address of a person or entity and merely state that it might be at fault "to the extent" it performed "any" work that might have caused or contributed to the plaintiff's damages. *Cendejas, supra*, ¶ 20. However, "a notice of nonparty at fault must be read together with a party's timely disclosures." **Bowen Prods., Inc. v. French**, 231 Ariz. 424, 427, 296 P.3d 87, 90 (Ct. App. 2013). A notice that is insufficient on its face may be sufficient when the party's disclosures reveal the factual basis for the non-party's alleged fault. *Id.*

Willful and Wanton Conduct

A.R.S. § 12-2505(A) bars a plaintiff who has acted intentionally, willfully or wantonly from claiming the benefits of comparative fault. But a willfully- or wantonly-acting defendant may seek a reduction in liability based upon the comparative fault of the plaintiff, **Wareing v. Falk**, 182

Ariz. 495, 897 P.2d 1381 (Ct. App. 1995), or a non-party, *Lerma v. Keck*, 186 Ariz. 228, 921 P.2d 28 (Ct. App. 1996). Treating claimants differently from defendants neither improperly discriminates against claimants nor violates equal protection. Unlike a defendant, a willful and wanton claimant is using the court system to benefit from an injury caused by his or her willful and wanton conduct. A willful and wanton defendant, on the other hand, is involuntarily brought before the court and is simply attempting to limit his liability. When a defendant argues that the plaintiff's conduct was willful and wanton, the jury must first decide whether the plaintiff was contributorily negligent and, if so, by what percentage that negligence should reduce the plaintiff's recovery. The jury is then instructed that if it finds the plaintiff's conduct was willful or wanton, it should not determine relative degrees of fault, and may find completely for the plaintiff or the defendant as it sees fit. This approach is the only one compatible with Article 18, § 5 of the Arizona Constitution, which requires the jury to decide all issues of contributory negligence. *Williams v. Thude*, 180 Ariz. 531, 885 P.2d 1096 (Ct. App. 1994), *aff'd and remanded*, 188 Ariz. 257, 934 P.2d 1349 (1997); *Gunnell v. Arizona Public Service Co.*, 202 Ariz. 388, 46 P.3d 399 (2002).

Indivisible Injury

The "single indivisible injury rule" is still intact in Arizona after the abolition of joint and several liability. *Cramer v. Starr*, 240 Ariz. 4, 8, ¶ 15, 375 P.3d 69 (2016) (citing *Piner v. Superior Court*, 192 Ariz. 182, 962 P.2d 909 (1998)); *A Tumbling-T Ranches v. Paloma Investment Limited Partnership*, 197 Ariz. 545, 5 P.3d 259 (Ct. App. 2000). That is, when a plaintiff's injury is indivisible, even though caused by successive accidents, the plaintiff may assert a claim against all wrongdoers without having to prove the extent of injury caused by each. Rather, each defendant is liable for the entire amount of unapportioned damages, and the burden of apportionment shifts to the defendants. Successive tortfeasors are responsible for the entire amount of damages if "their acts occur closely in time and place" and the plaintiff receives successive injuries that "the trier of fact determines to be unapportionable between or among the several tortfeasors." *Piner*, 192 Ariz. at 196, ¶ 18.

When the jury renders a judgment for the plaintiff in an indivisible injury case, payment by one defendant of the full amount of damages constitutes a satisfaction of the plaintiff's rights against all tortfeasors legally responsible for the plaintiff's indivisible injury. See *Bridgestone/Firestone North America Tire, L.L.C. v. Naranjo*, 206 Ariz. 447, 79 P.3d 1206 (Ct. App. 2003). In *Naranjo*, the plaintiffs' rental car rolled over due to tire failure, injuring them and killing one passenger. They sued the rental company. The jury rendered a \$9-million-plus verdict for the plaintiffs, allocating 30% fault to the non-party tire company. APS paid the entire amount. In the meantime, the tire company brought a declaratory judgment action against APS and the plaintiffs arguing it was not liable for contribution for the judgment. The plaintiffs counterclaimed for negligence and strict products liability. The court granted summary judgment for the tire company. As a matter of law, APS was not entitled to contribution from the tire company because APS and the tire company were joint tortfeasors who caused an indivisible injury. The plaintiffs had no cause of action against the tire company because the plaintiffs had already recovered their full damages from APS and had filed a satisfaction of judgment in that case.

Assumption of the Risk

The Arizona Constitution, article 18, section 5, provides that “the defense of contributory negligence or of assumption of the risk shall, in all cases whatsoever, be a question of fact and shall, at all times, be left to the jury.” This principle applies to both express and implied assumption of the risk. ***Phelps v. Firebird Raceway, Inc.***, 210 Ariz. 403, 111 P.3d 1003 (2005). In *Phelps*, a racecar driver sued the racetrack for injuries he sustained during the race when he lost control of his vehicle and crashed into a wall. Before the race, the driver signed a release and covenant not to sue together with a release and waiver of liability, assumption of risk and indemnity agreement. The racetrack sought summary judgment based upon the express contractual assumption of the risk agreement. The trial court granted the racetrack’s request and dismissed the action. The court of appeals affirmed. The Supreme Court reversed, holding that article 18, section 5 of the Arizona Constitution required the defense of assumption of risk be a question of fact for the jury in all cases whatsoever and at all times. Even though there was an express contractual assumption of the risk agreement, the constitutional language required a jury to decide the issue.

The constitutional right to have a jury decide the issue of assumption of the risk applies even where the actor is engaged in criminal conduct. ***Sonoran Desert Investigations, Inc. v. Miller***, 213 Ariz. 274, 141 P.3d 754 (2006). There, Hernandez died of asphyxiation after Howard apprehended him on suspicion of shoplifting. Howard was a private security guard employed by Sonoran Desert Investigations (SDI) who had been assigned to a Tucson Safeway store. Howard confronted Hernandez after seeing him conceal bottles of moisturizer in his clothing and walk toward the front of the store. SDI claimed it was not liable as a matter of law, based on § 12-712(B) (providing that the jury in a civil case may find the defendant not liable if the claimant was committing a misdemeanor and was at least fifty per cent responsible for the injury). The court held the statute unconstitutional, because it would mean that Hernandez’s criminal conduct would trigger the defendant’s non-liability. The constitutional guarantee also requires the jury to decide issues of the plaintiff’s comparative negligence. ***Gunnell v. Arizona Public Service Co.***, 202 Ariz. 388, 394, 46 P.3d 399, 405 (2002). In ***Salt River Project Agricultural Improvement & Power Dist. v. Westinghouse Electric Corp.***, 176 Ariz. 383, 861 P.2d 668 (Ct. App. 1993), the court of appeals held that contributory negligence and assumption of the risk are always a question of fact for the jury; and jury instructions that compel, direct, or require the jury to find for the defendant if it finds negligence or assumption of the risk by the plaintiff violate article 18, section 5. The jury must be instructed simply to determine whether or not the plaintiff assumed the risk and, if so, the jury has discretion whether to find for the plaintiff or the defendant. See also ***Williams v. Thude***, 180 Ariz. 531, 885 P.2d 1096 (Ct. App. 1994), *aff’d* and *remanded*, 188 Ariz. 257, 934 P.2d 1349 (1997).

A court may constitutionally preclude a person who has been properly incarcerated for a criminal conviction from suing for negligence when the alleged harm is the incarceration itself. ***Muscat by Berman v. Creative Innervisions LLC***, 244 Ariz. 194, 199, 418 P.3d 967, 972 (Ct. App. 2017). *Muscat*, a child abuser, was placed in a group home and was supposed to be supervised at all times. A staff member failed to supervise him at a church, Muscat molested a child, and he was

arrested. Muscat sued the home, claiming he was arrested as a result of the home's negligence. His complaint was dismissed. The court did not decide whether the "wrongful conduct rule" applies in Arizona (stating that a wrongdoer cannot base a tort claim on his own actions). The court held that Muscat failed to state a claim because the only harm he claimed was related to his proper incarceration. "No properly-convicted criminal has a legally protected interest in being free from the inherent consequences of the resulting sentence." This result, said the court, was not in conflict with the constitutional doctrines of contributory negligence or assumption of risk. *Id.* at 200, 418 P.3d at 973.

The "firefighter's rule" says that a first responder who is injured in the course of rendering help cannot sue the person who called for help. The rule is a type of assumption of the risk theory. The reasoning is that the tort system is not the appropriate vehicle for compensating public safety employees for injuries sustained as a result of negligence that creates the very need for their employment. ***Espinoza v. Schulenburg***, 212 Ariz. 215, 217, 129 P.3d 937, 939 (2006). The firefighter's rule does not apply to off-duty first responders. Excluding volunteers from the application of the firefighter's rule serves the important societal goal of encouraging those most qualified to stop and render aid to do so—or at least of not discouraging them from rendering aid by precluding suit for injuries suffered in the course of their volunteer service. However, the firefighter's rule only applies to first responders, not to caregivers who privately contract to help others. ***Sanders v. Alger***, 242 Ariz. 246, 251, 394 P.3d 1083, 1088 (2017) (firefighter's rule did not prevent an in-home caregiver from suing an elderly patient who fell on the caregiver and injured him).

Liability for the Acts of an Independent Contractor

Normally, the employer of an independent contractor is not vicariously liable for the contractor's conduct. ***Ft. Lowell–NSS Ltd. P'ship v. Kelly***, 166 Ariz. 96, 101, 800 P.2d 962, 967 (1990). However, an employer of an independent contractor will remain vicariously liable if the contractor is performing a "non-delegable duty." ***Wiggs v. City of Phoenix***, 198 Ariz. 367, 371, 10 P.3d 625, 629 (2000). The "non-delegable duty" is really a misnomer. A non-delegable duty is not one that the employer *cannot* delegate to an independent contractor; it one that is so important that, having delegated the duty, the employer will remain liable for the contractor's conduct. The rule is based on the principle that certain duties of employers are so important that they may not escape liability by delegating performance to another. Such duties arise in those "special situations in which the law prescribes a duty requiring a higher degree of care." ***Ft. Lowell–NSS Ltd. P'ship***, 166 Ariz. at 101, 800 P.2d at 967; ***Lee v. M & H Enterprises, Inc.***, 237 Ariz. 172, 176, ¶ 13, 347 P.3d 1153, 1157 (Ct. App. 2015). Non-delegable duties may be imposed by statute, by contract, by franchise or charter, or by the common law. *See, e.g., DeMontiney v. Desert Manor Convalescent Ctr. Inc.*, 144 Ariz. 6, 695 P.2d 255 (1985) (county's duty to provide safe treatment to involuntarily detained mental patients); ***Ft. Lowell–NSS Ltd. P'ship***, 166 Ariz. at 101, 800 P.2d at 967 (duty of a possessor of land to keep his premises reasonably safe for invitees); ***Wiggs***, 198 Ariz. at 370, ¶ 8, 10 P.3d at 628 (city's duty to maintain streets in reasonably safe condition); ***Simon v. Safeway, Inc.***, 217 Ariz. 330, 339, ¶ 24, 173 P.3d 1031, 1040 (Ct. App. 2007) (Safeway did not owe a nondelegable duty to provide security services, but having voluntarily assumed

that duty within the context of the heightened duty it already owed to its business invitees, Safeway created a nondelegable duty to protect its invitees from the intentionally tortious conduct of those it hired to provide security on its premises); ***Flood Control Dist. of Maricopa County v. Paloma Inv. Ltd. P'ship***, 230 Ariz. 29, 39, ¶ 26, 279 P.3d 1191, 1201 (Ct. App. 2012) (dam owner's duty to maintain a dam in a safe condition). Compare ***Myers v. City of Tempe***, 212 Ariz. 128, 132, ¶ 18, 128 P.3d 751, 755 (2006) (the duty to provide emergency services may be delegated).

The abolition of joint and several liability in Arizona (in favor of purely comparative fault) does not affect the non-delegable duty concept. When an employer is vicariously liable for the independent contractor's conduct, the employer's remedy is to seek either indemnity or contribution from the negligent independent contractor. See ***Nelson v. Grayhawk Properties, Inc.***, 209 Ariz. 437, 104 P.3d 168 (Ct. App. 2004). The independent contractor can still be held independently liable for its own negligence if it breaches the applicable standard of care. *Id.*

A consent judgment in favor of a principal who has a non-delegable duty does not automatically bar a claim against the tortfeasor agent. ***Jamerson v. Quintero***, 233 Ariz. 389, 391, ¶ 8, 313 P.3d 532, 534 (Ct. App. 2013). In *Jamerson*, the agent argued that the dismissal of the principal (due to settlement) automatically required dismissal of the agent/independent contractor. The agent reasoned that because the principal was only vicariously liable under the non-delegable duty concept, if the principal could not be held liable, then that must mean no liability for the agent. The court disagreed. Settlement with and dismissal of the *agent* would automatically relieve the *principal* of vicarious liability, because if there is no agent liability, there can be no vicarious liability on the principal. But the converse is not true. The agent's liability is not derivative, as is the principal's. So the principal's settlement says nothing about the agent's liability. And because the principal is jointly and severally liable with the agent, A.R.S. § 12-2506(D), dismissal of the principal does not automatically discharge the agent from liability. However, any judgment against the agent will be reduced by the amount the principal paid to settle.

CONTRIBUTION

A.R.S. §§ 12-2501 through 12-2504 incorporate the Uniform Contribution Among Tortfeasors Act. "Contribution" is the concept whereby one who has paid more than his portion of liability for a plaintiff's injuries recovers the excess from the other joint tortfeasor.

The right of contribution arises if "two or more persons become jointly or severally liable in tort for the same injury to person or property or for the same wrongful death." A.R.S. § 12-2501(A). The right of contribution exists only if a tortfeasor has paid more than his pro rata share of the common liability. A.R.S. § 12-2501(B). The amount of contribution to which a tortfeasor is entitled is the amount he paid in excess of his pro rata share. *Id.* A settling tortfeasor may not seek contribution from a non-settling tortfeasor whose liability is not extinguished by the settlement, nor can he seek contribution to the extent the settlement is unreasonable. A.R.S. § 12-2501(D). The statute does not, however, abrogate the common law right of indemnity and it does not apply to breaches of trust or fiduciary obligations. A.R.S. § 12-2501(F).

Contribution and indemnity are sometimes confused. Contribution is available when one defendant who has paid more than his proportionate share of liability to the plaintiff seeks to recover the excess from joint tortfeasors who have paid less than their proportionate share. “Indemnity” occurs when one defendant’s full liability is shifted to another person who becomes obliged, for some reason, to pay those damages (such as when an innocent employer pays the employee’s liability to the plaintiff due to vicarious liability). Indemnity is addressed in the Contribution Act only to the extent that the Act forbids a tortfeasor who has an indemnity obligation to another tortfeasor from seeking contribution from that other tortfeasor.

Where the defendants were acting in concert and the recovery is joint and several, a release or covenant not to sue or not to enforce the judgment given in good faith to one of them does not discharge the others from liability (unless its terms so provide), but it does reduce the claim against the others to the extent of the settlement amount. A.R.S. § 12-2504; **Jamerson v. Quintero**, 233 Ariz. at 392, 313 P.3d at 535. It also discharges the settling tortfeasor from any liability for contribution to the other tortfeasor.

There is no right of contribution between tortfeasors when their liability or potential liability is “several only.” **PAM Transp. v. Freightliner Corp.**, 182 Ariz. 132, 133, 893 P.2d 1295, 1296 (1995). Thus, when a tortfeasor who settles any and all claims arising out of an accident is subject to several liability, that tortfeasor cannot seek contribution from other defendants who are similarly severally liable. This decision effectively limits contribution actions to only those situations where defendants are jointly liable.

A plaintiff may waive the joint liability of both settling and non-settling parties and, by formal agreement, hold the non-settling parties only severally liable, thereby precluding the non-settling parties’ rights to contribution from the settling parties. **Herstam v. Deloitte & Touche, LLP**, 186 Ariz. 110, 919 P.2d 1381 (1996).

There is no right of contribution in favor of any tortfeasor whom the trier of fact finds has intentionally, willfully or wantonly caused or contributed to the injury or wrongful death. A.R.S. § 12-2501(C).

“Common Liability”

“Common liability” refers to the dollar amount shared by joint tortfeasors for which they are legally answerable to the plaintiff. **Parker v. Vanell**, 170 Ariz. 350, 824 P.2d 746 (1992); **PAM Transport v. Freightliner Corp.**, 182 Ariz. 132, 134, 893 P.2d 1295, 1297 (1995). Since there is no more joint liability in Arizona, except for the narrow situations discussed above, in most cases there is no “common liability” to discharge and, accordingly, no right of contribution when a single tortfeasor settles the plaintiff’s claim against him. **Cella Barr Assoc., Inc. v. Cohen**, 177 Ariz. 480, 868 P.2d 1063 (Ct. App. 1994).

As is noted above, the employer of an independent contractor can be held liable for an independent contractor’s torts where an employer owes a non-delegable duty. In these situations, joint liability is preserved, and so the employer may seek contribution from the

independent contractor, even where the employer has some degree of independent liability. **Wiggs v. City of Phoenix**, 198 Ariz. 367, 371, 10 P.3d 625, 629 (2000); A.R.S. § 12-2506(E).

In strict products liability actions, liability is several only. Each entity is liable for its own actions in distributing a defective product. **State Farm Ins Co. v. Premier Manufactured Sys. Inc.**, 217 Ariz. 222, 172 P.3d 410 (2007). Thus, contribution would not apply.

INDEMNITY

The general rule is that there is no indemnity among joint tortfeasors. Arizona recognizes exceptions to this rule where it is equitable to shift liability for the loss from one joint tortfeasor to another. In **Cella Barr Assoc., Inc. v. Cohen**, *supra*, the plaintiff wanted to apply an exception in the RESTATEMENT OF RESTITUTION § 90 allowing indemnity among joint tortfeasors where the party seeking indemnity is an agent who has become liable in tort, without any fault of his own, simply by following the instructions of another agent of the principal. The court did not decide whether § 90's exception applied in Arizona because Cella Barr was not acting at the direction of Cohen. Thus, it is not clear yet whether Arizona will follow this exception to the general rule barring indemnity among joint tortfeasors.

Like the contribution situation, joint liability is preserved where a defendant who owes a non-delegable duty is found vicariously liable for the actions of its independent contractor. The employer may seek indemnity against the independent contractor in cases of pure vicarious liability. **Wiggs**, 198 Ariz. at 371, 10 P.3d at 629; A.R.S. § 12-2501(F)(1).

Arizona's equitable indemnity law allows a plaintiff to seek indemnity from a culpable indemnity defendant if the plaintiff was subject to derivative or imputed liability and discharges an actual obligation that the culpable indemnity defendant owed to a third party. **KnightBrook Ins. Co. v. Payless Car Rental Sys. Inc.**, 243 Ariz. 422, 424, 409 P.3d 293, 295 (2018). The plaintiff in a common law indemnity action generally must show: (1) it discharged a legal obligation owed to a third party; (2) for which the indemnity defendant was also liable; and (3) as between the two, the obligation should have been discharged by the [indemnity] defendant. There is no duty of indemnity unless the payment discharges the primary obligor from an existing duty. An actual obligation is necessary for an equitable indemnity claim. *Id.* **KnightBrook** rejected the notion that a right of indemnity could exist based only on the payor's "justifiable belief" that he owed a duty to the third party. *Id.* at 426, 409 P.3d at 297.

After settling with a homeowner, a general contractor may obtain indemnity from a subcontractor only if the general proves the extent of the subcontractor's fault. **MT Builders, L.L.C. v. Fisher Roofing, Inc.**, 219 Ariz. 297, 197 P.3d 758 (Ct. App. 2008).

SETTLEMENT CREDIT

A.R.S. § 12-2504 states that when the plaintiff gives a tortfeasor a release or covenant not to execute in good faith, that discharges the tortfeasor to whom it is given from all liability for contribution to any other tortfeasor. It does not discharge any other tortfeasor unless its terms

so provide. But it reduces the plaintiff's claim against the others to the extent of the greater of either any stipulated amount or the consideration paid for it. The statute does not apply to damages that sound primarily in contract. *John Munic Enters., Inc. v. Laos*, 235 Ariz. 12, 16-17, ¶ 12, 326 P.3d 279, 283-84 (Ct. App. 2014). The statute also does not apply where the liability is several only. *Neil v. Kavena*, 176 Ariz. 93, 859 P.2d 203 (Ct. App. 1993) (statute no longer applicable after abolition of joint and several liability).

In those few cases where joint and several liability applies, the courts take a "settlement-first" approach to deciding the amount to credit a non-settling defendant. See *Shelby v. Action Scaffolding, Inc.*, 171 Ariz. 1, 827 P.2d 462 (1992).¹ Shelby fell from scaffolding and was injured. Action rented the scaffold to Shelby's employer. General Scaffolding sold the equipment to Action. Shelby sued Action for negligence and General Scaffolding for strict products liability. The case went to trial. After all parties had presented their evidence, General Scaffolding settled with Shelby for \$250,000. The jury then returned a verdict of \$650,000 for the plaintiff, allocating 30% fault to Action and 70% fault to Shelby.

The trial court reduced Shelby's damages in proportion to his fault before deducting the settlement amount from the reduced damages. This is called a "fault-first formula." The court of appeals, however, deducted the settlement amount from his damages first, before reducing those damages in proportion to Shelby's fault. This is a "settlement-first formula."

The Supreme Court held that the settlement-first formula was consistent with the legislative intent, the contribution statute, and fundamental fairness. The settlement-first formula allows a plaintiff, rather than a non-settling defendant, to benefit from the settlement with a joint tortfeasor. In this case, Shelby negotiated a \$250,000 settlement, which was quite favorable given that the jury found Shelby caused all but \$195,000 of his damages. The settlement-first formula allowed Shelby to recover a portion of the damages caused by Action in addition to the settlement amount. If the court had applied the fault-first formula, Action would have been relieved of any responsibility due to the offset for General's settlement.

Intentional Joint Tortfeasors

Intentional joint tortfeasors are entitled to a credit against a judgment for the amount of the plaintiff's settlement with other joint tortfeasors. *Bishop v. Pecanic*, 193 Ariz. 524, 975 P.2d 114 (Ct. App. 1998). There, a group of tortfeasors committed an intentional tort. Some, but not all, of the defendants settled with the plaintiff before trial. The trial proceeded against the remaining defendants. The jury found the defendants had acted in concert, rendering them jointly and severally liable for the judgment. A.R.S. § 12-2504(1) required the award to be reduced by the amount of the settlement, even though defendants had committed an intentional tort.

¹ *Shelby* pre-dated the effective date of the statute abolishing joint and several liability. If *Shelby* had been filed after the statute's effective date, the court's analysis would have been different. See *Gemstar Ltd. v. Ernst & Young*, 185 Ariz. 493, 508, 917 P.2d 222, 237 (1996); *Bishop v. Pecanic*, 193 Ariz. 524, 527, ¶ 9, 975 P.2d 114, 117 (Ct. App. 1998).

Joint liability under A.R.S. § 12-2506(D)(1) requires proof that the parties made a conscious agreement to commit an intentional tort and actively took part in the intentional tort. A conscious agreement to commit a “tortious act” will not suffice to impose joint liability, unless the tortious act is an intentional tort. ***Mein ex. re. Mein v. Cook***, 219 Ariz. 96, 193 P.3d 790 (Ct. App. 2008). To “act in concert,” the tortfeasors must knowingly agree to commit an intentional tort. *Id.*

GUEST STATUTE

A guest statute generally provides that a non-paying automobile passenger may not sue the driver when the passenger is injured as a result of the driver’s simple negligence. Many guest statutes allow a suit for wilful misconduct or, sometimes, intoxication. Arizona does not have a guest statute.

PARENTAL IMMUNITY

A parent is not immune from liability for tortious conduct toward her child. ***Broadbent v. Broadbent***, 184 Ariz. 74, 907 P.2d 43 (1995). Rather, Arizona has a “reasonable and prudent parent” standard. In other words, parents can assert the defense of having acted “as a reasonable and prudent parent under the circumstances.” Liability will be imposed even if the negligent act involved some matter of parental supervision, discretion, care, custody and control. In ***Broadbent***, a mother left her child unattended near a swimming pool. The child suffered a near drowning, causing permanent brain damage. The child, through his father, sued the mother for negligent supervision. The court held that the mother’s admitted negligent conduct was actionable. The mother was not protected from liability by “parental immunity.”

Johnson v. Pankratz, 196 Ariz. 621, 2 P.3d 1266 (2000), held that in an ordinary negligence action, the plaintiff need not produce expert testimony to establish the standard of care. ***Johnson*** involved a daughter’s suit against her father for negligent parental supervision at the playground. The court held that the jury could rely on its own experience in determining whether the father acted with reasonable care under the circumstances.

Parents are not immune from liability for their child’s malicious or willful misconduct that injures the person or property of another. A.R.S. § 12-661. Such misconduct “shall be imputed” to the parents or legal guardian with custody or control of the child, regardless of whether the parents or guardian could have anticipated the misconduct. A.R.S. § 12-661(A). The parents or guardian having custody or control will be held jointly and severally liable with the child for actual damages resulting from the misconduct, up to a maximum of \$10,000 for each tort committed by the child. A.R.S. § 12-661(A), (B). This liability is in addition to any other liability imposed by law. A.R.S. § 12-661(B).² However, a parent who has neither custody nor control of a child is not liable under this statute. ***Pfaff By & Through Stalcup v. Ilstrup***, 155 Ariz. 373, 373, 746 P.2d 1303, 1303 (Ct.

² The parental liability statute does not limit an insurer’s right to exclude coverage for a child’s acts imputed to the parents or legal guardian. A.R.S. § 12-661(C).

App. 1987). “Control requires present ability to affect the conduct of another,” while mere “[p]otential ability is insufficient.” *Id.* Thus, for example, a father who lived 120 miles away from his 17-year-old son could not be held liable for his son’s sexual assault under the parental liability statute. *Id.*

Arizona allows a claim for liability against a parent for negligent entrustment of a dangerous object (such as a vehicle) to a child where a plaintiff can show the defendant owned and controlled the item in question. *See e.g., Acuna v. Kroack*, 212 Ariz. 104, 110, ¶ 22, 128 P.3d 221, 227 (Ct. App. 2006); *Tissicino v. Peterson*, 211 Ariz. 416, 419, ¶ 12, 121 P.3d 1286, 1289 (Ct. App. 2005). Arizona is also one of the few jurisdictions that still recognizes the family purpose doctrine, which “subjects the owner of a [vehicle] to vicarious liability when the owner provides an automobile for the general use by members of the family ... and when the vehicle is so used by a family member.” *Young v. Beck*, 227 Ariz. 1, 4, ¶ 8, 251 P.3d 380, 383 (2011).

DRAM SHOP LIABILITY

Common Law

Arizona first adopted a common law dram shop cause of action in *Branningan v. Raybuck*, 136 Ariz. 513, 667 P.2d 213 (1983), and *Ontiveros v. Borak*, 136 Ariz. 500, 667 P.2d 200 (1983). In these two cases, the Arizona Supreme Court held that tavern owners could be held liable if they sold liquor to intoxicated patrons where the tavern owner should have known that such conduct created unreasonable risk of harm to others who may be injured on or off the tavern owner’s premises. Recently, however, the Arizona court of appeals held that Arizona’s dram shop statutes (which hinge liquor licensee liability on overserving someone who is “obviously intoxicated”) expressly preempt common law negligence claims. *Torres v. Jai Dining Services (Phoenix), Inc.*, 508 P.3d 1148, 1159 (Ct. App. 2022); A.R.S. § 4-312(B). The plaintiff in *Torres* has sought review with the Arizona Supreme Court, but as of the date of publication, that process has not been completed. As such, for now, common law dram shop claims remain preempted and thus invalid until and unless the Arizona Supreme Court decides otherwise.

A.R.S. § 4-301 (Social Host)

In 1985, the Legislature enacted statutes addressing the civil liability of those who furnish alcohol to others. A.R.S. § 4-301 states that a social host – *i.e.*, a non-licensee – is not liable in damages for personal or property damages allegedly caused by the furnishing or serving of liquor to a person of the legal drinking age. Though the statute “limits” liability, it is not unconstitutional under the Arizona Constitution, art. 18, § 6 (“The right of action to recover damages for injuries shall never be abrogated....”), because there was no right of action against a tavern owner in the common law at the time the constitution was adopted. *Bruce v. Chas Roberts Air Conditioning*, 166 Ariz. 221, 801 P.2d 456 (Ct. App. 1990).

Hernandez v. Arizona Bd. of Regents, 177 Ariz. 244, 866 P.2d 1330 (1994), *vacated in part*, 187 Ariz. 506, 930 P.2d 1309 (1997), reiterated that A.R.S. § 4-301 provides no protection for social

hosts who provide alcohol to minors. The plaintiff in *Hernandez* was injured by a minor who had been given alcohol at a fraternity party. Because A.R.S. § 4-301 did not apply, the plaintiff could maintain a common law negligence action against those who served the minor.

In *Petolicchio v. Santa Cruz County Fair & Rodeo Assoc.*, 177 Ariz. 256, 866 P.2d 1342 (1994), the Supreme Court held that this statute does not protect a defendant who neither furnished nor sold alcohol to the minor. There, the minor stole the liquor from the defendant's locked cabinet and gave it to his underage friends, one of whom drove a car and injured a passenger. The court held that the social host statute applies only to people who furnish or serve alcohol. Because the alcohol was stolen, the statute did not apply and common law principles governed.

Arizona's drinking age of 21 governs whether social host immunity is available. *Knoell v. Cerkvenik-Anderson Travel, Inc.*, 185 Ariz. 546, 917 P.2d 689 (1996). There, the defendant provided tours to Mexico for recent high school graduates. As part of the trip, the defendant hosted parties in Mexico and furnished alcoholic beverages. The legal drinking age in Mexico is 18. Timothy Knoell was an 18-year-old participant. He consumed the defendant's alcohol and allegedly jumped or fell to his death from the balcony of his hotel room. Timothy's parents sued. Because Timothy was not of legal drinking age in Arizona, § 4-301 did not protect the defendant with social host immunity.

In *Riddle v. Arizona Oncology Servs., Inc.*, 186 Ariz. 464, 924 P.2d 468 (Ct. App. 1996), an employer ordered his employee to leave work due to the obvious signs of intoxication. On the way home, the employee was involved in a motor vehicle accident. The court held that the employer owed no duty to a third party motorist to control the conduct of the off-duty employee who consumed illegal drugs before and during work. The court reasoned that the employer did not furnish the employee with any intoxicants or with a vehicle. It simply instructed her to leave the premises because of her intoxicated condition and inability to work. Under those circumstances, the employer did not have a duty to control the employee's actions or to prevent her from operating a vehicle.

In *Andrews, Woodward v. Eddie's Place, Inc.*, 199 Ariz. 240, 16 P.3d 801 (2000), the court of appeals held that the two-year personal injury statute of limitations applied to a claim against a liquor establishment, rather than the one-year statute applicable to liability created by statute, where the plaintiff based the suit, in part, on common law liability. The court held that the dram shop statute did not create a new claim against liquor licensees, but simply attempted to codify the common law theory of dram shop liability. The validity of this case is in question now, given the Court of Appeals' holding in *Torres* that the dram shop statutes preempt any common law claim. If that holding survives Supreme Court review, the statute of limitations will be one year.

In *Barkhurst v. The Kingsmen of Route 66, Inc.*, 234 Ariz. 470, 323 P.3d 753 (Ct. App. 2014), the court held that a volunteer, nonprofit organization that sponsored an annual rodeo and related events, and listed on its website various activities including an evening of entertainment at a restaurant, did not owe a duty of care to an assault victim who was injured in the restaurant parking lot two and a half hours after the entertainment had ended. The organization was not a

social host, but merely a promoter of events, and had no control over the restaurant or its entertainment.

A.R.S. § 4-311 (Licensee Liability)

This statute sets forth the conditions under which one who is not a social host can be liable for serving alcohol. As noted above, under the recent *JAI Dining* case, this statutory cause of action is currently the only basis for asserting dram shop liability against a liquor licensee.

A.R.S. § 4-311(A) states that a liquor licensee is liable for personal injuries and property damage, or for wrongful death, if (1) it sold alcohol to a person who was “obviously intoxicated” or under the legal drinking age, and (2) the purchaser drank the alcohol, and (3) the purchaser’s alcohol consumption was a proximate cause of the injury, death, or property damage.

A.R.S. § 4-311(B) provides that no licensee is chargeable with knowledge of previous acts by which a person becomes intoxicated at other locations unknown to the licensee unless the person was obviously intoxicated.

A.R.S. § 4-311(C) provides that if an underage person purchases alcohol from a licensee, and causes injuries or property damage as a result of consumption within a reasonable time after the sale, it shall create a rebuttable presumption that the underage person consumed the alcohol provided by the licensee.

A.R.S. § 4-311 (D) defines “obviously intoxicated” as “inebriated to such an extent that a person’s physical faculties are substantially impaired and the impairment is shown by significantly uncoordinated physical action or significant physical dysfunction that would have been obvious to a reasonable person.”

In *Carrillo v. El Mirage Roadhouse, Inc.*, 164 Ariz. 364, 793 P.2d 121 (Ct. App. 1990), the court held that a liquor licensee has a duty not to sell, serve or furnish alcohol to anyone regardless of their condition, if the licensee has actual or constructive knowledge that an intoxicated person will ultimately receive and consume the alcohol. In effect, a licensee cannot sell liquor to a person whom he knows or should know will give the liquor to an intoxicated person. Here, there was ample evidence from which a trier of fact could find that the Roadhouse knew an intoxicated individual’s friends were giving him alcohol after the bartenders refused to serve him anymore. The continued viability of this case is in question given the current preemption of a common law dram shop claim.

In *Henning v. Montecini Hospitality, Inc.*, 217 Ariz. 242, 172 P.3d 430 (Ct. App. 2007), the court held that an owner of a bar owed no duty of care to an injured party with regard to hiring, training and supervising bar employees who worked for a different company that managed the bar. The bar, a Famous Sam’s franchise, was owned by Montecini Hospitality and operated by Zimbow Enterprises. The plaintiffs sued Montecini, Famous Sam’s (the franchisor), and Zimbow for negligence under the dram shop statutes and for the negligent hiring, training and supervision of their employees. Settlements were reached with both Zimbow and Famous Sam’s. Montecini

moved for summary judgment contending it owed no duty under the dram shop laws because it had no possession or control of the bar, nor did it employ any of the servers when the accident occurred. The court affirmed summary judgment for Montecini, reasoning that the Legislature significantly limited the liability of non-licensees for serving alcohol, and the court “would exceed [its] authority were [it] to substitute [its] own public-policy determinations for those of the Legislature.”

In **McMurtry v. Weatherford Hotel, Inc.**, 231 Ariz. 244, 293 P.3d 520 (Ct. App. 2013), the court held that a genuine issue of material fact existed (precluding summary judgment) as to whether a hotel used reasonable care in escorting an intoxicated guest from the hotel bar to the guest’s room, given the falling hazard posed by the room’s window/balcony configuration. A licensee’s liability turns on whether it fulfilled its duty to exercise reasonable care in serving intoxicants to patrons who might later injure themselves or others, either on or off the premises.

Other Issues

In **Hoeller v. Riverside Resort Hotel**, 169 Ariz. 452, 820 P.2d 316 (Ct. App. 1991), the defendant was a Nevada casino that served an Arizona resident, who then drove into Arizona and injured the plaintiff. The court ruled that Arizona law, rather than Nevada law, applied to protect the Arizona victim. But in **Williams v. Lakeview Co.**, 199 Ariz. 1, 13 P.3d 280 (2000), a Nevada casino served alcohol to someone who later caused an accident in Arizona. In a 3-2 decision, the Supreme Court held that Arizona did *not* have personal jurisdiction over the Nevada casino absent a causal connection between the casino’s Arizona contacts and the plaintiffs’ claims. The court emphasized, however, that jurisdiction questions are case-specific and fact intensive, thus leaving open the possibility that Arizona might have jurisdiction over an out-of-state vendor in other circumstances.

In **Patterson v. Thunder Pass, Inc.**, 214 Ariz. 435, 153 P.3d 1064 (Ct. App. 2007), the court addressed whether a tavern fulfilled its duty of reasonable care by driving an intoxicated patron home; and whether the patron’s return to the tavern constituted a superseding, intervening event that broke the chain of proximate causation. An intoxicated patron backed her vehicle into a parked Jeep as she attempted to leave the tavern. The tavern confiscated her keys and called her a cab. The cab never arrived, so a tavern employee drove the patron home and then returned the keys to her. Within an hour, and unbeknownst to the tavern employees, the patron returned to the parking lot behind the tavern to get her vehicle. After obtaining her vehicle, the patron was involved in a high-speed head-on collision with a vehicle driven by Patterson. Patterson sued the tavern for over-serving the patron. The court held that the tavern’s intervening acts of separating the patron from her vehicle and driving her home broke the chain of legal causation and relieved the tavern of liability. The patron’s decision to return to retrieve her vehicle while she was still intoxicated was unforeseeable and extraordinary and thus constituted a superseding and intervening event that negated any negligence on the part of the tavern or its employees.

In **Dupray v. JAI Dining Services (Phoenix), Inc.**, 245 Ariz. 578, 432 P.3d 937 (Ct. App. 2018) , Panameno drank a significant amount of alcohol before imbibing at JAI’s establishment. His

friend drove Panameno to the friend's house. After 15 or 20 minutes, Panameno drove to his girlfriend's house where the girlfriend argued with him for being intoxicated and tried to take his keys. Panameno drove off in anger and crashed into Dupray who was on a Vespa-type scooter. Dupray sued JAI. The court held that there was sufficient evidence that JAI breached its duty in overserving Panameno; and the fact that his friend drove him away from the club did not absolve JAI of liability. The evidence, said the court, "does not show that the club's personnel took any action to see that Panameno reached home safely." Further, a reasonable jury could conclude that JAI should have foreseen Panameno's collision with Dupray. The court nevertheless reversed the verdict for Dupray because the trial court failed to instruct the jury on "intervening and superseding cause." The jury could have concluded that although JAI's negligence in overserving Panameo was the actual cause of the collision, the chain of causation was broken by Panameno's independent decisions to drive to his girlfriend's house and then drive away from her house even though he was intoxicated and was warned not to drive.

In *Torres v. JAI Dining Services (Phoenix) Inc.*, 252 Ariz. 28, 497 P.3d 481 (2021), an intoxicated patron left an establishment drunk and arrived home safely. The court rejected the argument that his decision to sleep for a while and then drive again was an intervening, superseding cause as a matter of law. The court found no "authority for limiting the scope of risk in dram shop cases to the patron's drive from the liquor licensee's venue to the patron's home or similar resting place." Instead, the "risk of liability ends when the patron sobers up" and the jury should decide the intervening, superseding cause issue. The court distinguished *Patterson* because club personnel did not separate the patron from his truck or ensure his safe transportation home. They knew only that he drove away from the club after being escorted out. A jury could reasonably conclude that Villanueva's act in driving while intoxicated, even after he reached home, although an intervening cause of the accident, was nevertheless foreseeable by someone in the club's position and not extraordinary in hindsight.

SETTLEMENT OF A MINOR'S CASE

A minor does not have capacity to enter into a binding contract, including settlement agreements. RESTATEMENT (SECOND) OF CONTRACTS §§ 7, 12, 14. Therefore, obtaining a binding settlement of a minor's claim requires court approval. In *Gomez v. Maricopa County*, 175 Ariz. 469, 857 P.2d 1323 (Ct. App. 1993), the court held that the court must appoint a guardian and/or conservator, and approve the settlement, before the minor's claim can be settled. Failure to take these steps leaves open the possibility that the minor can later reopen the claim.

The Legislature has amended A.R.S. § 14-5103 since *Gomez*, but the amendments do not affect the foregoing provisions. The statute says that a person under a duty to pay or deliver money or personal property to a minor, including monies related to the settlement of a civil claim, may perform this duty, in amounts not exceeding \$10,000 annually, by paying or delivering money or property to any of the following:

- The minor, if the minor is married;
- Any person having the care and custody of the minor and with whom the minor resides;

- The guardian of the minor; or
- A financial institution incident to a deposit in a federally insured savings account in the sole name of the minor and giving notice of the deposit to the minor.

For years, the general understanding was that A.R.S. § 14-5103 permitted settlement of a minor's claim for less than \$10,000 without obtaining formal court approval. *Gomez* changed that. A.R.S. § 14-5103 only governs the method of payment; it does not eliminate the need for court approval of a guardian or conservator before a settlement is binding.³

Probate Rule 53, adopted effective January 1, 2020, removes all doubt that *Gomez* is the law even on settlements under \$10,000. Subsection (a) provides that “no settlement of a claim brought on behalf of a minor or an adult in need of protection is binding on the minor or the adult in need of protection unless it is approved by a judicial officer,” except that a conservator may enter into a binding settlement not involving personal injury or wrongful death without court approval. Subsection (b) states that any court may approve a minor's settlement under \$10,000, but only a probate court may approve a minor's settlement over \$10,000.

A federal court in which a minor's claims are being litigated has a duty to protect the minor's interests. *Robidoux v. Rosengren*, 638 F.3d 1177, 1181 (9th Cir. 2011); *Salmeron v. United States*, 724 F.2d 1357, 1363 (9th Cir. 1983); *K.T. v. Ramos*, 2012 WL 443732, at *7 (D. Ariz. Feb. 13, 2012). Under Rule 17(c), the district court can appoint a guardian *ad litem* to protect a minor in an action. *Adamson v. Hayes*, 2010 WL 5069885, at *4 (D. Ariz. Dec. 7, 2010). The process of appointing a guardian *ad litem* is procedural and state law will not apply to cases brought in federal courts. *M.S. v. Wermers*, 557 F.2d 170, 174 n. 4 (8th Cir.1977); *Adamson v. Hayes*, 2010 WL 5069885, at *4 (D. Ariz. Dec. 7, 2010).

To ensure a minor's interests are protected in a proposed settlement agreement, the federal court must review and approve the settlement agreement before a guardian ad litem has authority to bind the minor to the agreement. *Robidoux v. Rosengren*, *supra*, quoting *Dacanay v. Mendoza*, 573 F.2d 1075, 1080 (9th Cir. 1978) (“a district court is required to ‘conduct its own inquiry to determine whether the settlement serves the best interests of the minor’”). It is the court's order approving the settlement that vests the guardian ad litem with the legal power to enforce the agreement. *Id.* at 1079; *K.T. v. Ramos*, *supra*.

Conservatorships

A conservator is “a person who is appointed by a court to manage the estate of a protected person.” A.R.S. § 14-1201(10). Unlike a guardian, who “has the powers and responsibilities of a custodial parent regarding the ward's support, care and education,” A.R.S. § 14-5209(A), a

³ Significant legislative history supports an argument that court approval is not necessary to settle a minor's claim in an amount less than \$10,000. However, obtaining a guardian for all minor settlements is the best practice.

conservator's powers are limited to the minor's finances and other property. *See, e.g.*, A.R.S. §§ 14-5420, -5424, and -5425.

Typically, in a personal injury case, the settlement of a minor's claim consists of a lump sum deposited in a federally insured bank account, or the purchase of an annuity, as described below. In those civil settlements, a conservatorship is necessary to protect the minor's interests, as is described above. The court may appoint a conservator when "the court determines that a minor owns money or property that requires management or protection that cannot otherwise be provided." A.R.S. § 14-5401(A)(1). Arizona permits the court to "appoint an individual or a corporation, with general power to serve as trustee, as conservator of the estate of a protected person," A.R.S. § 5410, subject to certain statutorily required disclosures, A.R.S. § 14-5106. Venue for the conservatorship is appropriate either in the county where the protected person resides, or in any county of the state where the person has property, if he does not reside in the state. A.R.S. § 14-5403.

When settling a minor's claim, any person who is interested in the minor's estate or affairs, including that person's parent, guardian, or custodian, may petition for appointment as conservator. A.R.S. § 14-5404(A). These "non-licensed fiduciaries" are required to complete the training prescribed by the Arizona Supreme Court before the court hears the matter. Ariz. R. Probate P. 10; Arizona Judicial Branch: Probate, www.azcourts.gov/probate/Training.aspx (last visited June 29, 2022). The petition must set forth certain information, including the petitioner's interest in the minor's estate, the minor's age, and a general description of the estate in question. A.R.S. § 14-5404(B). Certain people who might have an interest in the conservatorship proceedings, such as the minor's biological parents, must be notified. A.R.S. § 14-5405; *see also* A.R.S. § 14-5406 (providing that interested persons may request notice).

When a conservatorship petition is filed based on the minority of the person to be protected, the court must hold a hearing to address certain aspects. A.R.S. § 14-5407(A). Because the goal of the conservatorship proceeding is to protect the minor's interests, the court must appoint an attorney to represent the minor if at any time during the proceedings "the court determines that the interests of the minor are or may be inadequately represented." *Id.*

"After the hearing, and after making specific findings on the record that a basis for the appointment of a conservator or any other protective order has been established, the court shall make an appointment or other appropriate protective order." A.R.S. § 14-5407(E). After appointment, the conservator's duty is "to act as a fiduciary," and to observe statutorily mandated standards. A.R.S. § 14-5417.

Unless the court otherwise orders, a conservatorship regarding a minor's assets generally terminates on the protected minor's eighteenth birthday. A.R.S. §§ 14-5401(B), -5430. In the case of a settlement that provides for the purchase of an annuity, however, the conservatorship will involve only a single transaction – the purchase of the annuity. A.R.S. § 14-5409. That "single transaction conservatorship" terminates as soon as the "special conservator" files the annuity contract with the court. *Id.*

Guardianships

A.R.S. § 14-5209 sets forth the powers and duties of a minor’s guardian. Those powers include:

1. “Receive monies payable for the support of the ward under the terms of any statutory benefit, insurance system, private contract, devise, trust, conservatorship or custodianship, and monies or property of the ward paid or delivered pursuant to § 14-5103.”
2. “Take custody of the person of the ward and establish the ward’s place of residence in or outside this state, if consistent with the terms of an order of a court of competent jurisdiction relating to the detention or commitment of the ward.”
3. “If no conservator for the estate of the ward has been appointed, institute proceedings, including administrative proceedings, or take other appropriate action to compel the performance by any person of a duty to support the ward or to pay amounts for the welfare of the ward.”
4. “Facilitate the ward’s education, social or other activities and consent to medical or other professional care, treatment or advice for the ward. A guardian is not liable by reason of this consent for injury to the ward resulting from the negligence or acts of third persons unless a parent would have been liable in the circumstances.”
5. “Consent to the marriage or adoption of the ward.
6. “If reasonable, delegate to the ward certain responsibilities for decisions affecting the ward’s well-being.”

A.R.S. § 14-5209(C).

If you have questions regarding the information in this chapter, please contact the author.

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CHAPTER 2: PERSONAL INJURY DAMAGES

OVERVIEW

Common law damages are typically categorized into three types: compensatory damages, punitive damages, and nominal damages.

Compensatory tort damages are designed to restore the plaintiff, as nearly as possible, to the position in which he would have been, had the tort not occurred. Compensatory, or actual, damages are intended to redress the injury or loss that a plaintiff has suffered by reason of the defendant's wrongful conduct. These include both economic damages, which compensate for objectively verifiable monetary losses – including loss of earning capacity and/or lost wages and medical and other out-of-pocket expenses – and non-economic damages, which include the plaintiff's pain and suffering, mental anguish, injury and disfigurement, loss of consortium, and other losses that cannot be easily expressed in monetary terms. A plaintiff need not prove compensatory damages with mathematical certainty; however, they must not be speculative or conjectural. *Coury Bros. Ranches, Inc. v. Ellsworth*, 103 Ariz. 515, 446 P.2d 458 (1968). Future damages are generally available only if such consequences are reasonably certain to occur.

In addition to compensatory damages, the plaintiff may also be entitled to punitive damages if the defendant acted maliciously, wantonly, and willfully. *Linthicum v. Nationwide Ins. Co.*, 150 Ariz. 326, 723 P.2d 675 (1986). The goal of punitive damages is to punish and deter malicious conduct. *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003); *Desert Palm Surgical Grp., P.L.C. v. Petta*, 236 Ariz. 568, 584, 343 P.3d 438, 454 ¶47 (Ct. App. 2015).

At the other end of the spectrum are nominal damages. Generally, nominal damages are a trivial sum of money (one dollar) when a violation or technical invasion of a legal right causes no actual, provable injury or damages. The award of nominal damages, while a token amount, secures the plaintiff's status as the prevailing party for the purposes of awarding attorney's fees (where allowed) and costs. *Roberts v. City of Phoenix*, 225 Ariz. 112, 236 P.3d 265 (Ct. App. 2010); *Cummings v. Connell*, 402 F.3d 936 (9th Cir. 2005).

Proximate Cause

A plaintiff can only recover those damages that are the direct and proximate consequence of the defendant's wrongful act. *Valley Nat'l Bank v. Brown*, 110 Ariz. 260, 517 P.2d 1256 (1974). In Arizona, the proximate cause of an injury is that cause which, in a natural and continuous sequence, unaccompanied by any efficient intervening cause, produces an injury, and without which the injury would not have occurred. *Pompeneo v. Verde Valley Guidance Clinic*, 226 Ariz. 412, 249 P.3d 1112 (Ct. App. 2011).

Generally, the plaintiff must prove through medical and/or other evidence that the defendant's conduct more probably than not caused his injuries. *Pompeneo*, 226 Ariz. At 415, 249 P.3d at 1115. The question of proximate cause is usually for the jury, and the plaintiff has the burden of

proving by a preponderance of the evidence a causal connection between the defendant's conduct and the injuries claimed. *Dupray v. JAI Dining Servs. (Phoenix), Inc.*, 245 Ariz. 578, 584, 432 P.3d 937, 943 ¶18 (Ct. App. 2018); *Rhodes v. Int'l Harvester Co.*, 131 Ariz. 418, 641 P.2d 906 (Ct. App. 1982). Whether the opinion of a medical expert is necessary to establish the causal relationship depends on the nature of the injury, the circumstances under which it was sustained, and the plaintiff's condition before and after the alleged injury. However, when the issue of a causal connection is debatable, defendants often file motions for summary judgment or motions in limine arguing that the plaintiff has no admissible evidence of proximate cause. *Markowitz v. Ariz. Parks Bd.*, 146 Ariz. 352, 706 P.2d 364 (1985).

Causation issues can directly affect the amount of damages recoverable in actions for personal injuries or death. For instance, a defendant will not be liable for a plaintiff's condition or disability that pre-exists the defendant's conduct, but the defendant will be liable for exacerbating the pre-existing disability or condition if the evidence supports it. *Gasiorowski v. Hose*, 182 Ariz. 376, 897 P.2d 678 (Ct. App. 1994). These plaintiffs are typically referred to as "eggshell" plaintiffs.

Jury Awards

Determining the amount of damages is left to the judgment of the jury. The jury is the sole arbiter of the facts, and it is their function to weigh the evidence. Plaintiff bears the burden of supplying the jury with some evidentiary and logical basis for calculating a compensatory award. Jurors are not bound to accept even uncontested testimony, and a jury may award such damages as they deem reasonable and fair in accordance with their common knowledge, experience and good sense. *Estate of Reinen v. N. Ariz. Orthopedics, Ltd.*, 198 Ariz. 283, 287 ¶ 12, 9 P.3d 314, 318 (2000). A jury is not obligated to award damages to a plaintiff, even if it finds for the plaintiff on liability, and the range of any award must be supported by the evidence.

Because awarding damages is the fact finder's duty, judges are reluctant to tamper with a jury's damage award unless the award is so excessive or inconsequential as to be unjust. A jury's wide-ranging authority to determine the amount of damages, however, is not unbridled. The jury award is subject to limited trial court oversight through a post-trial order of remittitur or new trial. *Larsen v. Decker*, 196 Ariz. 239, 995 P.2d 281 (Ct. App. 2000). The rationale for the court's authority to issue such orders is to prevent so-called "runaway jury" verdicts. If the trial judge finds the damage award is tainted by "passion or prejudice," or is "shockingly or flagrantly outrageous," the court must order a new trial. *Soto v. Sacco*, 242 Ariz. 474, 478 ¶ 9, 398 P.3d 90, 94 (2017) (cleaned up). If, however, the verdict is neither the result of passion or prejudice nor shockingly outrageous, but instead reflects "an exaggerated measurement of damages," the trial court may exercise its discretion to order remittitur. *Id.* A remittitur is a device for reducing an excessive verdict to the realm of reason. *Desert Palm Surgical Grp., P.L.C. v. Petta*, 236 Ariz. 568, 581 ¶ 38, 343 P.3d 438, 451 (Ct. App. 2015). A trial court grants a new trial conditionally; if the party against whom the remittitur is ordered refuses to accept it, the new trial is granted without further order. *Soto*, 242 Ariz. at 479 ¶¶ 11-12, 398 P.3d at 95. In exercising its discretion to reduce a jury's damages award, a trial court is cautioned to be "circumspect" and may not simply substitute its judgment for the jury's. *Ahmad v. State*, 245 Ariz. 573, 576 ¶ 5, 432 P.3d 932, 935

(Ct. App. 2018). Trial judges must specifically describe in their orders “why the jury award is too high or low” in “sufficient detail to apprise the parties and appellate courts of the specific basis for the court’s ruling.” **Soto**, 242 Ariz. at 480 ¶¶ 13-14, 398 P.3d at 96.

TYPES OF COMPENSATORY DAMAGES

A plaintiff in a tort action is entitled to recover those sums that will reasonably compensate him or her for all damages sustained as the direct, natural and proximate result of the defendant’s conduct, if the plaintiff establishes those amounts with reasonable certainty. **Cont’l Life & Accident Co. v. Songer**, 124 Ariz. 294, 304, 603 P.2d 921, 931 (Ct. App. 1979). In personal injury cases, Arizona jurors are given the following standard instruction when called upon to deliberate:

Measure of Damages

If you find [any] [defendant] liable to [plaintiff], you must then decide the full amount of money that will reasonably and fairly compensate [plaintiff] for each of the following elements of damages proved by the evidence to have resulted from the fault of [any] [defendant] [party] [person]:

1. The nature, extent, and duration of the injury.
2. The pain, discomfort, suffering, disability, disfigurement, and anxiety already experienced, and reasonably probable to be experienced in the future as a result of the injury.
3. Reasonable expenses of necessary medical care, treatment, and services rendered, and reasonably probable to be incurred in the future.
4. Lost earnings to date, and any decrease in earning power or capacity in the future.
5. Loss of love, care, affection, companionship, and other pleasures of the [marital] [parent-child] relationship.
6. Loss of enjoyment of life, that is, the participation in life’s activities to the quality and extent normally enjoyed before the injury.

RAJI (CIVIL) 6th Personal Injury Damages 1. Arizona does not have damage caps. **Wendelken v. Superior Court**, 137 Ariz. 455, 671 P.2d 896 (1983).

Pain and Suffering

Pain is the plaintiff’s psychological response to a physical injury. “Pain and suffering,” includes physical pain, the adverse emotional consequences attributable to that pain and the injury that caused it, and the frustration and anguish caused by the inability to participate in the normal pursuits and pleasures of life. The actual inability to participate in those normal pursuits of life is known as “hedonic damages” and is discussed below.

There is no precise rule by which the jury can quantify a pain and suffering damage award, because such compensation does not ordinarily lend itself to mathematical computation. The theory behind pain and suffering damages is that mental/emotional suffering is a natural

consequence of severe physical injury. The jury has complete discretion to award pain and suffering. Generally, the plaintiff may introduce evidence of his or her health and physical condition before and after the injury to establish the nature, extent, and consequences of the injuries the defendant caused.

A plaintiff cannot recover for possible injury; rather, he or she may recover only for those losses that are reasonably certain, or probable to occur in the future. **Coppinger v. Broderick**, 37 Ariz. 473, 295 P. 780 (1931). A plaintiff can, however, recover for the reasonable probability of some future disability and permanent injury. Like any other future loss, the plaintiff must prove the permanent nature of the injury to a degree of reasonable certainty or probability. Proof of a permanent injury is a prerequisite to introducing evidence on life expectancy. **Besch v. Triplett**, 23 Ariz. App. 301, 532 P.2d 876 (1975). Future damages require proof by a preponderance of the evidence that plaintiff will suffer future pain and suffering, medical expenses, impairment and/or physical disability in the future. In **DeStories v. City of Phoenix**, 154 Ariz. 604, 744 P.2d 705 (Ct. App. 1987), for example, the court of appeals held that future damages were not awardable to construction workers who were exposed to and inhaled asbestos dust. Though they suffered no physical injury, the construction workers sued for future damages, claiming the exposure gave them an increased risk of developing asbestosis or lung cancer. The court of appeals upheld summary judgment for the defendant. It reasoned that an increased risk of injury is not compensable absent some proof that an actual injury is reasonably certain to occur in the future. *Id* at 606, 744 P.2d at 707. And here, the plaintiffs offered no evidence that any one of them would contract a disease to a reasonable degree of medical probability. *Id* at 607, 744 P.2d at 708.

Plaintiffs often introduce expert medical testimony to support a claim of future harm. Any physician who testifies must opine that the cause of plaintiff's condition and its future effects are reasonably certain. See **Allen v. Devereaux**, 5 Ariz. App. 323, 426 P.2d 659 (1967). The jury may accept or reject all or part of a witness' testimony.

Emotional Distress

To be compensable, emotional disturbances must be more than temporary, transitory or inconsequential, but claims for fear of disease are compensable in appropriate circumstances. For example, in **Monaco v. HealthPartners of S. Ariz.**, the plaintiff was a medical patient who was erroneously administered a radioactive substance, which increased his risk of contracting leukemia from 1 in 16,000 to 3 in 100. 196 Ariz. 299, 995 P.2d 735 (Ct. App. 1999). He never contracted the disease; but his fear of contracting the disease caused problems sleeping, night sweats, and required psychological counseling after which he was diagnosed with post-traumatic stress disorder. The appellate court held that this was sufficient evidence of substantial long-term emotional disturbances to support a claim for negligent infliction of emotional distress. *Id*.

Pet owners cannot recover for emotional distress or loss of companionship resulting from the negligent injury or death of their pet. **Kaufman v. Langhofer**, 223 Ariz. 249, 222 P.3d 272 (Ct. App. 2009). Arizona law treats pets as personal property and allows recovery equal to the fair

market value of the pet at the time of its death. *Roman v. Carroll*, 127 Ariz. 398, 399, 621 P.2d 307, 308 (Ct. App. 1980). While the legislature in 2015 removed the word “dog” from the definition of “personal property,” see A.R.S. § 1-215(30), this change is not likely to alter the rule of *Kaufman*. A negligent infliction claim still requires the plaintiff to have witnessed injury to a closely related person, and “[b]ecause humans are not related to pets, limits cannot be based on degree of consanguinity...”; further, there is no reason, “as a matter of public policy, the law should offer broader compensation for the loss of a pet than would be available for the loss of a friend, relative, work animal, heirloom, or memento. . . .” *Kaufman*, 223 Ariz. at 255-56, 222 P.3d at 278-79. Finally, pets are not included in the definition of “person.” A.R.S. § 1-215(29). The *Kaufman* court did note, however, that its decision was limited to negligent conduct; and Arizona might allow recovery of emotional distress damages for a loss involving intentional, willful, malicious or reckless conduct. *Id.* at 279 n.13.

MEDICAL EXPENSES

Past Medical Expenses

Damages for past medical expenses are virtually always included in tort cases to restore the injured individual to a financial position substantially equivalent to that which he would have occupied had he not been injured. As with other forms of damages, the plaintiff bears the burden of producing evidence from which the jury can calculate and compensate him for prior medical expenses.

Expenses that might qualify for compensation are numerous and may require proof of the reasonable value of items and services such as consultants, nurses, home health care providers, ambulance service, prosthetic devices and medicine. In addition, a plaintiff may recover medical expenses incurred in order to mitigate his/her damages. However, a plaintiff should not receive compensation for items connected with medical care unrelated to his/her injuries. If the medical expenses are for treatment of a number of ailments, only one of which was caused by the defendant, the plaintiff has the burden of proving what portion of his/her medical expenses are attributable to the defendant’s act.

Since the measure of recovery is the reasonable value of the services, the jury may award a lower amount than the actual cost of the medical treatment, even though a physician testifies that in his/her opinion the treatment was necessary or the actual cost is reasonable. On the other hand, if the actual cost is less than the reasonable value, recovery is limited to the actual cost.

In *Lopez v. Safeway Stores, Inc.*, 212 Ariz. 198, 129 P.3d 487 (Ct. App. 2006), the court of appeals held that an injured plaintiff was entitled to claim and recover the full amount of her reasonable medical expenses the health care provider *charged*, without any reduction for the amounts written off by her physicians pursuant to contractually agreed-upon rates with her insurance carriers. In other words, the plaintiff was entitled to claim the full amount of the billed medical charges, even though neither she nor her health insurer would ever have to pay the full-billed amount. The court reasoned that this serves the fundamental purpose of the collateral source

rule – to prevent a tortfeasor from deriving any benefit from compensation or indemnity that an injured party has received from a collateral source. See Chapter 4 for a discussion of the collateral source rule.

Future Medical Expenses

To recover future medical expenses, the future treatment must be “reasonably probable” to occur, and plaintiff must have some evidence of the nature and cost of the future treatment. *Saide v. Stanton*, 135 Ariz. 76, 659 P.2d 35 (1983). Evidence of the duration, amount, and cost of treatment must be definite. *Valley Nat’l Bank of Ariz. v. Haney*, 27 Ariz. App. 692, 694, 558 P.2d 720, 722 (1976). Though future treatment is an estimate, the jury must have some data upon which it can reasonably estimate the cost of future damages. *Henderson v. Breesman*, 77 Ariz. 256, 269 P.2d 1059 (1954). Recovery is not allowed if based on pure speculation.

Medical Monitoring Expenses

Claims seeking damages for medical monitoring or medical surveillance have become common in toxic tort litigation. Medical monitoring claims are premised on the theory that a plaintiff exposed to a toxic substance because of the defendant’s conduct should not be forced to shoulder the often substantial cost of periodic medical tests that might be necessary to detect cancer or other diseases. Claims for medical monitoring are akin to claims for future medical expenses in that the proponent of the claim must provide competent medical evidence that such expenses are reasonably probable and necessary. *Yslava v. Hughes Aircraft Co.*, 845 F. Supp. 705 (D. Ariz. 1993).

Courts generally recognize that plaintiffs exposed to toxic substances often have a demonstrated need to monitor their physical condition over an extended period of time. See *Burns v. Jaquays Min. Corp.*, 156 Ariz. 375, 752 P.2d 28 (Ct. App. 1987). As such, unlike a “fear of disease” claim, the plaintiff in an exposure claim need not demonstrate any additional or present injury as the basis of the damages claim. Rather, the claim is based on the present need for medical monitoring.

LOST WAGES/IMPAIRMENT OF EARNING CAPACITY

When a plaintiff has lost income because of injuries sustained, he is entitled to recover damages for either or both: (1) loss of time and earnings, and (2) loss or impairment of earning capacity. *Hatcher v. Hatcher*, 188 Ariz. 154, 933 P.2d 1222 (Ct. App. 1996). “Loss of time” or “loss of earnings” compensates the injured party for wages lost because of the injury, and loss or impairment of earning capacity compensates the victim for all moneys that could have been earned in the future, but for the injury. Loss of earnings is an item of special damage and must be pleaded and proved. *Mandelbaum v. Knutson*, 11 Ariz. App. 148, 149, 462 P.2d 841, 842 (1969).

The value of the impairment or decrease in earning capacity due to injury has been defined as the “permanent diminution of ability to earn money.” Courts typically view this element as a “lost

stream of income” composed of the difference between what the plaintiff would have earned without the injury and the forecasted actual earnings given the injuries for the plaintiff’s projected working life. Impairment of earning capacity is not necessarily measured by an injured person’s employment or salary at the time of the injury and past earnings need not be shown. **Ball Corp. v. George**, 27 Ariz. App. 540, 556 P.2d 1143 (1976). In fact, a plaintiff may recover for impairment of earning capacity even if he has never been employed, or was temporarily unemployed at the time of the injury.

An injured person might assert that an injury caused that person to abandon plans to change employment, to obtain additional education or training, or to otherwise advance a career. In the face of such an assertion, the court recognizes a distinction between persons with only vague hopes of entering a new profession and those with demonstrated ability and intent to do so.

To determine lost earning capacity, the jury may consider a variety of factors, including the plaintiff’s age, life expectancy, work-life expectancy, health habits, occupation, talents, skill, experience, training, probable pay raises, promotions and other advancements, declining earning capacity due to age, and the like. Both sides routinely use economic or medical expert testimony to establish or refute the impairment of the plaintiff’s earning capacity. Experts generally consider the plaintiff’s actual earnings before and after the injury. See **Felder v. Physiotherapy Assocs.**, 215 Ariz. 154, 158 P.3d 877 (Ct. App. 2007).

LOSS OF CONSORTIUM

A claim for loss of consortium compensates the injured party’s family member for the loss of love, affection, protection, support, services, companionship, care, society, and in the marital relationship, sexual relations resulting from the tort to the injured party. **Barnes v. Outlaw**, 192 Ariz. 283, 286, 964 P.2d 484, 487 (1998). Loss of consortium is a derivative claim that requires the claimant to prove all the elements of the underlying tort. **Martin v. Staheli**, 248 Ariz. 87, 92 ¶ 17, 457 P.3d 53, 58 (Ct. App. 2019). Any defenses applicable to the injured party (i.e., assumption of risk, comparative negligence, etc.) are also available against the lost consortium claimant. **Quadrone v. Pasco Petroleum Co.**, 156 Ariz. 415, 752 P.2d 504 (Ct. App. 1987).

To recover loss of consortium damages, the claimant must prove “a severe, permanent and disabling injury” which renders the person “unable to exchange love, affection, care, comfort, companionship and society in a normally gratifying way.” **Pierce v. Casa Adobes Baptist Church**, 162 Ariz. 269, 273, 782 P.2d 1162, 1166 (1989). Such an injury does not need to be the functional equivalent of death, or even be catastrophic. The threshold level of interference with the normalcy of the relationship is a question of law to be decided by the judge. Once the judge has decided that threshold level of interference exists, it is up to the trier of fact (judge or jury) to determine the amount recoverable (if any) based on the interference.

Although Arizona’s Survival Statute, A.R.S. § 14-3110, provides that an injured person’s loss of consortium claim does not survive his death, the injured person’s death does not extinguish his survivors’ loss of consortium claim if the death was unrelated to his claim for allegedly negligent

medical treatment. *Martin*, 248 Ariz. 87, 457 P.3d 53. In *Martin*, the court of appeals held the patient's death extinguished his own non-economic claims, but the family members could still pursue their claim for the alleged injury to their familial relationship with the injured person from the time of his injury until his death. *Id.* at 93-94, 457 P.3d at 59-60.

Loss of consortium claims are subject to the "each person" limitation often found in insurance policies. *Stillman v. Am. Family Ins.*, 162 Ariz. 594, 785 P.2d 114 (Ct. App. 1990). There, the insurance policy limited liability coverage to \$100,000 for injuries to "each person" and \$300,000 for "each occurrence." The court held that for purposes of the policy, only "one" party (the child) was injured, and thus, the insurer's liability on the parents' loss of consortium claim was limited by its total policy limitation of \$100,000 for that one person.

Arizona recognizes three types of loss of consortium claims: (1) loss of spousal consortium; (2) loss of filial consortium; and (3) loss of parental consortium.

Loss of Spousal Consortium

A claim for loss of spousal consortium occurs when an injured party, as a result of his/her injuries, is unable to provide his or her spouse with love, affection, care, comfort, companionship, society and moral support. The claim belongs to the spouse of the injured party as a separate cause of action.

Spouses estranged, or not enjoying such "consortium," at the time of the injury, are unable to recover. A loss of consortium claim puts into issue the normalcy and quality of the relationship between the parties prior to the injury. *Bain v. Superior Court*, 148 Ariz. 331, 714 P.2d 824 (1986). As such, the defense can seek and admit into evidence very personal information regarding the nature of the claimant's pre-injury relationship with the injured spouse compared to the post-injury relationship.

Loss of Filial Consortium

Arizona recognized a parent's right to recover for loss of their minor child's consortium in *Reben v. Ely*, 146 Ariz. 309, 705 P.2d 1360 (1985). There, a minor child was administered liquid cocaine thought to be liquid Tylenol. Severe and permanent brain damage resulted. The court allowed the parents' claim for the loss of their son's love, companionship, and society. The focus in deciding a claim for loss of a child's consortium is the interference in the normal relationship between a parent and child. *Miller v. Westcor Ltd. P'ship*, 171 Ariz. 387, 831 P.2d 386 (Ct. App. 1991). In *Frank v. Superior Court*, 150 Ariz. 228, 722 P.2d 955 (1986), the court expanded *Reben* to include adult children. Prior to *Frank*, courts held that upon the child's reaching the age of majority, the reciprocal legal obligations of support and obedience ended, thereby ending a parent's entitlement to the services and earnings of their adult children. *Frank* allowed parents to recover the lost "economic security" their adult children provided to them.

In *Pierce v. Casa Adobes Baptist Church*, 162 Ariz. 273, 782 P.2d 1166 (1989), *vacated on other grounds*, 162 Ariz. 269, 782 P.2d 1162 (1989), the court pointed out that although a parent may

recover lost wages due to time away from work in caring for an injured child, these damages are not part of a loss of consortium claim, but rather they are part of the injured child's claim for medical expenses and provision of care. Double recovery is not allowed. If the injured party recovers lost future earnings, the consortium claimant cannot recover money for "loss of financial support."

Loss of Parental Consortium

Arizona recognizes a child's right to recover for loss of parental consortium. In *Villareal v. State Dep't of Transp.*, 160 Ariz. 474, 774 P.2d 213 (1989), the court held that a child may recover for loss of parental consortium when the parent suffers a serious, permanent, disabling injury rendering the parent unable to provide love, care, companionship, and guidance to the child and the parent-child relationship is destroyed or nearly destroyed. The court reasoned that children have a right to enjoy a mutually beneficial relationship with their parents, and society needs to protect a child's right to receive the benefits derived from the parental relationship. However, the court limited the definition of "parent" to biological and adoptive parents, and specifically excluded injuries of siblings, grandparents, other relatives and friends for the purposes of this type of claim.

HEDONIC DAMAGES

Hedonic damages are awarded "for the loss of enjoyment of life, or for the value of life itself, as measured separately from the economic productive value that an injured or deceased person would have had." Hedonic damages are an attempt to compensate the plaintiff for the monetary value associated with a loss of the everyday pleasures of life, as distinct from the economic or productive value of life.

In *Ogden v. J.M. Steel Erecting, Inc.*, 201 Ariz. 32, 31 P.3d 806 (Ct. App. 2001), the court of appeals held that hedonic damages can be a component of a general damages claim, distinguishable from, and not duplicative of, damages for pain and suffering. The court explained that an award for pain and suffering compensates the injured person for the physical discomfort and emotional response to the sensation of pain caused by the injury itself. In contrast, hedonic damages compensate for the limitations on the injured person's ability to participate in and derive pleasure from the normal activities of daily life, or for the individual's inability to pursue his/her talents, recreational interests, hobbies, or avocations. The court clarified this ruling in *Quintero v. Rogers*, 221 Ariz. 536, 212 P.3d 874 (Ct. App. 2009), stating that *Ogden* did not say hedonic damages were distinct from pain and suffering, but rather, each claim is a slightly different way of arguing for a general damages award. Thus, hedonic damages are not excluded from "pain and suffering" under the survival statute, A.R.S. § 14-3110.

PROPERTY DAMAGE CLAIMS

In general, the measure of damages for injury to personal property when it is not destroyed is the difference in the value of the property immediately before and immediately after the

damage. If the property has no market value, its actual worth to the owner is the test. **State v. Brockell**, 187 Ariz. 226, 928 P.2d 650 (Ct. App. 1996).

When the property is repaired or restored, however, the measure of damages includes the cost of repair with due allowance for any difference between the value of the property before the damages and the value after repairs, as well as the loss of use. In Arizona, property damage claims include compensation for the cost of repair, residual diminution in fair market value, and loss of use. **Farmers Ins. Co. v. RBL Inv. Co.**, 138 Ariz. 562, 675 P.2d 1381 (1983) (citing the RESTATEMENT (SECOND) OF TORTS § 928 (1977)).

Arizona law does not require the sale or transfer of a damaged personal property to establish a claim for diminution in value or to prove the loss in value. **Oliver v. Henry**, 227 Ariz. 514, 260 P.3d 314 (Ct. App. 2011). The loss can be established through other competent means, such as an expert appraisal of the pre-loss and post-repair values. Moreover, a plaintiff does not need to actually rent a substitute chattel to make a claim for damages involving a loss of use. **Aries v. Palmer Johnson**, 153 Ariz. 250, 735 P.2d 1373 (1987). The damages may be based upon the reasonable rental value of a substitute item, whether or not the plaintiff actually rents the item.

Diminution in Value

These damages flow from property damage claims involving toxic spills or the disposal of toxic wastes. Plaintiffs generally allege that these acts constitute a diminution in the value of their property created by the contamination's proximity. **Nucor Corp. v. Emp'rs Ins. Co. of Wausau**, 231 Ariz. 411, 296 P.3d 74 (Ct. App. 2012). Common law nuisance claims are also attributed to the property damage and its disruption to the plaintiffs' daily routine of life. This category of damages is independent of personal physical injury and therefore is unrelated to the impairment to quality of life that is associated with pain and suffering damages.

ECONOMIC LOSS DOCTRINE

The Economic Loss Doctrine generally prohibits tort actions that seek only "pecuniary damage[s] not arising from injury to the plaintiff's person or from physical harm to property." Although some courts apply the doctrine to bar tort recovery of purely pecuniary losses, Arizona takes a narrower approach. In Arizona, the doctrine bars only the recovery of "pecuniary or commercial damage, including any decreased value or repair costs for a product or property that is itself the subject of a contract between the plaintiff and defendant, and consequential damages such as lost profits." **Sullivan v. Pulte Home Corp.**, 232 Ariz. 344, 306 P.3d 1 (2013). A contracting party is limited to its contractual remedies for purely economic loss. **Flagstaff Affordable Housing Ltd. P'ship v. Design Alliance, Inc.**, 223 Ariz. 320, 223 P.3d 664 (2010). The Economic Loss Doctrine does not apply, however, to negligence claims by a plaintiff who has no contractual relationship with the defendant. **Sullivan**, 232 Ariz. at 346 ¶ 9, 306 P.3d at 3. Arizona's economic loss doctrine serves to encourage the private ordering of economic relationships, protect the expectations of contracting parties, ensure the adequacy of contractual remedies, and promote accident-deterrence and loss-spreading. *Id.* at ¶ 10. **Flagstaff** held that where the Economic Loss Doctrine

applies, a party will be limited to its contract remedies *unless* the parties have specifically provided in their contract for tort remedies.

An aggrieved party may, however, recover for personal injuries or damage to property proximately caused by a non-contracting party. See ***Carstens v. City of Phoenix***, 206 Ariz. 123, 129 ¶ 28, 75 P.3d 1081, 1087 (Ct. App. 2003), *rejected on other grounds by Flagstaff Affordable Housing Ltd. P’ship*, 223 Ariz. at 325 ¶ 23, 223 P.3d at 669. Tort remedies are available if the defect presented a real danger of harm to persons or other property, if an “accident” occurred, if the damage was of the type recognized as “tort damage” (harm to persons or other property), or if some combination of these factors applies. In such cases, the plaintiff will be able to recover for all damages – personal injury, property damage to other property, property damage to the product itself, and all consequential damage generally allowed in tort actions. ***Salt River Project Agr. Imp. & Power Dist. v. Westinghouse Elec. Corp.***, 143 Ariz. 368, 380, 694 P.2d 198, 210 (1984), *abrogated on other grounds by Phelps v. Firebird Raceway, Inc.*, 210 Ariz. 403, 111 P.3d 1003 (2005). A federal district court recently applied the doctrine and *Westinghouse* in the context of a defaulted student loan. The harm allegedly suffered by the plaintiff was “directly attributable to the alleged breach of a specified contractual provision and the foreseeable result of such breach.” ***Andrich v. Navient Sols. Inc.***, 2020 WL 1508449, at *6 (D. Ariz. Mar. 30, 2020), citing *Westinghouse Elec. Corp.*, 143 Ariz. at 379-80, 694 P.2d 198.

PRE-EXISTING CONDITION, UNUSUALLY SUSCEPTIBLE PLAINTIFF

In tort actions, a plaintiff may recover damages for aggravation of a preexisting condition. ***Kalaf v. Assyd***, 60 Ariz. 33, 130 P.2d 1036 (1942). Defendants must take plaintiffs as they find them at the time of the accident and cannot complain if the plaintiff was more seriously injured by the accident than another person would have been. ***City of Scottsdale v. Kokaska***, 17 Ariz. App. 120, 495 P.2d 1327 (1972); ***Verde Combination Copper Co. v. Reito***, 22 Ariz. 445, 198 P. 462 (1921). In these situations, jurors may be given an instruction that reads:

Pre-Existing Condition, Unusually Susceptible Plaintiff

[Plaintiff] is not entitled to compensation for any physical or emotional condition that pre-existed the fault of [Defendant]. However, if [Plaintiff] had any pre-existing physical or emotional condition that was aggravated or made worse by [Defendant’s] fault, you must decide the full amount of money that will reasonably and fairly compensate [Plaintiff] for that aggravation or worsening.

You must decide the full amount of money that will reasonably and fairly compensate [Plaintiff] for all damages caused by the fault of [Defendant], even if [Plaintiff] was more susceptible to injury than a normally healthy person would have been, and even if a normally healthy person would not have suffered similar injury.

RAJI (CIVIL) 6th Personal Injury Damages 2. Plaintiffs are not entitled to compensation for any physical or emotional condition that pre-existed the fault of defendant. However, if plaintiff had

any pre-existing physical or emotional condition that was aggravated or made worse by defendant’s fault, the jury must decide the full amount of money that will reasonably and fairly compensate plaintiff for that aggravation or worsening – even if a normally healthy person would not have suffered similar injury. *See, e.g., Papastathis v. Beall*, 150 Ariz. 279, 281, 723 P.2d 97, 99 (Ct. App. 1986) (“The trauma to a pre-existing condition causing the worsening of that condition was a substantial factor in his eventual death and is a basis for liability.”).

DAMAGES FOR WRONGFUL DEATH OF SPOUSE, PARENT, OR CHILD

In Arizona, a wrongful death claim is purely statutory and governed by A.R.S. §§ 12-611 through 12-613. A.R.S. § 12-611 provides that “[w]hen death of a person is caused by wrongful act, neglect or default, ... the person who ... would have been liable if death had not ensued shall be liable to an action for damages.” The statutory scheme directs that “the jury shall give such damages as it deems fair and just with reference to the injury resulting from the death to the surviving parties who may be entitled to recover, and also having regard to the mitigating or aggravating circumstances attending the wrongful act, neglect, or default. A.R.S. § 12-613. The decedent’s pain and suffering is not included in the measure of damages and cannot be claimed as damages by the surviving claimants. *See Duenas v. Life Care Ctrs. of Am., Inc.*, 236 Ariz. 130, 138 ¶ 25, 336 P.3d 763, 771 (Ct. App. 2014) (wrongful death damages “that may be recovered are the beneficiaries’, not the decedent’s”); *Girouard v. Skyline Steel, Inc.*, 215 Ariz. 126, 131–32 ¶ 19, 158 P.3d 255, 260-61 (Ct. App. 2007) (“[A] survivor may not recover for mental anguish resulting from the negligent acts of the defendant prior to the decedent’s death, ... [n]or may a survivor recover for mental anguish resulting from actual or perceived pain and suffering experienced by the decedent during the time leading up to death because such period of time precedes the death of the decedent”).

In some wrongful death cases, a jury may award zero damages if they deem it “fair and just.” *Walsh v. Advanced Cardiac Specialists Chartered*, 229 Ariz. 193, 273 P.3d 645 (2012). Arizona’s recommended jury instruction states:

Damages for Wrongful Death of Spouse, Parent, or Child

If you find [Defendant] liable to [Plaintiff], you must then decide the full amount of money that will reasonably and fairly compensate [Survivor(s)] [separately] for each of the following elements of damages proved by the evidence to have resulted from the death of [Decedent].

1. The loss of love, affection, companionship, care, protection, and guidance since the death and in the future.
2. The pain, grief, sorrow, anguish, stress, shock, and mental suffering already experienced, and reasonably probable to be experienced in the future.
3. The income and services that have already been lost as a result of the death, and that are reasonably probable to be lost in the future.
4. The reasonable expenses of funeral and burial.

5. The reasonable expenses of necessary medical care and services for the injury that resulted in the death.

RAJI (CIVIL) 6th Personal Injury Damages 3. An action for wrongful death can be brought by and in the name of the surviving husband or wife, child, parent or guardian, or personal representative of the deceased person *for and on behalf of* the surviving husband or wife, children or parents, or if none of these survive, on behalf of the decedent's estate. A.R.S. § 12-612. In other words, a wrongful death action is *one action* for damages with *one plaintiff* and *one judgment*, but the jury will make separate awards to each beneficiary in proportion to their proven damages. See **Wilmot v. Wilmot**, 203 Ariz. 565, 569, 58 P.3d 507, 511 (2002). Though either parent can be the named plaintiff for the death of a child, and though each has a claim for damages, both cannot be named plaintiffs in separate actions. Likewise, though there may be several surviving children, each with claims, they cannot file multiple separate lawsuits. Whoever files first is deemed the named plaintiff for the benefit of all beneficiaries who may have a claim for damages. The Estate has a claim only if there is no surviving spouse, parent or child. **Gonzalez v. Ariz. Pub. Serv. Co.**, 161 Ariz. 84, 775 P.2d 1148 (Ct. App. 1989).

Surviving adult children, no matter their age or marital status, have a claim for the death of a parent. Likewise, a parent has a claim for the death of a child, regardless of the child's age or marital status. A spouse has a claim only if legally married to the deceased. A spouse must prove the existence of a valid marriage, which is determined by examining the law of the place where the couple was married. **Donlann v. Macgurn**, 203 Ariz. 380, 55 P.3d 74 (Ct. App. 2002). Co-habiting partners do not have a wrongful death claim. Long time girlfriends, boyfriends or fiancés are not wrongful death claimants, either.

Biological children of the decedent are proper wrongful death claimants, but biological children who are adopted by another before the death of the biological parent do not have standing to sue for the wrongful death of the biological parent. The right to bring a wrongful death action is a "legal consequence" of the parent-child relationship (a right that by statute cannot exist without the relationship); and that right is lost upon adoption. **Edonna v. Heckman**, 227 Ariz. 108, 111 ¶ 14, 253 P.3d 627, 630 (Ct. App. 2011). Legally adopted children have a wrongful death claim, but stepchildren and foster children do not. Siblings, grandparents, aunts, uncles and cousins do not have a claim and cannot be either plaintiffs or statutory beneficiaries.

Damages for Survival Claims

A.R.S. § 14-3110 provides that "[e]very cause of action, except a cause of action for damages for breach of promise to marry, seduction, libel, slander, separate maintenance, alimony, loss of consortium or invasion of the right of privacy, shall survive the death of the person entitled thereto or liable therefor, and may be asserted by or against the personal representative of such person, provided that upon the death of the person injured, damages for pain and suffering of such injured person shall not be allowed." Upon a claimant's death, any claim he had for pain and suffering and/or hedonic damages is extinguished. See **Quintero v. Rodgers**, 221 Ariz. 536, 212 P.3d 874 (Ct. App. 2009).

Claims for punitive damages survive the death of the plaintiff as well as the death of the tortfeasor under A.R.S. § 14-3110. *Id.*

The elder abuse statute, A.R.S. § 46-455, provides an exception to the rule that a pain and suffering claim extinguishes upon the claimant's death. ***Denton v. Superior Court***, 190 Ariz. 152, 945 P.2d 1283 (1997). These claims may be brought against any person employed to provide care, was a de facto guardian or conservator, who has been appointed by the court, or who causes or permits the life of an adult to be injured or endangered.

PUNITIVE DAMAGES

Punitive damages are awarded over and above compensatory damages to punish the wrongdoer and deter others from emulating his/her conduct. ***Linthicum v. Nationwide Ins. Co.***, 150 Ariz. 326, 723 P.2d 675 (1986). RAJI (CIVIL) 6th Personal Injury Damages 4 states:

Punitive Damages

If you find [Defendant] liable to [Plaintiff], you may consider assessing additional damages to punish [Defendant] or to deter [Defendant] and others from similar misconduct in the future. Such damages are called “punitive” damages.

To recover punitive damages, [Plaintiff] has the burden of proving by clear and convincing evidence, either direct or circumstantial, that [Defendant] engaged in the misconduct with one or more of the following states of mind:

1. [Defendant] intended to cause injury; or
2. [Defendant] was motivated by spite or ill will; or
3. a. [Defendant] acted to serve his own interests, having reason to know and consciously disregarding a substantial risk that his conduct might significantly injure the rights of others; or
b. [Defendant] consciously pursued a course of conduct knowing that it created a substantial risk of significant harm to others.

To prove this required state of mind by clear and convincing evidence, [Plaintiff] must persuade you that the punitive damages claim is highly probable. This burden of proof is more demanding than the burden of proof of “more probably true than not true,” which applies to all other claims in this case, but it is less demanding than the burden of proof of “beyond a reasonable doubt,” which is used in criminal cases.

The law provides no fixed standard for the amount of punitive damages you may assess, if any, but leaves the amount to your discretion. However, if you assess punitive damages, you may consider the character of [Defendant]'s conduct or motive, the nature and extent of the harm to plaintiff that [Defendant] caused, and the nature and extent of defendant's financial wealth.

Entitlement to Punitive Damages

To justify a punitive damage award, the inquiry should be focused on the defendant's mental state. "Something more" is required above the mere commission of a tort. Arizona courts have developed a shorthand reference for this "something more," requiring that the plaintiff "prove the defendant's evil hand was guided by an evil mind." *Nardelli v. Metro. Grp. Prop. & Cas. Ins. Co.*, 230 Ariz. 592, 277 P.3d 789 (Ct. App. 2012). The standard of proof is by clear and convincing evidence, which may be established by either direct or circumstantial evidence. *Linthicum v. Nationwide Ins. Co.*, 150 Ariz. 326, 723 P.2d 675 (1986); *Hyatt Regency Phoenix Hotel v. Winston & Strawn*, 184 Ariz. 120, 132, 907 P.2d 506, 518 (Ct. App. 1995).

Although the case law since *Linthicum* has used the phrase "evil mind" as short hand to describe the state of mind to establish a claim for punitive damages, the RAJI punitive damage jury instruction, which was revised in 2018, removed the phrase "evil mind" based on the Civil Jury Instruction Committee's belief that the phrase is a legal term of art that could be confusing to jurors because they might apply or be influenced by their own religious or social perspective. As noted above, the current recommended instruction instructs jurors that they may award punitive damages if plaintiff proves clearly and convincingly that: (a) the defendant intended to injure the plaintiff; or (b) the defendant's wrongful conduct was motivated by spite or ill will; or (c) the defendant acted to serve his own interests, having reason to know and consciously disregarding a substantial risk that his conduct might significantly injure the rights of others; or (d) the defendant consciously pursued a course of conduct knowing that it created a substantial risk of significant harm to others.

An evil mind can be inferred "from a defendant's conduct or objectives." *Nardelli*, 230 Ariz. at 604, 277 P.3d at 801 ¶ 61. For instance, it may be inferred when a defendant's conduct is so outrageous or egregious that it can be assumed he intended to injure or that he consciously disregarded the substantial risk of harm created by his/her conduct. *Gurule v. Illinois Mut. Life & Cas. Co.*, 152 Ariz. 600, 734 P.2d 85 (1987); *Tritschler v. Allstate Ins. Co.*, 213 Ariz. 505, 144 P.3d 519 (Ct. App. 2006); *Hyatt Regency Phoenix Hotel v. Winston & Strawn*, 184 Ariz. 120, 907 P.2d 506 (Ct. App. 1995). A jury may also infer an evil mind if the defendant deliberately continued his/her actions despite inevitable or highly probable harm that would follow. *Gurule*, 152 Ariz. at 602, 734 P.2d at 87. In comparing bad faith claims to punitive damages claims, the court of appeals has stated that claims for punitive damages require proof of facts beyond those required to prove bad faith, i.e., the clear and convincing evidence that the defendant's conduct was undertaken with an evil mind. *Sobieski v. Amer. Std. Ins. Co. of Wisconsin*, 240 Ariz. 531, 382 P.3d 89 (Ct. App 2016); *Tritschler*, 213 Ariz. 505, 144 P.3d 519.

The Arizona Supreme Court recently clarified the standard for punitive damages in *Swift v. Carman*, ___ P.3d ___, 2022 WL 3591972 (Ariz. Supreme Court August 23, 2022). The court reiterated that only a knowing culpability warrants punitive damages. In an intentional tort case, such as bad faith, the knowing culpability can exist if the defendant was motivated by spite or ill will. In a negligence case, however, by definition there is no intent to injure. As such, the only means by which the plaintiff is likely to meet the punitive damage standard is by demonstrating

the outrageousness of a defendant’s conduct. As the court put it, “Absent proof of the intent to cause harm or that the defendant acted out of spite or ill will, outrageous conduct will always be required to sustain a claim for punitive damages in negligence cases.” *Id.* at ¶ 25.

For example, in

Quintero v. Rogers, 221 Ariz. 536, 212 P.3d 874 (Ct. App. 2009), the court held that a punitive damages claim could proceed where the driver, who pled guilty to reckless driving and endangerment, was weaving in and out of traffic prior to the collision, had approached intersection traveling more than 25 miles-per-hour above posted speed limit, and then pumped the brakes slightly and swerved to avoid an on-coming vehicle, which caused him to fishtail and cross over median into oncoming traffic.

In the garden variety traffic accident or other negligence case, however, the ***Swift*** court noted, “it will be only the rare negligence case that meets this standard [of intent to cause harm or that the defendant acted out of spite or ill will].” In ***Swift***, said the court, the driver’s conduct did not meet the punitive damage standard because negligence—even gross negligence—is not enough for punitive damages.

Absent a specific exclusion, punitive damages are covered under the liability portion of an insurance policy. ***Price v. Hartford***, 108 Ariz. 485, 502 P.2d 522 (1972). On the other hand, punitive damages are not covered under an uninsured motorist (UM) or underinsured motorist (UIM) endorsement to an insurance policy unless the endorsement clearly states there is coverage for punitive damages. ***State Farm Mut. Auto Ins. Co. v. Wilson***, 162 Ariz. 247, 782 P.2d 723 (Ct. App. 1989), ***modified on remand***, 162 Ariz. 251, 782 P.2d 727 (1989).

The Constitutionality of Punitive Damages Awards

The Due Process Clause of the United States Constitution limits the size of punitive damages awards. Grossly excessive punitive damage awards violate the Fourteenth Amendment. The Arizona Court of Appeals has held, however, that a 1:1 ratio of punitive to compensatory damages is not unconstitutional. ***Sec. Title Agency, Inc. v. Pope***, 219 Ariz. 480, 200 P.3d 977 (Ct. App. 2008); ***Hudgins v. Sw. Airlines***, 221 Ariz. 472, 212 P.3d 810 (Ct. App. 2009).

As a general rule, the appropriate size of a punitive damage award is measured by three guideposts: “(1) the degree of reprehensibility of the defendant’s misconduct; (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award; and (3) the difference between punitive damages awarded by the jury and the civil penalties authorized or imposed by comparable cases.” ***State Farm Mut. Auto. Ins. Co. v. Campbell***, 538 U.S. 408, 123 S. Ct. 1513 (2003) (citing ***BMW of N. Am., Inc. v. Gore***, 517 U.S. 559 (1996)); *see also Hudgins*, 221 Ariz. at 490, 212 P.3d at 828 ¶151 (applying *Gore* factors, namely “the degree of reprehensibility of the defendant’s misconduct, the ratio between compensatory and punitive damages, and how the award compares with other penalties”). In *Campbell*, the United States Supreme Court commented that few awards of punitive damages more than nine times the amount of the compensatory damage award would satisfy due process. Defendants should be

punished because they engaged in conduct that harmed the plaintiff, not because they are an unsavory individual or business.

The degree of reprehensibility of the defendant's conduct is the most important factor. To analyze reprehensibility, Arizona courts consider whether: (a) the harm caused was physical as opposed to economic; (b) the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others; (c) the target of the conduct had financial vulnerability; (d) the conduct involved repeated actions or was an isolated incident; and (e) the harm was the result of intentional malice, trickery, or deceit, or mere accident. In *Hudgins*, 221 Ariz. 472, 212 P.3d 810, a punitive damage award ratio (of punitive-to-compensatory damages) of 8:1 was unconstitutionally excessive. The defendant's conduct fell on the low to middle range of the reprehensibility scale, and compensatory damages were substantial in light of the actual injury. The court reduced the punitive damages award to a 1:1 ratio.

In a similar case, the court in *Security Title Agency, Inc.*, , reduced a punitive damage award from an approximately 6:1 ratio to a 1:1 ratio. 219 Ariz. 480, 200 P.3d 977. In doing so, the court reasoned that the harm suffered was economic as opposed to physical, defendant's acts did not threaten health or safety, few reprehensible factors were present, and plaintiff received a substantial compensatory damage award.

In *Nardelli v. Metro. Grp. Prop. And Cas. Ins. Co.*, 230 Ariz. 592, 277 P.3d 789 (Ct. App. 2012), the court noted that an award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety. When compensatory damages are substantial, a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee. The court held that when the reprehensibility of conduct is low to moderate, punitive damages should remain at a 1:1 ratio.

Arizona courts have, however, awarded punitive damages in amounts greater than a 1:1 ratio. In *Arellano v. Primerica Life Insurance*, 235 Ariz. 371, 332 P.3d 597 (Ct. App. 2014), the court reduced a punitive damages award from a 13:1 ratio to a 4:1 ratio because the defendant's conduct fell within "the middle to high range of reprehensibility."

These general principles notwithstanding, ratio caps may apply to punitive damages awards for specific types of claims. See, e.g., *Exxon Shipping Co. v. Baker*, 554 U.S. 471 (2008) (holding 1:1 ratio of compensatory to punitive damages is the upper limit in maritime tort cases).

Punitive Damage Claims Survive Death

As discussed above, punitive damage claims survive the death of the plaintiff as well as the tortfeasor. In *Quintero v. Rodgers*, 221 Ariz. 536, 212 P.3d 874 (Ct. App. 2009), the court held that the survival statute (A.R.S. § 14-3110) does not preclude a decedent's personal representative from maintaining a punitive damages claim, because punitive damages do not compensate for the decedent's "pain and suffering." See also *Haralson v. Fisher Surveying Inc.*, 201 Ariz. 1, 31 P.3d 114 (2001) (punitive damages claim survives tortfeasor's death and may be recoverable against his estate). In *Haralson*, punitive damages were recoverable where the

deceased driver crossed the centerline, causing a head on collision while in a “drugged stupor.” The court cited other examples where punitive damages might be appropriate, such as terrorist attacks, bombings, mass murderers and serial killings, but refused to limit the circumstances to such “outrageous conduct.” The court reasoned that “while a punitive damage award cannot punish a deceased wrongdoer for his or her reprehensible conduct, it may deter its future occurrence by others.”

Vicarious Liability for Punitive Damages

Hyatt Regency Phoenix Hotel v. Winston & Strawn, 184 Ariz. 120, 907 P.2d 506 (1995), reaffirmed the rule in Arizona that an employer is vicariously liable for punitive damages for acts its employees commit in furtherance of the business and within the scope of employment. The plaintiff need not establish a separate “evil mind” on the part of the employer, but without evidence of an employee’s evil mind, punitive damages cannot be assessed against the employer independently. A deceased’s employer can also be vicariously liable for punitive damages if the deceased was acting in the course and scope and in furtherance of his/her employer’s business when the tort was committed. *Haralson v. Fisher Surveying Inc.*, 201 Ariz. 1, 31 P.3d 114 (2001).

BAD FAITH DAMAGES

Damages awarded in a bad faith case are described in more detail in the bad faith section of this Guide. In general, the jury is instructed that if it finds the defendant breached the duty of good faith and fair dealing, and that plaintiff suffered other damages in addition to the judgment that was entered against him, the jury must decide the full amount of money that will reasonably and fairly compensate plaintiff for each of the following elements of damage proven by the evidence to have resulted from defendant’s breach of the duty of good faith and fair dealing:

1. Monetary loss or damage to credit reputation experienced and reasonably probable to be experienced in the future; and
2. Emotional distress, humiliation, inconvenience, and anxiety experienced and reasonably probable to be experienced in the future.

Rawlings v. Apodaca, 151 Ariz. 149, 726 P.2d 565 (1986); *Farr v. Transamerica Occidental Life Ins. Co.*, 145 Ariz. 1, 699 P.2d 376 (Ct. App. 1984).

CLAIMS MADE BY UNDOCUMENTED ALIENS

Non-resident aliens can pursue wrongful death claims. *Bonthron v. Phoenix Light & Fuel Co.*, 8 Ariz. 129, 130, 71 P. 941, 941 (1903). Resident aliens may also pursue wrongful death and personal injury claims. See *Parra v. Continental Tire North Am., Inc.*, 222 Ariz. 212, 213 P.2d 361 (Ct. App. 2009).

In the 2006 general election, Arizona voters amended Article 2 of Arizona’s Constitution to include § 35 which reads, “[a] person who is present in this state in violation of federal immigration law related to improper entry by an alien shall not be awarded punitive damages in

any action in any court in this state.” **Article 2, § 35** thus denies standing to recover punitive damages to any person present in Arizona in violation of federal immigration law related to improper entry by an alien. Similarly, **A.R.S. § 12-512**, enacted in 2011, states that “A person who is present in this state in violation of federal immigration law related to improper entry by an alien shall not be awarded punitive damages in any action in any court in this state.”

MITIGATION OF DAMAGES

Although an injured party is often said to have “duty to mitigate damages,” this term is misleading because there is no liability for failing to take such steps. A party is merely precluded from recovering avoidable damages. **W. Pinal Family Health Ctr., Inc. v. McBryde**, 162 Ariz. 546, 785 P.2d 66 (Ct. App. 1989). The defendant has the burden of proving that plaintiff failed to reasonably mitigate his/her damages. **Barnes v. Lopez**, 25 Ariz. App. 477, 544 P.2d 694 (1976). The plaintiff has a duty to exercise due care and to act diligently to protect his or her own interest. The principle that a plaintiff must undertake reasonable measures to protect his or her own interests is a “paradigm judicial principle of historic origins.” **Law v. Superior Court**, 157 Ariz. 142, 755 P.2d 1130 (Ct. App. 1986). However, the injured party need only exercise reasonable care to mitigate damages. **Life Investors Ins. Co. of Am. v. Horizon Res. Bethany, Ltd.**, 182 Ariz. 529, 898 P.2d 478 (Ct. App. 1989). “Extraordinary or risky actions are not required” of the injured party “unless it would be unreasonable to fail to take those actions.” **Solar-W., Inc. v. Falk**, 141 Ariz. 414, 687 P.2d 939 (Ct. App. 1984).

COMPARATIVE FAULT AND CONTRIBUTORY NEGLIGENCE

A.R.S. § 12-2501 states that “if two or more persons become jointly or severally liable in tort for the same injury ... there is a right of contribution among them[;] ... [n]o tortfeasor is compelled to make contribution beyond his own pro rata share of the entire liability.” In Arizona, joint and several liability is abolished in most circumstances. **State Farm Ins. Cos. v. Premier Manufactured Sys., Inc.**, 213 Ariz. 419, 142 P.3d 1232 (Ct. App. 2006). Ours is a system of comparative fault, making “each tortfeasor responsible for paying his or her percentage of fault and no more.” **Young v. Beck**, 227 Ariz. 1, 251 P.3d 380 (2011). A comparative fault case is one in which a party contends that someone other than, or as well as, a single defendant (including the plaintiff) is at fault. This concept is more thoroughly covered in Chapter 1 of this Guide.

In **Cramer v. Starr**, 240 Ariz. 4, 6, 375 P.3d 69, 71 (2016), however, the plaintiff could claim an allegedly negligent driver who caused an accident was also liable for an allegedly negligent surgery occasioned by the accident, so long as the jury allocated fault between the parties in accordance with A.R.S. § 12-2501. The court said the jury could hold a driver liable for additional harm resulting from an allegedly negligent spinal fusion surgery performed on plaintiff after the accident where the plaintiff proved the driver’s negligence created a reasonably foreseeable risk that such surgery might have been necessary and that surgery might have been performed negligently. Such fault cannot, however, be “automatically impute[d]” to the defendant under the common law “original tortfeasor rule.” **Cramer**, 240 Ariz. at 6, 375 P.3d at 71.

NON-USE OF SEATBELT/MOTORCYCLE HELMET

The plaintiff's non-use of a seatbelt or motorcycle helmet goes to the question of his/her comparative fault and is an affirmative defense. Non-use of a seatbelt or motorcycle helmet bears on the issue of damages and not on any other issue. Defendant has the burden of proving that the plaintiff's non-use was unreasonable under the circumstances and that it caused injuries that would not have occurred, or would have been lessened, had the seatbelt or motorcycle helmet been used. The jury must then decide whether any such fault should reduce plaintiff's full damages. If the jury does decide the plaintiff's fault should reduce the plaintiff's damages, the court will reduce plaintiff's damages by the percentage of fault assigned by the jury. **Law v. Superior Court**, 157 Ariz. 142, 755 P.2d 1130 (Ct. App. 1986); **Warfel v. Cheney**, 157 Ariz. 424, 758 P.2d 1326 (Ct. App. 1988). The court of appeals has held that an Arizona resident may not recover damages for injuries that were avoidable by the use of a seat belt or motorcycle helmet in an accident in another state. **Garcia v. GMC**, 195 Ariz. 510, 990 P.2d 1069 (Ct. App. 1999).

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CHAPTER 3: CIVIL RULES UPDATE

Here are the new and updated Rules from the last year.

ARIZONA SUPREME COURT

The Supreme Court changed the term “court reporter” to either “certified reporter” or “authorized transcriber” across all courts. *See, e.g.*, Ariz. Sup. Ct. R. 30 (Verbatim Recording of Judicial Proceedings); Ariz. R. Civ. P. 43(g)(2) and 75(f); ARCAP 10.

ARIZONA RULES OF CIVIL PROCEDURE

Rule 4.1(l)(1) (service of process within Arizona) and 4.2 (outside of Arizona): For service by publication, the serving party must now additionally file a motion with the court supported by affidavit that sets forth the serving party’s reasonably diligent efforts to serve the person, and show that the service provided by Rule 4.1(c) through 4.1(k)—including an alternative means of service—is impracticable. Then, then court may, on the motion and without notice to the person to be served, order that service be accomplished by publication under the conditions described in the rule. A serving party may initiate the service by publication procedure described in Rule 4.1(l)(2) prior to moving for such an order or while the motion is pending.

Rule 47(e) and (f): Regarding peremptory challenges, peremptory strikes in jury selection were abolished effective January 1, 2022.

Rule 68(g): Regarding the amount of sanctions for a rejected offer of judgment, “[a] party who rejects an offer, but does not obtain a more favorable judgment, must pay as a sanction twenty percent of the difference between the amount of the offer and the amount of the final judgment.” This is an increase from 10% previously.

Rules 16 and 47 were further amended on emergency basis in accordance with the elimination of peremptory challenges, effective January 1, 2022, and will be reviewed for permanent adoption in August 2022. The emergency amendments include:

Rule 16(e): During scheduling and management of actions, the court may discuss at the Trial-Setting Conference “the areas of inquiry” and “specific questions” the court and the parties will ask during voir dire, including limitations on oral or written examination and whether to give brief pre-voir dire opening statements.

Rule 16(f): If a case is tried to the jury, the parties must file—in addition to a Joint Pretrial Statement,—not only the usual “agreed-on set of jury instructions,” “additional jury instructions,” “verdict forms,” and “questions for oral voir dire,” but also newly added “questions for a case-specific written questionnaire” which the parties agree on as well as any additional questions.

Rule 47(b): Regarding juror information, the court added a detailed description of duties of the clerk to safeguard confidentiality of eligibility (for purposes of jury selection), biographical information, and case-specific written questionnaires. The rule further directs the court or the clerk to provide the parties with the written questionnaires “[b]efore conducting oral voir dire,” which the parties must not disclose to the public and may disclose “only to the extent necessary for the proper conduct of the case.”

Rule 47(c): Regarding voir dire oath and procedure, each juror must swear or affirm the answers to the case-specific written questionnaires are truthful. At the beginning of examination, the court must explain voir dire, how prospective jurors’ information will be used, and who may have access to it. The written questionnaires should include questions about the prospective juror’s qualifications to serve, hardship, and whether he or she could render a fair and impartial verdict. The court must conduct voir dire orally.

Rule 47(d): Regarding challenges for cause, the party challenging a juror for cause has the burden to establish by a preponderance of the evidence that the juror cannot render a fair and impartial verdict. In making its determination, the court must consider the totality of a prospective juror’s conduct and answers given during voir dire.

ARIZONA RULES FOR THE FAST TRIAL AND ALTERNATIVE RESOLUTION (FASTAR) PILOT PROGRAM

Pima County Amendments adopted in December 2021:

Rule 108: Parties are not required to file a joint report or proposed scheduling order per Rule 16(c), Ariz. R. Civ. P.

Rule 117: Arizona Rules of Evidence apply, but certain medical bills described by the rule are admissible unless there is a specific legal objection in the joint pretrial statement.

Rule 121(b)(G): An arbitrator will make all legal rulings except on newly added “motions concerning disclosure and discovery.”

Rule 122: Discovery limits in an alternative resolution proceeding are the same as in FASTAR Rule 112(b) (90 days).

ARIZONA RULES OF CIVIL APPELLATE PROCEDURE

Rule 2: “Authorized transcriber” has the same meaning as set forth in Supreme Court Rule 30(a)(2).

U.S. COURT OF APPEALS FOR THE NINTH CIRCUIT

The court republished its rules of procedure on March 23, 2022. The rules show no changes.

U.S. DISTRICT COURT (ARIZONA) LOCAL RULES – CIVIL

LRCiv 56.1: Amended the motion for summary judgment rule to add a new subparagraph (g) which provides: “The Court may modify the foregoing procedures in its discretion.”

LRCiv 79.1: Sensitive exhibits, whether or not received as evidence, remain in the custody of the arresting or investigating agency or its designee throughout the proceedings, unless otherwise ordered by the Court.

LRCiv 83.10: This rule requires litigants to consider using Alternative Dispute Resolution (ADR) at an appropriate stage in each litigation matter; maintain confidentiality of the ADR proceedings unless otherwise ordered by the presiding judge or magistrate judge; 28 U.S.C § 455 applies to any magistrate judge referred for ADR. Further, the amendment prohibits a litigant from offering to engage in ADR as a reason to delay the processing of the case under the Rule 16 scheduling order.

FEDERAL RULES OF CIVIL PROCEDURE

In April 2022, Justice Roberts submitted to Congress an amendment to Federal Rule of Civil Procedure 7.1, which addresses disclosure statements. The proposed amendment would require non-governmental corporations who are parties or *intervenors* to identify any parent corporation or publicly held corporation owning 10% or more of its stock. It also specifies that a party or an intervenor must file a disclosure statement in a diversity case, and identify the name and citizenship of any individual or entity whose citizenship is attributed to that party or intervenor when the action is either filed or removed, or when a later event occurs that could affect the court’s diversity jurisdiction.

FEDERAL RULES OF APPELLATE PROCEDURE

In April 2021, Justice Roberts, Jr., submitted to the Congress an amendment to Federal Rule of Appellate Procedure 3 (Appeal as of Right-How Taken) and FRAP 6 (Appeal in a Bankruptcy Case), rules which the Supreme Court had already adopted effective December 1, 2021. The old rule required a party to file a notice of appeal identifying the "judgment, order, or part thereof" that it is appealing. Some courts interpreted that language strictly to hold that a party who named a specific order waived their right to appeal other orders. The revised rule fixed that issue to prevent parties from inadvertently waiving their rights.

The new rule and commentary also address a number of other, similar pitfalls, such as when a party inadvertently refers to the final decision as an "order" rather than a "judgment," or appeals a final order dismissing all claims but the Court later issues a separate final judgment.

COURTS ADMINISTRATIVE ORDERS DUE TO COVID-19

U.S. Supreme Court

In July 2021, the Court rescinded orders related to COVID-19 subject to clarifications. See 2021 US Order 0061.

Ninth Circuit

As of 2/23/2022, oral in-person arguments will be permitted beginning March 1, 2022. Attorneys retain the option to appear remotely by video without a motion. The court urged counsel to review the in-person hearing protocols and Amended Vaccination Order. Panels will continue to exercise their discretion under the rules to submit cases without argument; to hold hearings remotely; or to postpone argument to a later date. When in-person or remote argument is held, it will be live streamed to facilitate public access.

Arizona District Court

In March 2022, the court rescinded its requirement to wear face coverings in district court and bankruptcy court.

Arizona Supreme Court

As of July 15, 2021, our Supreme Court directed that the statewide court health emergency plan is now in Phase III, and courts may modify their practices and operations accordingly.

If you have questions regarding the information in this chapter, please contact the author.

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CHAPTER 4: THE COLLATERAL SOURCE RULE

OVERVIEW OF THE COLLATERAL SOURCE RULE

The collateral source rule prevents defendants in tort cases from introducing evidence that a source independent of the defendant has provided payments or benefits to the injured party. *Taylor v. S. Pac. Transp. Co.*, 130 Ariz. 516, 519, 637 P.2d 726, 729 (1981); RESTATEMENT (SECOND) OF TORTS § 920A(2). This means that the defendant cannot get credit for payments the plaintiff has received from another source (such as an insurer), even if those payments covered all or part of the harm for which the defendant is liable. *Taylor*, 130 Ariz. at 519, 637 P.2d at 729. A defendant cannot argue that a plaintiff has already been made whole for his losses by his own insurance company. *Michael v. Cole*, 122 Ariz. 450, 595 P.2d 995 (1979).

RATIONALE FOR THE COLLATERAL SOURCE RULE

The reasoning behind the collateral source rule is that a tortfeasor should not escape liability simply because the injured party purchased insurance. *Taylor*, 130 Ariz. at 519, 637 P.2d at 729; *Lopez v. Safeway Stores, Inc.*, 212 Ariz. 198, 202, 129 P.3d 487, 491 (Ct. App. 2006).

The collateral source rule addresses the competing goals of ensuring that a tortfeasor pays only that amount to the plaintiff to make him whole, and ensuring that the tortfeasor pays for his wrong and is not advantaged by the happenstance that the plaintiff has another source of reimbursement. The collateral source rule favors the injured party and ensures that the tortfeasor does not escape liability, even if that means the injured party is allowed to recover twice. *Lopez*, 212 Ariz. at 202, 129 P.3d at 491. In other words, when an injured party receives compensation from another source, either the victim or the tortfeasor will receive a windfall, and Arizona law favors providing the victim with that windfall. *Id.*

APPLICATION OF THE COLLATERAL SOURCE RULE IN ARIZONA

For the collateral source rule to apply, the compensation paid to a plaintiff must be fully independent of the defendant. *Burrington v. Gila County*, 159 Ariz. 320, 325–26, 767 P.2d 43, 48–49 (Ct. App. 1988). The most common application of the collateral source rule occurs when an injured plaintiff recovers insurance benefits for an injury and is also allowed to recover that amount from the tortfeasor who caused the injury. *Taylor*, 130 Ariz. at 519, 637 P.2d at 729. Because the defendant had nothing to do with the plaintiff's decision to purchase insurance, the defendant cannot benefit from that decision and remains liable for the full amount of damages caused by his tortious conduct.

The collateral source rule also prevents a defendant in a wrongful death action from showing that the plaintiff has remarried and that his new spouse is able to make the same contributions to the plaintiff's life as the deceased spouse. *Taylor*, 130 Ariz. at 519, 637 P.2d at 729. The court reasons that allowing evidence of a remarriage might have the undesired effect of discouraging wrongful death plaintiffs from remarrying until after the lawsuit is settled. *Id.*

The collateral source rule allows a plaintiff to claim as damages the full billed amount of the medical services he received, even if his health care provider accepted a reduced amount for those services pursuant to an agreement with the plaintiff's health insurer. *Lopez*, 212 Ariz. at 198, 129 P.3d at 487. The defendant cannot admit evidence that neither the plaintiff nor his health insurer would ever have to pay the full billed amount. This serves the fundamental purpose of the collateral source rule – to prevent a tortfeasor from deriving any benefit from compensation or indemnity that an injured party has received from a collateral source.

The collateral source rule also allows a victim to seek recovery from a tortfeasor for medical expenses that the government has paid. *Sw. Fiduciary, Inc. v. Arizona Health Care Cost Containment Sys. Admin.*, 226 Ariz. 404, 409, 249 P.3d 1104, 1109 (Ct. App. 2011).

In claims for lost wages, the collateral source rule prevents the defendant from showing that the plaintiff has received unemployment compensation and similar benefits. *Fleming v. Pima County*, 141 Ariz. 149, 155, 685 P.2d 1301, 1307 (1984); *Hall v. Olague*, 119 Ariz. 73, 74, 579 P.2d 577, 578 (Ct. App. 1978).

EXCEPTIONS TO THE COLLATERAL SOURCE RULE

Contract Claims

The collateral source rule does not apply to “ordinary” breach of contract claims. *Norwest Bank (Minnesota), N.A. v. Symington*, 197 Ariz. 181, 189, 3 P.3d 1101, 1109 (Ct. App. 2000). This is because the law of contracts prevents parties from profiting more from the breach of an obligation than from its full performance. *Id.* Allowing a plaintiff to recover damages from a collateral source and from the defendant would lead to the plaintiff profiting more from the breach than from the contract's full performance. *Id.*

However, in *Munic Enterprises, Inc. v. Laos*, 235 Ariz. 12, 326 P.3d 279 (Ct. App. 2014), the Arizona court of appeals held that the collateral source rule can be applied in contract cases that involve a “willful or tortious character.” In *Munic*, the trial court found that the defendant borrowers intentionally misrepresented the amount and status of their assets offered as collateral for the purpose of obtaining a loan. *Id.* at 20, 326 P.3d at 287. Judgment was entered against them and in favor of the lender. The Court of Appeals upheld the application of the collateral source rule to preclude the borrowers from claiming an offset for money the lender had received in settling a malpractice claim against its lawyer in connection with his work on the loan. *See id.*

Tortfeasor's Insurer

The defendant's insurance is not a collateral source because it is not fully independent of the defendant; therefore, payments the defendant (through his insurer) made to the plaintiff are admissible. *Bustos v. W.M. Grace Dev.*, 192 Ariz. 396, 399, 966 P.2d 1000, 1003 (Ct. App. 1997).

Medical Malpractice Claims

The Legislature has created an exception to the collateral source rule for medical malpractice cases. A.R.S. § 12-565 provides that a defendant in a medical malpractice action may introduce evidence of payments the plaintiff has received or will receive from a source independent of the defendant. If a defendant chooses to introduce this evidence, the plaintiff may introduce evidence of any payments plaintiff made to secure his right the payments or benefits. Plaintiff may also show that his tort recovery will be subject to a lien; that the plaintiff is legally obligated to reimburse the provider of the payments; or that the provider of the payments or benefits has a right of subrogation to the rights of the plaintiff in the medical malpractice action.

The purpose of this exception is to help medical professionals obtain insurance coverage at reasonable rates, by eliminating double or triple recovery by medical malpractice plaintiffs. By reducing the amount insurers are required to pay out in lawsuits, the exception allows insurers to provide lower malpractice premiums. *Eastin v. Broomfield*, 116 Ariz. 576, 585, 570 P.2d 744, 753 (1977). In *Eastin*, the Arizona Supreme Court held this exception to the collateral source rule constitutional. *Id.* at 585, 570 P.2d at 753.

If you have questions regarding the information in this chapter, please contact the author.

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CHAPTER 5: ALTERNATIVE DISPUTE RESOLUTION

OVERVIEW

Each year, more and more cases are resolved through the use of Alternative Dispute Resolution (ADR) processes. The primary reason for this is that litigation has been increasingly expensive and parties seek to resolve their disputes more quickly. As a consequence, litigants have become increasingly receptive to using ADR to resolve cases that traditionally were resolved through the jury trial process.

Over the years, litigants have considered and used a number of ADR processes. Among them, the most popular have been arbitration, mediation, short trials and early neutral case evaluation. This chapter will discuss the advantages and disadvantages of each of these ADR methods and offer useful practice tips to maximize the benefit of each.

Recognizing the cost and time involved in resolving disputes through the jury trial process, the courts have increasingly turned to ADR to manage caseloads and make litigation more efficient and affordable for all litigants. The right to a jury trial is no longer automatic. Each county in Arizona now has a minimum dollar value for cases before litigants are entitled to a jury trial. Cases that do not reach this minimum threshold must go to mandatory arbitration, as discussed in more detail below.

Previously, litigants were required to meet very early on in the case to discuss settlement and the use of ADR. While that rule was abrogated about ten years ago, the courts still require parties, as part of their scheduling orders for each case, to participate in a mandatory settlement conference or private mediation before a trial date will be set. Rule 16(c), Ariz.R.Civ.P.

ARBITRATION

The subject of arbitration can be broken down into three separate categories:

- Mandatory arbitration;
- Voluntary arbitration; and
- UM/UIM arbitration.

There are differences between these three types of arbitration, but generally they hold the same advantages and disadvantages.

Advantages of Arbitration

Arbitration saves time and money. Most arbitration procedures can be completed in less than six months, and the defense costs involved should be less than those involved in litigation. Because

the Rules of Evidence for most arbitration proceedings are greatly relaxed, less discovery is normally necessary, and certainly fewer witnesses are called during the proceeding. The actual length of the proceeding is generally just a day or two days, as opposed to trial which might last several weeks. Often, cases are resolved in a half day or less. As a result, arbitration generally saves thousands of dollars in attorney's fees over a court trial.

Arbitration can also yield a better result in the right kind of case. If a claimant is particularly sympathetic (i.e., especially personable, a child, or a vulnerable or incapacitated adult), an arbitrator is less likely to be swayed by sympathy than a jury. Similarly, if the defendant is particularly unsympathetic (i.e., an intoxicated driver, a large corporation with a "deep pocket," or a person who is not personable) the arbitrator will likely be less swayed by prejudices that could affect a jury. This factor should always be given consideration in addition to the financial advantage of arbitration.

Arbitration should also be considered as a way of avoiding publicity and exposure that can come with a public jury trial. Generally, arbitrations are private matters and the decision of the arbitrator may not become part of the court record. As an example, a business owner sued for employment discrimination by a former employee might prefer arbitration as a way to avoid the potential negative publicity that might come with a very public jury trial.

Arbitration might also be the preferred method to resolve a dispute where a party is concerned about setting a negative precedent for future claims. When an insured sues his or her insurer, the insurer might want to resolve the claim without setting a precedent for the resolution of similar claims in the future – such as where a policy provision might be interpreted to have unintended consequences. The insurer might want to avoid a judge or jury determination of the intent of the specific policy language and a subsequent appeal that would establish binding precedent on the interpretation of that policy provision in the future.

Finally, in mandatory court arbitration proceedings where the court appoints the arbitrator, the court compensates the arbitrator for his or her time and there is no cost to the parties for the arbitrator's time. Rule 76(f), Ariz.R.Civ.P. This results in a cost savings to the parties, as arbitrator fees can run as high as \$500/hour or more.

Disadvantages of Arbitration

Arbitration has its disadvantages, and these can outweigh the advantages.

In most arbitrations, attorneys are the arbitrators. Experience has shown that attorney arbitrators are less likely to find for the defendant entirely, but are also less likely to award excessive amounts to plaintiffs. This is probably because attorney arbitrators view arbitration as a compromise. Especially in arbitrations that are appealable, such as mandatory court arbitration, attorney arbitrators tend to "split the baby" in the hope of discouraging an appeal from the arbitration award.

When considering arbitration, the sympathy factor addressed above should always be considered.

Another significant disadvantage to arbitration occurs in cases where the arbitration is not binding and the arbitration decision is appealed. When arbitration is non-binding, the parties will incur not only the expenses of the arbitration, but also the expenses of the ultimate jury trial if an appeal from the arbitration award is taken. In this circumstance, the arbitration becomes a wasted procedure in terms of both time and expense. Fortunately, statistics show that most arbitrated cases are resolved at that point or through settlement after arbitration. Very few cases end up going to a jury trial after an arbitration. The courts have attempted to minimize the number of appeals from court arbitrations by imposing significant sanctions on the appealing party if the award on appeal is not substantially greater than the arbitration award. See Rule 77(h), Ariz.R.Civ.P.

MANDATORY ARBITRATION

Arizona law requires the superior courts of each county to establish arbitration limits up to \$50,000. Each county in Arizona has established arbitration limits that vary from \$1,000 to \$50,000. The following chart shows the arbitration limits for each county in Arizona.

2018 County Limits for Mandatory Court Arbitration

County	Arbitration Limit
Apache	\$10,000
Cochise	\$50,000
Coconino	\$65,000
Gila	\$25,000
Graham	\$30,000
Greenlee	\$1,000
La Paz	\$1,000
Maricopa	\$50,000
Mohave	\$50,000
Navajo	\$25,000
Pima	\$1,000
Pinal	\$40,000
Santa Cruz	\$1,000
Yavapai	\$65,000
Yuma	\$50,000

Rule 72(e), Ariz.R.Civ.P., requires a plaintiff to file a “Certificate of Compulsory Arbitration,” which specifies whether the case is subject to compulsory arbitration. A case is subject to compulsory arbitration if only money damages are sought, and if the amount sought is no more than the maximum amount shown above (set by local rule). A defendant can contest the plaintiff’s certification that a case either is or is not subject to compulsory arbitration, and the court may, on its own motion, certify a case for compulsory arbitration at any time.

Even where a plaintiff certifies that the case comes within the mandatory arbitration limit, however, the arbitrator **may** award more than the jurisdictional limit. In other words, a plaintiff could certify a case for compulsory arbitration in Maricopa County, which has a \$50,000 limit, and the arbitrator **could** award that plaintiff \$60,000. As in any other arbitration, the only recourse is to appeal and have a jury trial in superior court. Either party always has the right to appeal. Rule 77(a) Ariz.R.Civ.P. Once a case is certified for arbitration, unless the parties agree otherwise to the appointment of an arbitrator to hear the case, the superior court clerk selects a name at random from a list of all lawyers qualified to serve as arbitrator. The only qualification is that the lawyer be an active member of the State Bar for at least 4 years. Rule 73(c)(1) Ariz.R.Civ.P. In *Scheehle v. Justices of the Supreme Court of the State of Arizona*, 211 Ariz. 282, 120 P.3d 1092 (2005), the Arizona Supreme Court upheld the rule authorizing superior courts to require active members of the State Bar to serve as arbitrators. Each side has one peremptory strike of the assigned arbitrator. Rule 73(f) Ariz.R.Civ.P. Once the arbitrator has been assigned, he or she fixes a time for the hearing. The arbitration hearing shall commence not fewer than 60 days, nor more than 120 days after his or her appointment. Rule 74(c) Ariz.R.Civ.P. Once the arbitration hearing is held, the arbitrator has 10 days to file his or her “Notice of Decision.” Rule 76(a) Ariz.R.Civ.P. The actual award should be filed within 20 days thereafter. Rule 76(b)(1) Ariz.R.Civ.P. These rules are intended to provide a quick resolution of the case.

It is a good idea to see if the opposing party will agree on an arbitrator. If so, the matter can be taken off the court system and into a private arbitration where the parties can customize the terms and conditions under which the matter will be arbitrated. One of the biggest complaints litigants have with the use of mandatory arbitration is that the litigants have no control over the selection of the arbitrator. Many times an arbitrator is appointed who is not familiar with the area of law involved in the dispute. Sometimes this can result in an unjust award which then results in an appeal. Choosing a private arbitrator, while more expensive because the litigants will be required to pay for the cost of the arbitrator, can sometimes be cheaper in the long run because the arbitration award will likely be more predictable, which reduces the likelihood of either side appealing the award.

MANDATORY ARBITRATION PROCEDURES

The rules of procedure for arbitration are relaxed. For example, depositions can be read during the arbitration without the need to call witnesses. Other evidence, such as medical bills and reports can be presented in written and summary fashion without the need to call witnesses to prove that summary evidence. Under certain circumstances, witness statements may also be admitted. There are, of course, procedures for screening this type of evidence prior to the

hearing. Rule 75(d) Ariz.R.Civ.P. As noted above, most arbitration proceedings are concluded in a day or less.

At the conclusion of the arbitration, the arbitrator issues a written award. Either party then has a right to appeal. Rule 77 Ariz.R.Civ.P. *See also Valler v. Lee*, 190 Ariz. 391, 949 P.2d 51 (Ct. App. 1997). If that right to appeal is exercised, the case reverts back to the superior court judge assigned to the matter, and the case proceeds as any other lawsuit de novo. Rule 77(d) Ariz.R.Civ.P. Discovery is permitted, and a regular jury trial is conducted. In *Valler*, the court of appeals held that an appeal of an arbitration award must be “tried de novo as to all parties, claims, and issues of law and fact” in order to prevent any unappealed portion of the award “from becoming final under Uniform Rule 5(c).” But in *Orlando v. Superior Court*, 194 Ariz. 96, 977 P.2d 818 (Ct. App. 1998), the court held that one plaintiff’s appeal had no effect on the non-appealing plaintiff’s award. There, two plaintiffs sued a motor-vehicle defendant who rear-ended the plaintiffs’ cars. The arbitrator awarded damages to one plaintiff only. The defendant appealed and the other plaintiff was not a party to the appeal. The court of appeals held that the appeal was effective only as to parties named in the appeal. The de novo appeal did not need to include all of the parties unless joinder was required by law. The Court distinguished *Valler* because joinder was necessary in that case.

The appealing party must deposit with the court a sum equal to the arbitrator’s total compensation (unless the party certifies he has insufficient funds). The arbitrator’s fee in Maricopa County is \$75 per hearing day. The ultimate jury award must be least 23% more favorable than the arbitration award, or else the appealing party must pay:

- The arbitrator’s compensation;
- Taxable costs;
- Reasonable attorney’s fees as determined by the trial judge for services necessitated by the appeal; and
- Reasonable expert witness fees incurred by the appeal.

Rule 77(h) Ariz.R.Civ.P. In *Farmers Ins. Co. v. Tallsalt*, 192 Ariz. 129, 962 P.2d 203 (1997), the Arizona Supreme Court addressed how the superior courts should assess attorney’s fees on appeal from an arbitration award when the arbitrator has awarded one or both parties \$0. The court held that in order for the appellant of an arbitration award of \$0 to avoid paying the appellee’s attorney’s fees, the appellant must obtain a judgment more than \$0, no matter how much greater.

A party’s failure to appear at an arbitration hearing precludes him from appealing an arbitration award against him, even if he is represented by counsel and participated in pre-hearing discovery. *Lane v. City of Tempe*, 199 Ariz. 370, 18 P.3d 164 (2001). A party’s offer to testify by phone constitutes a good faith attempt to appear at the arbitration hearing and does not constitute a waiver of the right to appeal. *Sabori v. Kuhn*, 199 Ariz. 330, 18 P.3d 124 (Ct. App. 2001).

In summary, the rule requiring mandatory arbitration of cases within the arbitration limits is designed to shorten the life of a case and reduce its expenses. The rule is also designed to reduce

the backlog of cases with a value less than the arbitration limits. The arbitration rules generally serve these purposes. The reduction in expense and time needs to be weighed against the potential for an award, when deciding whether to certify a case for arbitration. Normally, however, a defendant will not have a choice in whether a case is arbitrated, although he can be successful in persuading a judge that the facts of a case show it should be arbitrated despite the plaintiff's opposition. Rule 72(e) Ariz.R.Civ.P.

VOLUNTARY ARBITRATION

Any case can be arbitrated, despite its size, upon agreement of the parties. The same considerations discussed above apply in determining whether a case is appropriate for voluntary arbitration. Once that decision is made, the guidelines for how to conduct the arbitration are limitless.

The arbitrator can be selected in many ways. The parties can agree to have the court select the arbitrator through the mandatory procedure discussed above; the parties can agree on a single arbitrator; or the parties can agree to use UM/UIM-type arbitration in which each side selects one arbitrator and those two arbitrators select a third. It is also becoming more common for the parties to agree on a particular expert who serves either with the other arbitrators or as a sole arbitrator. For example, if the key issue in a case involves an orthopedic injury, the parties might agree to appoint a particular orthopedic surgeon or medical malpractice lawyer to serve as arbitrator or as co-arbitrator.

The same freedom applies to selecting the procedures to be used. Limits can be placed on the type of discovery that will be permitted or whether formal discovery will be permitted at all. Often, arbitrations are conducted with an agreed-upon high and low figure. The defendant is guaranteed not to pay more than the maximum amount agreed upon, but the plaintiff is guaranteed the minimum amount agreed upon. The arbitration could, of course, either be binding or non-binding, and many times the parties agree in advance on the evidence that will be introduced or the amount of time that each side will have to present their evidence.

All the options for customizing the arbitration process should be carefully considered when using a voluntary arbitration so as to maximize the benefits of arbitration in a particular case.

If appealing a voluntary arbitration, A.R.S. § 12-3023(A) sets out the reasons an award can be vacated. It states that the superior court "shall vacate" an award that is alleged to have been procured by corruption, fraud or undue means; or the arbitrator engaged in "evident partiality," corruption or misconduct; or the arbitrator exceeded his powers, conducted the arbitration without notice or refused to postpone the hearing despite sufficient cause; or that "[t]here was no agreement to arbitrate." The parties cannot stipulate to bypass the superior court and have their appeal go directly to the court of appeals, *Chang v. Siu*, 234 Ariz. 442, 446, 323 P.3d 725, 729 (Ct. App. 2014); but *Chang* declined to consider whether the parties may contract for expanded appellate review of the merits of an arbitrator's award (beyond those set forth in the statute).

CONTRACTUAL ARBITRATION CLAUSES

Arizona now follows the majority of jurisdictions in the country that have adopted the Federal Uniform Arbitration Act. The AZ-RUAA applies to all arbitration agreements made after January 1, 2011, except those agreements between an employer and employee, agreements contained in a contract of insurance, and certain other agreements involving banking institutions. The RUAA makes clear that certain provisions in agreements to arbitrate may not be waived before an actual dispute arises. The AZ-RUAA also provides for interim remedies before a final judgment – such as an injunction or provisional remedy, whether issued by an arbitrator or a court before an arbitrator is appointed and able to act. The AZ-RUAA also provides for the consolidation of separate arbitration proceedings unless the agreement to arbitrate specifically prohibits consolidation. Finally, the RUAA now gives arbitrators greater authority in the manner in which the arbitration proceeding is conducted.

Under the AZ-RUAA, a contractual agreement to arbitrate extends to claims arising out of a related contract that lacks an arbitration provision; to non-contract claims so long as a resolution of the claim requires reference to the contract; and to non-signatories in certain circumstances. ***Sun Valley Ranch, 308 LP v. Robson***, 231 Ariz. 287, 294 P.3d 125 (Ct. App. 2012). Arbitrators also have the power under the AZ-RUAA to appoint receivers and dissolve limited partnerships. Arizona courts thus appear willing to broadly interpret the scope of the RUAA and increase arbitrators' powers.

The enforceability of a contractual arbitration clause centers on whether the clause was part of an adhesion contract or is otherwise unenforceable as not within the contracting parties' reasonable expectations. In ***Broemmer v. Abortion Services of Phoenix, Ltd.***, 173 Ariz. 148, 840 P.2d 1013 (1992), the court refused to enforce an arbitration clause contained in a contract for abortion services, and allowed plaintiff to sue the abortion services entity and physician for malpractice. Because there was no conspicuous or explicit waiver of the fundamental right to a jury trial, or any evidence that such rights were knowingly, voluntarily and intelligently waived, the arbitration clause was part of a contract of adhesion and outside the plaintiff's reasonable expectations.

In ***North Valley Emergency Specialists, L.L.C. v. Santana***, 208 Ariz. 301, 93 P.3d 501 (2004), the court similarly refused to apply Arizona's Arbitration Act to arbitration agreements between employers and employees. In ***Schoneberger v. Oelze, Sr.***, 208 Ariz. 591, 96 P.3d 1078 (2004), the arbitration provision was in a document creating an inter vivos trust. The court held that the beneficiaries were not required to arbitrate their claims because such a trust was not a "written contract."

In ***Harrington v. Pulte Homes Corp.***, 211 Ariz. 241, 119 P.3d 1044 (2005), the Supreme Court upheld the enforceability of an arbitration clause in a contract between home purchasers and a home builder. Requiring the homeowners to arbitrate their construction defect claims against the homebuilders, the court rejected the homeowners' argument that the arbitration clause was unconscionable and violated their reasonable expectations.

These cases demonstrate that courts are in favor of enforcing an arms' length agreement to arbitrate disputes. The courts will enforce them so long as the terms are reasonable and do not otherwise violate a party's reasonable expectations.

In *Klesla v. Wittenberg*, 240 Ariz. 438, 380 P.3d 677 (Ct. App. 2016), the court addressed the enforceability of an arbitration award. The Kleslas moved for entry of judgment after receiving an arbitration award, and they requested attorney's fees. The trial court denied the fee request because the arbitration award did not include an award of attorney fees. The court of appeals affirmed because the Kleslas had sought entry of a judgment that encompassed more than they were awarded in the original arbitration award. The case is instructive because it demonstrates that the courts will not infringe upon the terms of parties' private arbitration agreements.

UM/UIM ARBITRATION

Most uninsured and underinsured motorist (UM/UIM) policies require the parties to arbitrate a dispute over the amount to be paid. The results of these arbitrations are not usually satisfactory to the defense. It seems that when three lawyers get together to arbitrate a case, a compromised result occurs that may be higher than any single attorney or jury might value the case. This factor should be considered when deciding an amount for which to settle a case prior to a UM/UIM arbitration. As long as arbitration provisions remain in insurance policies, this is a "fact of life." That is why some carriers are changing their UM/UIM policies to require a single arbitrator or to provide for a limited right of appeal. Some now even require the insured to file suit against the insurer in superior court, where the matter is taken completely out of arbitration and resolved through the traditional jury trial process.

Most UM/UIM arbitrations are conducted by a "panel of three" arbitrators. Each side selects an arbitrator and the two arbitrators select a third. To reduce costs and expedite the matter, opposing attorneys might agree on the third arbitrator in advance and only use that arbitrator rather than using three. As noted above, however, arbitrators in these settings generally compromise between the amount offered and the amount demanded. Sometimes, a jury would have provided a better result for the defense. Therefore, evaluating cases that will go to UM/UIM arbitration is different than evaluating cases that will be subject to a jury trial.

Preparing for arbitration is critical to success. Most people consider arbitration a money-saving method of resolving a case. Often times it is. One danger of arbitration is that parties can become overly lax in their preparation, thus resulting in a higher arbitration award. Adequate preparation is necessary, and often the preparation for an arbitration should be no less than preparation for a trial. This is particularly true when contesting the reasonableness or necessity of claimed medical expenses. Experience has shown that arbitrators will not consider an argument to reduce claimed medical expenses unless the defense presents competent expert medical testimony. Most policies do not provide a full right of appeal from a UM/UIM result, and therefore, adequate preparation insures the lowest award possible.

Most UM/UIM policies do not allow for an award of attorney's fees to the prevailing party unless expressly provided in an arbitration clause. *Canon Sch. Dist. No. 50 v. WES Constr.*, 180 Ariz. 148, 882 P.2d 1274 (1994). Similarly, most policies do not provide for an award of costs to the prevailing party in arbitration. Typically each side pays its own costs and the parties split the cost of the arbitrator(s).

Some plaintiffs' attorneys take the position that no discovery is allowed in UM/UIM arbitrations, and have refused to answer interrogatories, submit to depositions or exchange disclosure statements. These issues must ultimately be resolved by the arbitrator(s), but the policy provisions could be useful in this regard. For example, most policies require the insured to cooperate in resolving disputes, and almost all policies require a statement by the insured under oath. The policies also require the insured to submit documentation to support a claim and perhaps submit to a medical examination where those issues are involved. Some policies require the parties to follow the local rules of procedure for arbitration. All of these policy provisions can and should be used, where necessary, to force compliance with discovery requests in preparing for arbitrations.

Sample UM/UIM Policy Arbitration Clauses

Sample Clause No. 1

If there is no agreement, these questions shall be decided by arbitration upon written request of the insured or us. Each party shall select a competent and impartial arbitrator. These two shall select a third one. If unable to agree on the third one within thirty (30) days either party may request a judge a court of record in the county in which the arbitration is pending to select a third one. The written decision of any two arbitrators shall be binding on each party.

The arbitration shall take place in the county in which the insured resides unless the parties agree to another place. State court rules governing procedure and admission of evidence shall be used.

Sample Clause No. 2

If we and you, or your representative, do not agree on the legal responsibility of the uninsured motorist to pay your damages or the amount of damages, then upon the consent of both parties, the disagreement will be settled by arbitration.

The arbitration will take place in the county where you live. It will be conducted under the rules of the American Arbitration Association unless we, you, or your legal representative objects. In that case, you will select one arbitrator and we will select another. The two selected arbitrators will then select a third. If the two arbitrators are unable to agree on a third arbitrator within thirty (30) days, the judge of the court of record in the county of jurisdiction where arbitration is pending will appoint the third arbitrator.

Local court rules governing procedure and evidence will apply unless the arbitrators agree on other rules. The decision in writing of any two arbitrators will be binding on you, subject to the terms of insurance. Judgment on any award may be entered in any court having jurisdiction.

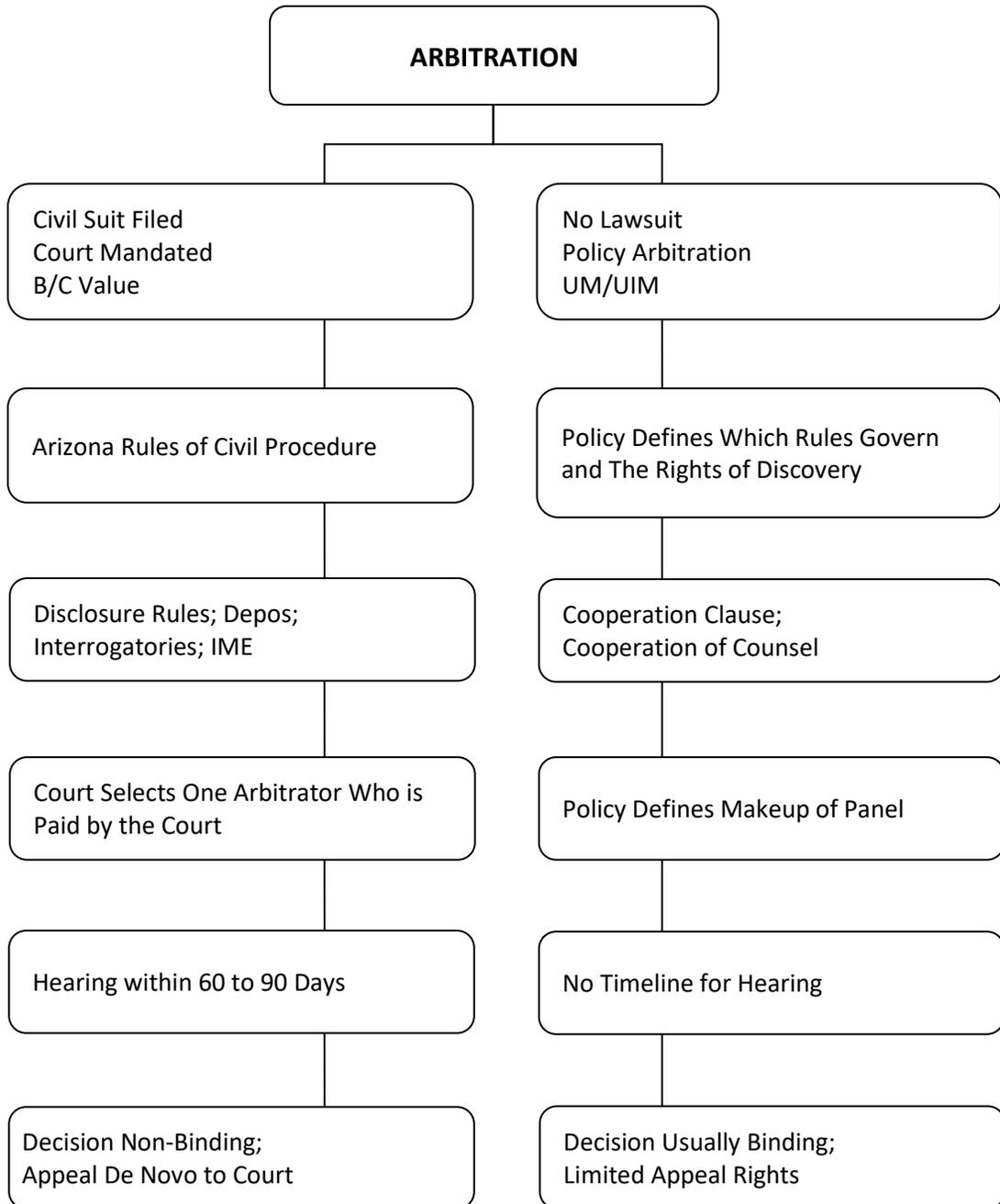
Sample Clause No. 3

If we and a covered person do not agree whether that person is legally entitled to recover damages under this part or as to the amount of damages, either party may make a written demand for arbitration. In this event, each party will select an arbitrator. The two arbitrators will select a third. If they cannot agree within thirty (30) days, either may request that selection be made by a judge of court having jurisdiction. Each party will pay the expenses it incurs and bear the expenses of the third arbitrator equally. Unless both parties agree otherwise, arbitration will take place in the county in which the covered person lives. Local rules of law as to procedure and evidence will apply. A decision agreed to by two of the arbitrators will be binding as to whether the covered person is legally entitled to recover damages and the amount of damages.

The following diagram illustrates the differences between mandatory and UM/UIM arbitrations:

SEE NEXT PAGE

Comparison of Mandatory Court Arbitration and UM/UIM Arbitration



MEDIATION AND SETTLEMENT CONFERENCES

Mediation is a voluntary procedure where parties present their cases before an impartial mediator who discusses the case jointly and/or individually with the parties to try and assist them in arriving at a settlement. Mediation is effective if the mediator is skilled and the parties are willing to be reasonable in settling the claim. An effective mediator can achieve a settlement even when there is a vast difference of opinion in case value at the outset of the mediation.

Mediation typically involves a discussion of the dispute by the parties, as opposed to the presentation of witnesses and evidence as would take place at an arbitration or trial. Therefore, a mediation will normally be attended only by the parties and their representatives, their attorneys, and the mediator. The mediator has no power to render a decision or force the parties to accept a settlement. The mediator has no real authority to exert any pressure on either party, other than through persuasion.

Some mediation sessions begin with all parties together. The mediator may open the discussion by allowing both sides to present their positions. Usually, each side then meets individually with the mediator to present his or her case and perhaps present positions that are not to be disclosed to the other side. Often, a party will confidentially tell the mediator the actual maximum or minimum amount they would pay or accept in settlement. The mediator might meet with each side individually numerous times, and might at times get everyone back together for a joint session. Mediations generally last one-half to one full day.

Mediations are very much like settlement conferences conducted by superior court judges. Parties can request a “pro tem” judge to hear their settlement conference. Many lawyers volunteer their time to serve as pro tem settlement conference judges. A list can be obtained from the court. The settlement conference process is also entirely voluntary and non-binding. One advantage of utilizing a pro tem judge is that there is no cost to the parties for the pro tem’s time. One disadvantage of participating in a court settlement conference before a pro tem judge is that the parties do not have any control over which pro tem judge is appointed to the case.

Mediation and settlement conferences are often beneficial, and seldom detrimental. The only real disadvantage of a mediation or settlement conference is the time spent and the potential for “tipping one’s hand” regarding strategy that would otherwise be saved for trial. Under the current rules of disclosure, however, there is not much strategy than can be saved for trial anyway. Many times, a mediation provides valuable information about an opponent’s case or strategy. Thus, even if the case does not initially settle at a mediation or settlement conference, the discussion can focus future discovery and narrow the issues in dispute, ultimately leading to resolution of the case – sometimes with the parties returning again to mediation or a settlement conference. As such, a mediation or settlement conference risks only the time and money involved in the actual process. For that reason, parties should give strong consideration to mediation or a settlement conference early on in the case.

There are attorneys, former judges and services that specialize in conducting private mediations. Individuals involved have likely received specialized training in mediation techniques or are experienced attorneys or judges who have specialized skill or subject matter knowledge in the particular area in dispute. Careful consideration in selecting a mediator should be taken. Furthermore, the expenses involved should be clearly disclosed before proceeding with the mediation. Be careful to agree with the mediator in advance how much it will cost, and be certain to document with all parties exactly who will pay what portion of that cost. Some mediations, even for fairly simple personal injury claims, can cost several thousand dollars simply for the expense of the mediator. Alternatively, the parties will save the cost of a mediator if all parties can agree on an appropriate judge pro tem to conduct a settlement conference. A good settlement conference judge pro tem might be able to accomplish the same result – a reasonable settlement.

Because mediation is not a formal court proceeding and is voluntary, parties tend to prepare less for a mediation than for an actual arbitration or jury trial. This can be a big mistake. Parties should approach mediation with the intent to put forward the best possible case, sufficiently documented. Lawyers and clients should prepare to address all aspects of the case with the mediator. The greater the preparation for a mediation, the more likely the case will settle at the mediation. In this regard, it is extremely important to make certain that each person with sufficient settlement authority to settle the case attend the. An effective mediation tool can be to present the mediator with actual jury research of similar claims to support a party's settlement position.

The parties should approach mediation with a flexible attitude. Often, the inclusion of a non-monetary concession, such as an apology by the defendant or a change in a safety procedure in a worksite accident case can make a big difference in whether a case will settle at mediation. Therefore, the parties should approach mediation with a creative attitude and an open mind.

The importance of documenting the agreement reached by the parties during mediation cannot be stressed strongly enough. Because mediation is an informal proceeding, there is no court reporter to record the agreement of the parties. Many times an agreement will be reached at the end of a very long day when the parties are eager to conclude the process. However, great caution should be taken to adequately document all of the key terms and conditions agreed upon before the parties and their representatives leave the mediation – and to have the parties and their representatives sign the documented terms and conditions. If the terms and conditions are not adequately documented, they can later be held unenforceable by a court of law if disputed by one of the parties. See Rule 80(D) Ariz.R.Civ.P. Furthermore, parties can have buyer's remorse immediately after a mediation or will claim a position contrary to what was agreed upon during the mediation. Thus, it is extremely important to document all of the key terms and conditions **and** to ensure that the parties and their representatives acknowledge these terms and conditions in writing.

SUMMARY JURY TRIALS

The general idea of a summary jury trial is to drastically reduce the amount of time and expense involved in conducting a jury trial, while at the same time, obtain a result from a jury, rather than a panel of attorneys. The idea is to combine the advantages of arbitration and jury trial. The rules for summary jury trials are limited only by the imaginations of the attorneys involved. There are no specific court rules for summary jury trials.

As with arbitration, summary jury trials can be either binding or non-binding. The parties can agree for the summary jury trial to be wide open as to result, or it can contain a high-low agreement. The lawyers simply need to agree on the guidelines ahead of time. They should then prepare a comprehensive order for the judge to sign, specifying exactly how the trial will proceed.

The simplest form of a summary jury trial is for the lawyers to only present closing arguments. This can be effective where there is no real disagreement on the facts or the injuries, but the real disagreement is whether those facts create liability and/or how much the injuries are worth. The lawyers could agree, for example, that they will select a jury through the normal jury selection process, including voir dire, and they will then each have two hours (or any amount agreed upon) to present a closing argument. The jury will then deliberate as they would in any trial, and render a verdict. Again, this can be binding or non-binding by agreement.

A more complex summary jury trial would involve the presentation of evidence. A case that would be scheduled for a six week trial could easily be conducted in three or four days. The lawyers have to agree on as many facts as possible, and divide up the time they spend on presentation of their respective cases. For example, they can agree to conduct standard voir dire in selecting a jury; to allot thirty minutes for opening statements; and ten hours for presenting their respective cases. During that ten hours, they may call witnesses, and read from depositions and exhibits. The time they spend cross-examining the opponent's witnesses could count against the ten hour allotment for presenting their case. The parties would need to select a monitor to keep track of time; but the judge's bailiff or courtroom clerk often agrees to perform that role. Finally, the lawyers might agree to perhaps two hours each for closing argument. The jury would deliberate in normal fashion and render a verdict, which could be either binding or non-binding.

In large cases, defendants can use the summary jury concept to help them prepare for trial. Defense attorneys can conduct a summary jury trial in their office without the plaintiff present. Two lawyers from the defense firm would participate, with one arguing the plaintiff's side and one arguing the defense side. "Jurors" willing to participate for a fee are generally easy to find. However, they must be impartial, and unaware which side the firm represents. The lawyers may present live testimony, particularly if there is concern about how a key witness will come across to a jury. The rest of the evidence can be presented in written or oral form. Both lawyers can make opening and closing arguments. The panel of jurors then deliberates and renders a decision. This allows defense counsel the opportunity to see how a jury is likely to react to the case. It also allows the attorney to discuss with the jurors which evidence was most important, how they reacted to a particular witness, what kind of arguments would have been more

persuasive or less persuasive, etc. This can be an extremely valuable tool and typically costs as little as \$5,000 to conduct. In a lawsuit with a potential exposure of several hundred thousand dollars or more, a \$5,000 investment can be an excellent one.

EARLY NEUTRAL EVALUATION (ENE)

This ADR process provides a forum in which each side presents its case to a neutral evaluator who has expertise in the subject matter of the case. The evaluator might serve as a mediator or simply provide the parties with an evaluation of the strengths and weaknesses of their positions and an opinion on the value of the case. The evaluator can also assist with narrowing the issues and helping the parties establish realistic discovery schedules. The theory behind early neutral evaluation is to narrow the issues in dispute early on in the case and either settle the case or reduce litigation costs.

Mediation/Arbitration

This ADR process is a hybrid of mediation and arbitration in which the dispute is first mediated. A decision is then made by the neutral mediator on any issues left unresolved. In effect, the mediator becomes the arbitrator and the decision may be binding or advisory as determined by the parties in advance. This procedure can be effective where the parties agree on most, but not all of the issues.

Short Trial

Short trial is a form of the summary jury trial and is available through the court system. It is designed to be completed in one day. The short trial is a binding procedure employing a four-member jury and requiring about two hours for presentation of the case by each side. Most of the information is taken from depositions rather than using live witnesses in order to stay within the time limitations. No official record is kept of the short trial, and appeals are allowed only upon showing of fraud. A short trial is frequently used as an alternative to an arbitration because it has the same expeditious nature but allows for the merits to be decided by a panel of jurors as opposed to a single arbitrator. Pro tem judges are assigned to preside over the trial. Recordings of short trials are kept by the ADR Office in the Maricopa County superior court building, which can be viewed for reference.

ADR AT THE APPELLATE LEVEL

ADR has also taken hold at the appellate court level. While most are familiar with arbitration, mediation and summary jury trials at the trial court level, few are as familiar with the introduction of ADR at the appellate level.

Rule 29 — Accelerated Appeals

Rule 29 Ariz.R.Civ.App.P. provides a procedure for civil litigants to accelerate the appeal process. Civil appellate litigants may invoke the special Rule 29 procedures by stipulation or motion. Alternatively, the appellate court can order an appeal to be accelerated under Rule 29 on its own motion. Any party can object within ten days.

Under Rule 29(b) Ariz.R.Civ.App.P., briefs in accelerated appeals are prepared and filed as usual, unless the parties stipulate at the outset to filing “summary briefs.” Summary principal briefs, governed by Rule 29(c) Ariz.R.Civ.App.P., shall not exceed 3,600 words and reply briefs shall not exceed 1800 words. The argument section of the briefs contains only an outline of each argument presented, consisting of a summary statement of the argument and a list, without elaboration, of the authorities and specific pages thereof relied upon. No motion may be filed to vary the provisions of this subsection.

If the parties do not request oral argument, Rule 29(d) Ariz.R.Civ.App.P. states that the court must dispose of the appeal within 90 days of when briefing is complete. If oral argument has been requested, oral argument shall be heard within 90 days of when briefing is complete. If oral argument is heard, the parties get 30 minutes each (as opposed to the normal 20). After oral argument, the court must decide the appeal within three days. That decision need not be by memorandum decision or opinion. The court may enter an order summarily stating the basis for the disposition. Rule 29(e) Ariz.R.Civ.App.P. Alternatively, the court may render decision orally from the bench after oral argument.

If a petition for review is filed from an accelerated appeal, Rule 29(f) Ariz.R.Civ.App.P. requires the Supreme Court to give that appeal priority. If review is granted, the Supreme Court may decide the case by order, by memorandum decision, or by opinion.

A Rule 29 Ariz.R.Civ.App.P. procedure could be utilized in cases that are not complex, are not fact intensive, and which require a quick ruling. The usual appeal process can take a year currently, which makes accelerated appeals seem attractive. However, accelerated appeals are not for everyone. There is the concern that the parties are not able to fully argue their case, and due to the quick turnaround time, that the judges will not spend as much time pondering over the decision.

Rule 30 — Arizona Appellate Settlement Conference Program

The court of appeals also has an appellate settlement program to help litigants settle cases on appeal before they spend the time and money preparing briefs. Every appeal filed in the Arizona Court of Appeals under these rules is eligible for the program, with a few minor exceptions. The program is available at no additional cost to the parties beyond the normal appellate filing fees. A sitting court of appeals judge presides over the settlement conference. This allows the parties to get a realistic view as to the strength or weakness of their appeal. The court does not charge the parties for this service. If the conference occurs but the parties do not settle, the judge conducting the conference will not sit on the panel that decides the appeal. See the policies for

each division of the court of appeals for their specific procedures for conducting appellate settlement conferences.

If you have questions regarding the information in this chapter, please contact the author or any JSH attorney.

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CHAPTER 6: OFFERS OF JUDGMENT

REQUIREMENTS

Arizona has a rather extensive “offer of judgment” procedure and practice, set forth in Rule 68 of the Arizona Rules of Civil Procedure. For reasons discussed below, it is important to remember that the offer is an offer of judgment, not merely an offer of settlement. Literally, it means that the offeror is allowing a judgment to be entered in the action, and certain sections of the Rule provide for that very thing – the entering, signing and filing of a judgment against the defendant.

At any time more than 30 days before trial begins, any party may serve upon any other party an offer to allow judgment to be entered in the action. An offer must remain open for 30 days after it is served unless it is rejected before that time; but an offer made within 45 days of trial shall remain effective only for 15 days after service. If the case is assigned to arbitration under the Arizona Rules of Civil Procedure, then the offer of judgment must be made more than 25 days before the arbitration hearing date, and it expires at 5:00 PM on the 5th day before the hearing. Where the plaintiff serves an offer of judgment on a defendant within 60 days of filing the complaint, the offer remains open for 60 days.

The offer must be made in writing, must state a specific sum of money, and shall be inclusive of all damages, taxable court costs, interest, and attorney’s fees sought in the case. Alternatively, the offer can exclude an amount for attorney’s fees but the offer must specifically state that attorney’s fees are being excluded from the offer. The offer does not have to be “reasonable” relative to the lawsuit’s probable damages. *Stafford v. Burns*, 241 Ariz. 474, 389 P.3d 76 (Ct. App. 2017). The offer also does not have to be apportioned by claim or causes of action. That is, if a plaintiff is asserting several different claims against a defendant, the defendant can still make an offer of a lump sum of money to the plaintiff without designating a certain amount for each claim.

Multiple parties may make a joint, unapportioned offer of judgment to a single offeree. For example, multiple wrongful death claimants or a husband and wife may make a joint unapportioned offer of judgment to a single defendant. But unapportioned offers may not be made to multiple offerees. In other words, a defendant cannot make a joint unapportioned offer to multiple plaintiffs. A separate offer must be made to each plaintiff because when the jury returns a verdict, there will be separate awards for each plaintiff. The defendant can make the offers to multiple plaintiffs conditioned upon acceptance by all of the plaintiffs. Each offeree may serve a separate written notice of acceptance of the offer.

Additionally, a defendant can make an offer to a plaintiff contingent on the plaintiff using the proceeds to satisfy all liens that attach by operation of law to the proceeds and for which defendant could be held liable. See *Cuellar v. Vettorel*, 235 Ariz. 399, 332 P.3d 625 (Ct. App 2014).

If an offeree believes the offer is defective or objectionable, the offeree must serve written notice of the objection within 10 days of the date of the offer. Failure to timely object waives all objections to the offer's validity. See Rule 68(d), Ariz.R.Civ.P.

An offer not accepted within the specified time is deemed to be rejected. An acceptance of an offer must be in writing. Upon acceptance of an offer, either party may then file in the court the offer, proof of acceptance, and a proposed judgment complying with Rule 58(b).

Acceptance of an offer of judgment ends the entire litigation by or against the offering party (unless otherwise specified in the language of the offer) and extinguishes the accepting party's right to appeal any of the court's prior decisions concerning the offering party. **Lee v. ING Inv. Mgmt., LLC**, 240 Ariz. 158, 377 P.3d 355 (Ct. App. 2016). For example, if the plaintiff sued the defendant alleging five theories of recovery, but defendant defeats three of those on summary judgment, and thereafter defendant makes and plaintiff accepts an offer of judgment on the two remaining claims, plaintiff cannot appeal the dismissal of the first three claims. Rule 68 is intended to encourage settlement and avoid protracted litigation. By accepting the defendant's offer, plaintiff agrees to end the litigation on all claims encompassed by his complaint against the offering defendant.

Note: The usual practice in Arizona is for the parties to treat the acceptance of an offer of judgment as a settlement, and simply exchange a check for a settlement agreement and release; however, that practice is not what Rule 68 mandates. Under Rule 68, a plaintiff can insist on having a judgment entered against the defendant, which can then be filed as a public record. In such a case, the defendant should insist that the plaintiff file a satisfaction of judgment to show that the defendant paid the judgment.

ATTORNEY'S FEES

If an offer is accepted in a case where either party is seeking recovery of attorney's fees, but the attorney's fees are specifically excluded from the offer, the offeree can apply to the court for attorney's fees after accepting the offer. That is, the collection/award of attorney's fees can be above and beyond the amount of the offer of judgment itself. See **Lee v. Ing**. This means that where the complaint seeks attorney's fees and the law allows it, counsel should be aware that such fees can be awarded after the offeree accepts an offer that specifically excludes attorney's fees. Likewise, in cases involving claims for attorney's fees, an offering defendant might want to specifically state that any offer made to the plaintiff includes attorney's fees.

SANCTIONS

If an offeree rejects an offer, or fails to accept it within the allowable time period, and then does not obtain a more favorable judgment at trial, the offeree must pay, as a sanction, twenty percent of the difference between the amount of the offer and the amount of the final judgment.

Practice Tip: More than one offer can be made during the course of litigation, so a defendant can start with a lower offer in the early stages of litigation and, if necessary, increase the offer (or lower it) as more information is learned in the discovery process. Offers of judgment are a useful tool in cases where defendant's liability is admitted or very likely. Beware, however, that if a plaintiff makes multiple rejected offers and the defendant fails to "beat the offer" with respect to any of them, sanctions will be calculated from the date of the first rejected offer. **Orosco v. Maricopa County Special Health Care Dist.**, 241 Ariz. 529, 390 P.3d 375 (Ct. App. 2017).

What constitutes a "more favorable" judgment? The offer is not simply compared to the jury's verdict, but is compared to the judgment entered by the court. This includes taxable court costs and attorney's fees incurred as of the offer date, per Rule 68(g)(2). *See, e.g., Bradshaw v. Jasso-Barajas*, 231 Ariz. 197, 291 P.3d 991 (Ct. App. 2013); *Hall v. Read Dev., Inc.*, 229 Ariz. 277, 274 P.3d 1211 (Ct. App. 2012); *Berry v. 352 E. Virginia, L.L.C.*, 228 Ariz. 9, 261 P.3d 784 (Ct. App. 2011). For example, assume a defendant offers \$50,000 to plaintiff. At trial, the jury returns a verdict for plaintiff for \$45,000. As the prevailing party, plaintiff is entitled to recover his taxable court costs pursuant to A.R.S. § 12-332, which the court determines are \$15,000. If the case also involves attorney's fees, the court would determine the plaintiff's reasonable attorney's fees and, if appropriate, add those into the final judgment. The offer is then compared to the combined amount of the jury verdict, plus those taxable costs and attorney's fees reasonably incurred as of the date the offer was made. If those combined amounts exceed the offer, then plaintiff has obtained a judgment more favorable than defendant's offer, and no Rule 68 sanctions are triggered.

Conversely, if the plaintiff makes an offer of judgment to defendant for \$60,000 and the jury returns a verdict for \$45,000, it does not necessarily mean that defendant "beat" plaintiff's offer. Since plaintiff is deemed to be the prevailing party, plaintiff is entitled to collect his taxable costs and, in some types of cases, his attorney's fees. If the combined value of the verdict, taxable costs and attorney's fees equals or exceeds \$60,000, then defendant has not obtained a more favorable judgment than plaintiff's offer. Defendant will be responsible for paying Rule 68 sanctions.

When comparing the offer to the judgment, courts will not consider "non-monetary terms" of the offer where no monetary value is ascribed to those terms. **Williams v. King**, 248 Ariz. 311, ¶¶ 34-35, 460 P.3d 303, 310 (Ct. App. 2020) (affirming trial court's refusal to consider offer to make real property improvements when comparing offer to the judgment where no dollar value was assigned to the additional terms).

In **Reyes v. Frank's Service and Trucking, LLC**, 235 Ariz. 605, 334 P.3d 1264 (Ct. App. 2014), the court held that "taxable costs" includes such things as the cost of taking depositions. Such costs include counsel's reasonable travel expenses getting to and from the deposition (regardless of whether the deposition is in-state or out-of-state), court reporter fees, translator fees, and transcript fees. They will also include the fees a party must pay the opposing expert for his deposition.

Practice Tip: What good does it do a defendant to make an offer of judgment if the plaintiff does not have the assets or money to pay Rule 68 sanctions? Rule 68 sanctions can be deducted from the judgment entered in plaintiff's favor (assuming the jury has awarded plaintiff something at trial). For this reason, an offer of judgment is a good tool to use in cases where Plaintiff will likely be awarded damages. Where defendant obtains a complete defense verdict, the Rule 68 sanctions can be incorporated into the court's final judgment, which the defendant can then record as a lien against plaintiff's property.

If you have questions regarding the information in this chapter, please contact the author.

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CHAPTER 7: INSURANCE COVERAGE AND BAD FAITH

INSURER'S DUTIES TO ITS INSURED

Generally, liability insurers owe three separate duties to their insureds. These are: (1) the duty to defend; (2) the duty to indemnify and pay claims against the insured that are covered by the policy; and (3) the duty to act in good faith and deal fairly with the insured. **Arizona Prop. & Cas. Ins. Guar. Fund v. Helme**, 153 Ariz. 129, 735 P.2d 451 (1987).

Duty to Defend and Indemnify

Standard liability policies require the insurer to defend the insured against all actions brought against the insured which are, judging by the allegations in the complaint, potentially within coverage of the policy. As a starting point, the insurer is obligated to defend only if it would be bound to indemnify the insured if the injured person prevailed upon the allegations of the complaint. **Paulin v. Fireman's Fund Ins. Co.**, 1 Ariz. App. 408, 410-11, 403 P.2d 555, 557-58 (1965), *overruled on other grounds* by **Kepner v. W. Fire Ins. Co.**, 109 Ariz. 329, 509 P.2d 222 (1973). However, an insurer's duty to defend the insured is independent of and not limited by the insurer's duty to indemnify. The duty to defend is much broader and may be triggered even though ultimately the insurer is relieved of its duty to indemnify (i.e., actually pay the claims brought against the insured). Generally, a liability insurer has only three options when requested to defend an insured. The insurer can defend unconditionally and without reservation of rights. The insurer can defend under a reservation of rights, i.e., agree to provide a defense, while reserving its right to deny coverage depending upon policy language and ultimate resolution of the claims. The third option is for the insurer to refuse to defend the insured entirely. As will be discussed below, an insurer that chooses to defend under a reservation of rights, or chooses not to defend the insured at all, incurs risks.

Once an insurer accepts and assumes the duty to defend the insured, even if done mistakenly or voluntarily, the insurer must carry out the duty competently, diligently and in good faith. An insurer that voluntarily assumes the defense of an insured can be sued for deficiencies in that defense even when there is no actual coverage for the claims under the policy. **Lloyd v. State Farm Mut. Auto. Ins. Co.**, 176 Ariz. 247, 250, 860 P.2d 1300, 1303 (Ct. App. 1992), **appeal after remand**, 189 Ariz. 369, 943 P.2d 729 (Ct. App. 1996). In *Lloyd*, the insured was driving a race car when the plaintiff was injured. Although State Farm covered other of the insured's vehicles, this particular race car was not insured under the policy. When the insured was sued, State Farm initially provided a defense to the insured but subsequently withdrew its representation when it determined that no coverage existed. The court held that State Farm's initial acceptance of the defense, although gratuitous, created an obligation to act with good faith and fair dealing during its defense, even though there was no coverage under the policy. Consequently, a liability insurer

can be found liable for bad faith even when the policy does not require the insurer to defend or indemnify the insured.

In some circumstances, multiple insurance companies can share the duty to defend. An insurer that has a duty to defend, but fails to do so, can be compelled to contribute its share of defense costs. *Home Indem. Co. v. Mead Reinsurance*, 166 Ariz. 59, 61-62, 800 P.2d 46, 48-49 (1990).

Although the language of many insurance policies suggests that the tender or exhaustion of policy limits relieves the insurer of the duty to defend, Arizona case law holds otherwise. The mere fact that a primary insurer has paid or tendered its policy limits does not extinguish the insurer's duty to defend the insured, nor does it relieve the insurer of its responsibility for continuing defense costs. *California Cas. Ins. v. State Farm Mut. Auto. Ins. Co.*, 185 Ariz. 165, 168, 913 P.2d 505, 508 (1996). Rather, an insurer's duty to defend terminates when the insurer tenders the policy limits **and** obtains from the claimant either a complete release or a covenant not to execute against the insured's assets. *Id.* Likewise, an insurer's tender of policy limits does not end the duty to defend in the absence of a judgment, settlement, or release completely protecting the personal assets of the insured. *Cont'l Cas. Co. v. Farmers Ins. Co. of Ariz.*, 180 Ariz. 236, 883 P.2d 473 (1994) (Farmers properly discharged its duty to defend, and owed no share of defense costs because Farmers had paid policy limits and secured release of all claims except claims covered by the excess carrier).

The federal district court in Arizona addressed whether an insurer could obtain reimbursement of defense fees incurred defending non-covered claims. While this is not a controlling state court decision, it is the federal court's prediction as to how the Arizona Supreme Court would "likely" rule on the issue. In *Great American Assurance Company v. PCR Venture of Phoenix LLC*, 161 F. Supp. 3d 778 (D. Ariz. 2015), Great American sought to recover the defense fees it paid in defending its insured in an underlying matter, after establishing that coverage did not exist. Great American defended pursuant to a reservation of rights while the coverage issue was litigated. A California decision, *Buss v. Superior Court*, 16 Cal.4th 35, 939 P.2d 766 (1997), supported the request for reimbursement. But the district court declined to follow *Buss* based, in part, on the distinction between the duties to defend and indemnify. The duty to defend is broader, and by allowing recovery of fees in defending claims ultimately deemed "non-covered," the duty to defend would *only* exist where coverage under the policy also existed. This would make the two duties coextensive, contrary to Arizona law. Further, the court held there was nothing in the policy language permitting such reimbursement, and it was not proper to read provisions into the contract to permit reimbursement against the insured's interest.

Damron Agreements

In Arizona, if an insurer refuses to defend the insured, the injured plaintiff and the insured might enter into a Damron agreement. This is an agreement whereby the plaintiff and insured stipulate to a judgment against the insured, the plaintiff agrees not to execute the judgment, and the insured assigns his or her rights against the insurer to the plaintiff. The agreement is named for

Damron v. Sledge, 105 Ariz. 151, 460 P.2d 997 (1969). The claimant then pursues the insured's bad faith claim against the insurance company.

The claimant/injured party can obtain a judgment against the insured in one of several different ways. First, the insured can withdraw his answer and simply allow a default judgment to be entered against him. Alternatively, the claimant/injured party and the insured can agree to a stipulated judgment. Yet another alternative is for the parties to conduct a "damages" trial where the insured does not contest liability or damages. In *Damron*, the insured simply withdrew his answer and permitted a default judgment to be entered against him.

When the claimant/injured party seeks to collect the judgment from the insurer, the battle becomes a coverage dispute. The injured party seeks to prove that there is coverage under the policy and that the insurer was wrong in denying coverage to its insured. If the injured party prevails on the coverage issue, he seeks to collect from the insurer the judgment he obtained against the insured. If the insurer was wrong in refusing to defend the insured, the insurer may be liable for the amount of the judgment, up to the policy limits. If the insurer previously received and rejected a policy limits demand, the insurer's liability could exceed the policy limits. **State Farm Mut. Auto. Ins. Co. v. Paynter**, 122 Ariz. 198, 204, 593 P.2d 948, 954 (Ct. App. 1979). In *Paynter*, the court of appeals indicated that the decisive factor in extending liability beyond the policy limits was not the insurer's refusal to defend, but rather its rejection of an offer to settle within policy limits.

Although the trial court may refuse to enforce collusive agreements, *Damron* agreements in and of themselves are not collusive. Collusion does not exist merely because an insured allows a default to be taken in order to escape liability and financial risk by assigning his/her claims against his/her insurer to the plaintiff. An insured, however, cannot enter into a *Damron* agreement with an injured plaintiff in every case. Only when his or her insurer breaches its contractual obligations (express or implied) to the insured is the insured excused from his or her obligations under the cooperation clause of the insurance policy. **State Farm Mut. Auto. Ins. Co. v. Peaton**, 168 Ariz. 184, 192, 812 P.2d 1002, 1010 (Ct. App. 1990). Thus, an insured cannot settle with an injured plaintiff simply because the insurer declines to pay more than the amount of coverage that the insured purchased. *Id.* In *Peaton*, coverage was completely voided because the insured breached the policy's cooperation clause under these circumstances.

If an insurer refuses to defend its insured, and the insured enters into a *Damron* agreement with the plaintiff, the insurer might be able to intervene in the underlying action to contest the damages or judgment sought by the injured plaintiff. **H.B.H. v. State Farm Fire & Cas. Co.**, 170 Ariz. 324, 823 P.2d 1332 (Ct. App. 1991) (insurer defending under reservation of rights may intervene and participate in damages hearing set by plaintiff's and insured's *Damron* agreement where insurer had upheld its duty to defend). An insurer loses its right to intervene in a damage hearing, however, if the insurer has breached its contractual duty to defend its insured. **Purvis v. Hartford Accident & Indem. Co.**, 179 Ariz. 254, 877 P.2d 827 (1994). In *Purvis*, the insurer had not defended because it never received a tender. The court allowed the insurer to intervene at the damages hearing following the insured's entry into a *Damron* agreement, because the insurer

had not breached its duty to defend the insured. An insurer breaches its contractual duty to defend its insured if the insured made an unequivocal and explicit demand to the insurer to undertake the defense. A demand for indemnification is not necessarily an expressed demand to defend.

Other Circumstances Where Damron Agreements are Allowed

Damron agreements between a contractor, its excess carrier, and plaintiff are valid. In ***Colorado Cas. Ins. Co. v. Safety Control Co., Inc.***, 230 Ariz. 560, 288 P.3d 764 (Ct. App. 2012), a subcontractor's insurer challenged a Damron agreement between the contractor, its excess carrier, and the plaintiff, alleging that the agreement was procured through fraud and collusion because it improperly shifted liability. The court held that a contractor and its excess carrier can validly enter into a Damron agreement with a plaintiff, assigning their rights against the subcontractor's primary insurer who refused to defend the contractor as an additional insured. But the primary carrier was not *automatically* bound to the amount of the stipulated judgment, because the stipulated judgment did not indicate that the subcontractor was liable, nor did it provide any facts that would indicate the loss was covered by the primary insurer's policy.

In ***Botma v. Huser***, 202 Ariz. 14, 39 P.3d 538 (Ct. App. 2002), the court of appeals held that, in keeping with Arizona's prohibition of the assignment of a legal malpractice claim, such a claim could not be assigned when packaged with the assignment of a bad faith claim against an insurance carrier. The court reasoned that while allowing assignment of legal malpractice claims in Damron-type situations, or in any situation, would result in more compensation for some individual plaintiffs, permitting such assignments would cause immeasurable damage to the attorney-client relationships, the tort system, the court system, and the public's sense of justice. The court did hold, however, that plaintiff's malpractice claim did survive the invalid assignment. In other words, the malpractice claim could not be validly assigned, but its original owner still had the right to bring it himself.

An insurer is bound to facts stipulated to under a Damron agreement except when the stipulated facts are determinative of coverage. ***Quihuis v. State Farm Mut. Auto. Ins. Co.***, 235 Ariz. 536, 538, 334 P.3d 719, 721 (2014). In *Quihuis*, the insured entered into a Damron agreement after the insurer refused to defend on the grounds that the insured did not own the vehicle involved in an accident. The Damron agreement stipulated the insured owned a vehicle and negligently entrusted that vehicle to a negligent driver. Because ownership of the vehicle was determinative of both liability and coverage, the Arizona Supreme Court held the insurer was not precluded from litigating ownership of the vehicle exclusively for coverage purposes.

Morris Agreements

A Morris agreement is like a Damron agreement, but it is entered into when the insurer has agreed to defend under a reservation of rights (rather than refused to defend entirely). The standard liability policy contains a cooperation clause which requires the insured to cooperate with the insurer and aid the insurer in defense of plaintiff's claim. So long as the insurer performs

its obligations, i.e., meets its duty to defend and indemnify, the cooperation clause remains in full force. Accordingly, the insured is prohibited from making his or her own settlement with the injured plaintiff, or entering into any type of Morris or Damron agreement. Such action by the insured constitutes a breach of the insurance policy. **United Serv. Auto. Ass'n v. Morris**, 154 Ariz. 113, 741 P.2d 246 (1987); see also **State Farm Mut. Auto. Ins. Co. v. Peaton**. However, the cooperation clause prohibits the insured from independently settling a case without the insurer's involvement only when the insurer unconditionally assumes the duty to defend and indemnify. When an insurer defends under a reservation of rights, the insured is relieved from his or her obligations under the cooperation clause, and the insured is free to enter into a Morris agreement with the injured plaintiff.

Munzer v. Feola, 195 Ariz. 131, 985 P.2d 616 (Ct. App. 1999), emphasizes that the insured may enter into a Morris agreement only with respect to those counts or claims that the insurer is defending under a reservation of rights. If the insurer admits coverage and defends the insured without reservation as to a claim, while defending the insured under reservation of rights on a different claim in the same action, the insured may enter a Morris agreement only as to the claim defended under reservation of rights. In *Munzer*, Smith & Feola was sued for malpractice; Admiral defended it under a reservation of rights. The reservation pertained only to damages for attorney's fees. Admiral recognized coverage for other counts, claims and damages under the policy, and fully defended on those claims. But Smith & Feola entered into a Morris agreement with the plaintiff and allowed judgment to be entered against it for \$389,000 on all claims. The court ruled that Smith & Feola breached the cooperation clause of the policy because the stipulated judgment was not limited to damages relating to the "non-covered" counts. The Morris agreement voided the insurance coverage for the general damages portion of the case.

The plaintiff and insured also cannot use a Morris agreement to establish facts necessary to obtain coverage. In other words, they cannot decide, stipulate or set forth facts pertinent to resolution of the coverage dispute with the insurer. Morris agreements are limited to admitting facts essential to determining the insured's liability to the injured plaintiff in the underlying tort action.

Our courts recognize the danger that an insured being defended under a reservation of rights might settle with the injured plaintiff for an inflated amount, or might agree to an adverse judgment in a frivolous case, merely to escape personal financial exposure or annoyance. Consequently, in the Morris context, the amount of damages to which the insured and plaintiff agree is binding on the insurer only if the insured or injured plaintiff can show that the settlement terms and damages are "reasonable and prudent." This involves evaluating the facts bearing on the insured's liability and the injured plaintiff's damages, as well as the risks of going to trial, and trying to answer "what a reasonably prudent person in the insured's position would have offered to settle the case on its merits." See *Morris*, *supra*.

An insured and an insurer cannot join in a Morris agreement to avoid the insurer's obligation to pay policy limits and pass liability in excess of those limits on to other insurers. **Leflet v. Redwood Fire & Cas. Ins. Co.**, 226 Ariz. 297, 247 P.3d 180 (Ct. App. 2011). In *Leflet*, the court held that such

agreements are invalid because the agreements fall outside the scope and protection of Morris. The overarching goal of Morris is to permit the insured and the insurer to balance their competing interests in an atmosphere of fairness and defined risk – not to promote the transformation of the underlying contract and tort claims into bad faith claims at inflated values. The court found the settlement in this case unusual because it involved multiple layers of insurance, and an insurer was a party to the agreement. The insurers who participated in the settlement paid less than their policy limits despite the fact that the stipulated judgment exceeded their contribution by more than twentyfold. The clear intent and effect of the agreement was to favor these insurers and burden the subcontractors' insurers.

Pueblo Santa Fe Townhomes Owners' Ass'n v. Transcon. Ins. Co., 218 Ariz. 13, 178 P.3d 485 (Ct. App. 2008), addressed an insurer's delay and resulting in prejudice to the insured in a Morris context. There, the insurer did not issue a reservation of rights letter until 18 months after the notice of claim. In the interim, the court in this construction defect suit set various deadlines to include completion of testing and ordered that consultants not appearing at the testing would be unable to conduct other testing. The insured was never informed of this deadline and no one attended on behalf of the insured. Damages against the insured were estimated at \$2.1 million. Prior to the construction defect trial, the insured entered into a Morris agreement with the plaintiff and stipulated to a \$1.1 million judgment. The court of appeals found that due to the insurer's delay and resulting prejudice to the insured, the insurer was estopped from asserting any coverage defenses against the claimant. *See also Penn-America Ins. Co. v. Sanchez*, 220 Ariz. 7, 202 P.3d 472 (Ct. App. 2008) (issue of fact regarding whether the issuance of a reservation of rights 10 months after agreeing to defend resulted in prejudice so that the coverage defenses were deemed waived); *Wilshire Ins. Co. v. Yager*, 2018 WL 5801537 at *8 (D. Ariz. Nov. 5, 2018) (finding no prejudice resulting from insurer's delay in sending a reservation of rights letter to Defendant and granting summary judgment to insurer on issues of waiver and estoppel).

In ***Mora v. Phoenix Indem. Ins. Co.***, 196 Ariz. 315, 996 P.2d 116 (Ct. App. 1999), the court addressed the insurer's right to intervene in a Morris context. The plaintiff made a policy limits demand against defendant's insurer. The insurer failed to respond in a timely manner, and did not offer the policy limits until after the deadline had passed. Consequently, the insured entered into a Morris agreement with the injured plaintiff. The insured agreed to allow a default judgment to be entered against her, and the injured plaintiff agreed not to execute the judgment against the insured's personal assets. The insured assigned her claim against the insurance company to the injured plaintiff. The injured plaintiff scheduled a damages hearing with the court. The insurer, having been notified of the Morris agreement, sought to intervene in the damages hearing. The injured plaintiff objected, contending that the insurer forfeited its right to intervene by failing to offer the policy limits by the deadline, and by failing to give equal consideration to the rights of its insured. The trial court denied the insurer's motion to intervene, but the Court of Appeals reversed, vacated the judgment, and remanded for another damages hearing. Because the insurer had defended the insured, it still had the right to intervene and participate in the damages hearing to contest reasonableness of plaintiff's damages. An insurer does not forfeit the right to intervene if it breaches the duty to give due consideration to settlement offers.

If the insurer at least meets the duty to defend, it is normally entitled to a comprehensive “reasonableness” hearing to contest the fairness of the stipulated amount. **Himes v. Safeway Ins. Co.**, 205 Ariz. 31, 66 P.3d 74 (Ct. App. 2003). In the reasonableness hearing, the insured has the burden of proving, by a preponderance of the evidence, that the settlement amount (or requested amount, if no set dollar amount was stipulated in the Morris agreement) would be reasonable after an arm’s length negotiation between adverse parties on the merits of the case. The evidence at the reasonableness hearing should help the court in “evaluating the facts bearing on the liability and damages aspects of claimant’s case, as well as the risks of going to trial.”

The language of *Morris* and *Mora* provides an uncertain guarantee. In **Associated Aviation Underwriters v. Wood, et al.**, 209 Ariz. 137, 98 P.3d 572 (Ct. App. 2004), the court limited the insurer’s right in the “reasonableness” hearing. There, the insurer had fully defended on a reservation of rights, but also filed a declaratory action seeking a ruling that there was no coverage. The insureds then entered a Morris agreement, specifying \$35 million in damages, and the trial court entered judgment for that amount. However, in the damages hearing, and then in the related declaratory action, the court refused to hear evidence regarding the insured’s underlying liability, which evidence had strong bearing on the coverage question. The trial court declared that the causation issues were “subsumed” in the underlying judgment based on the Morris agreement, and thus that evidence on that issue would not be allowed in the reasonableness hearing on damages. The ruling was also applied to the declaratory action, thus effectively eliminating the insurer’s ability to demonstrate the absence of coverage, although it had defended the insured in the underlying action. Thus, after **AAU v. Wood**, the carrier’s right to intervene in a reasonableness hearing has been compromised.

In **Arizona Prop. & Cas. Ins. Guar. Fund v. Martin**, 210 Ariz. 478, 113 P.3d 701 (Ct. App. 2005), the insured entered a Morris agreement, and a default judgment was entered. The insurer brought a declaratory judgment action, though, and was allowed to offer evidence there, which undermined the factual bases for the Morris agreement. Although the insured argued that *Morris* and **AAU v. Wood** called for a different ruling, the court of appeals upheld the trial court’s decision to allow the evidence, which resulted in summary judgment for the carrier in the declaratory action. Thus, the extent to which an insurer may present evidence at a reasonableness hearing remains unclear.

In **Monterey Homes Arizona, Inc. v. Federated Mut. Ins. Co.**, 221 Ariz. 351, 212 P.3d 43 (Ct. App. 2009), the court addressed whether the insured could extinguish the insurer’s subrogation rights when settling with the plaintiff and agreeing to “no indemnity or defense payments.” There, Federated was defending under a reservation of rights and did not consent to the settlement. Federated sought to intervene in order to be subrogated for its defense fees. The court remanded to determine if plaintiff could show Federated had notice of settlement and that it was reasonable. If so, Federated’s subrogation claim was extinguished by its insured’s settlement with plaintiff.

As with Damron agreements, the policy limits are an insurer’s maximum exposure, provided that the insurer continues to provide a defense (even under a reservation of rights) and has not

rejected a policy limits demand or acted in bad faith. If the insurer acts in bad faith, it might be liable for paying any settlement or judgment in excess of the policy limits, as well as punitive damages, for committing the tort of bad faith.

VALIDITY OF POST-LOSS ASSIGNMENTS

Typically, an insured cannot assign the rights, benefits, or protections of their insurance policy unless the insurer explicitly consents. This non-assignment rule is based on the insurer's right to choose whom it insures. In *Farmers v. Udall*, however, the Arizona Court of Appeals held that this non-assignment rule does not apply to "post-loss assignments." *Farmers Ins. Exch. v. Udall*, 245 Ariz. 19, 424 P.3d 420 (Ct. App. 2018). Because post-loss assignments "do not grant [assignees] any rights greater than those held by the insureds-assignors," the court reasoned, the typical rule against assignment is inapplicable. There, Farmers insured several homeowners against potential water damage. The insureds' policies each contained a clause stating that their "interest in this policy [could] not be transferred to another person without [Farmers'] written consent." Nonetheless, after several policyholders suffered water damage to their homes, they quickly signed an agreement that transferred their "rights, benefits, proceeds, and causes of action" to EcoDry, an Arizona home-restoration company. EcoDry, after repairing the insureds' water-damaged homes, submitted its invoices directly to Farmers; and in each case, Farmers refused to pay the full amount of the invoice, arguing that EcoDry had expended unreasonable, unusual, or non-customary charges. After failing to recover the full amount of their invoices, EcoDry – standing in the shoes of the original policyholders – sued Farmers under the terms of the policies. Farmers moved to dismiss EcoDry's complaint, arguing their insureds' post-loss assignments were invalid and that EcoDry lacked standing to enforce the terms of the policies. The Court of Appeals affirmed the trial court's denial of Farmers' motion to dismiss, holding that Arizona law allows policyholders to freely assign their rights, benefits, and causes of action *after* the loss has occurred. However, because EcoDry only asserted a claim for breach of contract, the Court did not decide whether a potential bad faith claim is assignable.

DUTY OF GOOD FAITH AND FAIR DEALING (BAD FAITH)

Definition

The basis of the tort of bad faith is breach of the covenant of good faith and fair dealing implied in every contract. According to *Rawlings v. Apodaca*, 151 Ariz. 149, 153, 726 P.2d 565, 569 (1986), "neither party will act to impair the right of the other to receive the benefits which flow from their agreement or contractual relationship." If there is such an impairment, the aggrieved party may seek not only contractual but also tort damages.

Bad faith actions are generally classified as either first-party or third-party bad faith claims. The classifications depend on the type of insurance coverage at issue.

First-Party Bad Faith Claims

First-party claims arise when insurers contract to pay benefits directly to an insured, e.g., health, accident, homeowners, fire, disability, UM, UIM, med-pay, collision, etc. The plaintiff/insured claims that the insurer acted in bad faith in denying him coverage or refusing to pay him benefits.

Third-Party Bad Faith Claims

Third-party claims occur when an insurer contracts to defend and indemnify an insured against a claim by a third party. An insured can bring a third-party claim in the event he is subjected to excess liability by reason of an insurer's bad faith refusal to settle. Likewise, a third party bad faith claim can be brought by an assignee of the insured (such as the injured plaintiff in the underlying action) who obtains a right to bring a bad faith claim against the insurer.

Workers' Compensation Bad Faith

Per *Hayes v. Cont'l Ins. Co.*, 178 Ariz. 264, 872 P.2d 668 (1994), worker's compensation carriers are subject to liability for common law bad faith claims separate and apart from any statutory penalties contained within the Arizona Workers' Compensation statutes.

Because the Industrial Commission has exclusive jurisdiction to determine whether an injured worker is entitled to benefits and the amount of those benefits, the worker must first seek a compensability determination from the Industrial Commission before pursuing a claim of bad faith. In *Merkena v. Fed. Ins. Co.*, 237 Ariz. 274, 349 P.3d 1111 (Ct. App. 2015), plaintiff failed to challenge Federal's decision to terminate her benefits with the Industrial Commission and instead sued Federal for bad faith. The trial court granted Federal's motion for summary judgment on the ground that plaintiff failed to exhaust her administrative remedies. The court of appeals affirmed. It held that the Industrial Commission has exclusive jurisdiction to adjudicate a claim for denial of benefits. The superior court only had jurisdiction to consider allegations of bad faith claim handling since this did not arise out of Plaintiff's employment.

In *Doneson v. Farmers Ins. Exch.*, 245 Ariz. 484, 431 P.3d 198 (Ct. App. 2018), the Arizona Court of Appeals upheld an exclusion precluding med pay benefits "if workers' compensation benefits are required," despite the insured's reimbursement of the workers' compensation insurer. In *Doneson*, Plaintiff was injured in a car accident. Part of Plaintiff's medical bills were paid by workers' compensation, but he had to repay that amount, per the workers' compensation statute, when he recovered from the third-party tortfeasor. Plaintiff then sought medical payment from his own carrier, Farmers. Farmers denied the claim because its med pay provision excluded "bodily injury...during the course of employment if workers' or workmen's compensation benefits are required." Plaintiff argued that because he had to repay the benefits he received from workers' compensation, they were not "required." The Court of Appeals found in favor of Farmers, finding that the policy language was not reasonably susceptible to Plaintiff's interpretation.

Surety Bad Faith

In *S&S Paving & Construction, Inc. v. Berkley Regional Ins. Co.*, 239 Ariz. 512, 372 P.3d 1036 (Ct. App. 2016), the court of appeals held that a surety on a public bond issued under the Little Miller Act cannot be sued for bad faith. The City of Prescott retained Spire Engineering (“Spire”) as a general contractor for a public construction project. Berkley issued a payment bond for the project. S&S was a subcontractor for Spire and notified Berkley that it had not been paid for its work. When Berkley refused to pay S&S because the claim was untimely, S&S sued Berkley for breach of contract and bad faith. The statute of limitations barred the contract claim. The trial court also dismissed S&S’s bad faith claim concluding there was no contractual relationship or special relationship for the claim to survive. S&S appealed. The court of appeals affirmed. Arizona adopted the Little Miller Act (“Act”) in A.R.S. § 34-221. The Act requires contractors on public works projects to furnish payment bonds to protect claimants who supply labor and materials on a public project. And the statutory scheme for recovery under that bond is the claimant’s exclusive remedy. The court would not graft a common law remedy onto a statutory scheme that includes complete relief and specific conditions precedent to recovery. This result was consistent, said the court, with the way private project claimants are treated under the state’s mechanic’s lien laws.

STANDING TO ASSERT A BAD FAITH CLAIM

Generally, the named insured under the policy and any individual who becomes a “covered person” under the policy’s provisions can assert a claim for bad faith. The injured plaintiff in a third-party tort action does not have standing to bring a bad faith action against a defendant’s insurance company, absent an assignment of rights from the insured.

In *Fobes v. Blue Cross and Blue Shield of Arizona, Inc.*, 176 Ariz. 407, 861 P.2d 692 (1993), the court held an insured’s wife could not bring a bad faith action against the insurer for the denial of health benefits that led to the death of her husband, because she was not a covered person under the provisions of his policy. The insurer issued the health insurance policy solely to the husband, and the wife had her own separate policy. Accordingly, the wife had no standing to bring an action for bad faith.

In *Enyart v. Transamerica Ins. Co.*, 195 Ariz. 71, 985 P.2d 556 (Ct. App. 1998), the court ruled that under specific circumstances, the injured plaintiff in a tort action can become a “covered person” and have standing to bring a bad faith action. In *Enyart*, plaintiff was a third-party tort claimant. Plaintiff entered into a settlement agreement with the defendants and their insurers whereby plaintiff was to receive \$375,000 from an annuity as part of a structured settlement agreement. The settlement agreement called for the defendants’ insurance company to obtain a back-up annuity policy as a guarantee against the insolvency of the primary annuity company. The insurer never obtained the backup annuity and, as luck would have it, the primary company became insolvent. The plaintiff then sued the defendants’ insurance company that was supposed to purchase the backup annuity policy. The court held that the structured settlement agreements created a “special relationship” between the plaintiff and the “guarantor” insurance company.

In *Leal v. Allstate Ins. Co.*, 199 Ariz. 250, 17 P.3d 95 (Ct. App. 2000), the court held that Allstate's gratuitous offer to treat the Leals as "customers" did not equate to a promise to give equal consideration to the Leals' interest. The Leals were involved in a minor-impact accident with an Allstate insured. Allstate advised the Leals they did not need to retain an attorney and they were considered "customers." Allstate further promised them good customer service, including a promise that Allstate would discuss fair payment of their claim. Allstate made a settlement offer which the Leals rejected. Subsequently the Leals hired an attorney. The case was arbitrated and appealed and the Leals received \$23,000 at trial. The Leals sued Allstate, claiming Allstate breached its assumed or implied duty of good faith and fair dealing, and that Arizona mandatory liability law created a duty for Allstate to negotiate their claims fairly and in good faith.

The court found that Allstate's offer to treat the Leals as customers did not create any sort of "special relationship" from which the duty of good faith and fair dealing could be implied. There was no special contract between the Leals and Allstate. The court also rejected the Leals' argument that this duty was imposed by law since accident victims are the intended beneficiaries of insurance statutes. The court held accident victims are not the intended beneficiaries of every policy provision, and mandatory insurance laws do not require an insured to pay a third-party claimant until a judgment is entered.

STATUTE OF LIMITATIONS

Bad faith claims are subject to a two-year statute of limitations. In a first party claim for bad faith, the statute of limitations does not begin to run until the insurer intentionally denies, fails to process, or fails to pay a claim without a reasonable basis. *Ness v. W. Sec.*, 174 Ariz. 497, 851 P.2d 122 (Ct. App. 1992). According to *Thompson v. Property & Casualty Ins. Co. of Hartford*, 2015 WL 1442795 (D. Ariz. March 30, 2015), an unpublished decision, the statute begins to run on the date of the original denial for coverage, even if the insurance company is asked to reconsider. There, Plaintiff claimed his home was burglarized between July 24, 2009 and July 31, 2009. After submitting a claim and sitting for an examination under oath, Hartford denied his claim on May 3, 2011, after it determined that Plaintiff intentionally concealed or misrepresented material facts and circumstances regarding his claim. Thereafter, Plaintiff's counsel wrote to Hartford requesting a revised decision. On September 11, 2012, Hartford sent Plaintiff's counsel another letter confirming its original denial. Thereafter, on October 29, 2013, Plaintiff sued for breach of contract and bad faith. Hartford moved for summary judgment because Plaintiff had not filed his bad faith claim within two years from the date of the original denial letter, May 3, 2011. Plaintiff's counsel argued the statute of limitations should begin on the date of Hartford's second letter, September 11, 2012. The court agreed with Hartford, and held the statute of limitations ran from Hartford's first denial letter because it had unequivocally denied Plaintiff coverage under the policy. After Hartford had completed its investigation, it determined there was no coverage. The court stated there was no room for ongoing negotiation in this statement.

In a third-party bad faith failure-to-settle claim, the statute of limitations does not begin to run until the underlying judgment becomes final and non-appealable. *Taylor v. State Farm Mut. Auto. Ins. Co.*, 185 Ariz. 174, 179, 913 P.2d 1092, 1097 (1996).

STANDARDS FOR IMPOSING LIABILITY FOR BAD FAITH CLAIMS

First-Party Bad Faith Standard – “Fairly Debatable” or “Reasonable Basis”

For years, Arizona courts would not hold an insurer liable for bad faith if the insurer challenged a first party claim that was fairly debatable or if it denied a claim so long as the insurer had a reasonable basis for its action. *Filasky v. Preferred Risk Mut. Ins. Co.*, 152 Ariz. 591, 734 P.2d 76 (1987); *Clearwater v. State Farm Mut. Auto. Ins. Co.*, 164 Ariz. 256, 792 P.2d 719 (1990). Even if ultimately wrong in questioning a claim, the insurer could not be held liable in bad faith if a reasonable basis existed for denying the claim. *Aetna Cas. & Sur. Co. v. Superior Court*, 161 Ariz. 437, 778 P.2d 1333 (Ct. App. 1989). Whether a claim is fairly debatable, however, depends upon the particular facts of the case.

A few significant decisions have held that an insurer might still be held liable for bad faith even if a claim is “fairly debatable,” and even if the insurer might have had a reasonable basis for its decision. Likewise, the fact that the insurer may have ultimately paid the contract benefits due under the insurance policy does not shield the insurer from a claim for bad faith. An insurer may be liable for bad faith not because of the ultimate decision it reached, but because of the manner and method it utilized in reaching its decisions. *Rawlings, supra*.

In *Zilisch v. State Farm Mut. Auto. Ins. Co.*, 196 Ariz. 234, 995 P.2d 276 (2000), the Arizona Supreme Court significantly limited the “fairly debatable” defense. After an automobile accident, Zilisch made a claim for underinsured motorist benefits. State Farm initially made no offer to settle the UIM claim, questioning whether Zilisch’s injuries and damages were significant enough to trigger UIM benefits. State Farm contended that the value of Zilisch’s UIM claim was fairly debatable. However, the Supreme Court held that even if a claim is fairly debatable, an insurer has the obligation to immediately conduct an adequate investigation, act reasonably in evaluating the claim, and act promptly in paying a legitimate claim. This obligation exists regardless of whether a claim is fairly debatable. Thus, an insurance carrier may be liable for bad faith on a fairly debatable claim if it did not act in good faith or act promptly in evaluating and investigating the claim. See also *Twin City Fire Ins. Co. v. Burke*, 204 Ariz. 251, 63 P.3d 282 (2003).

Knoell v. Metro. Life Ins. Co., 163 F. Supp. 2d 1072 (D. Ariz. 2001), held that the issue of whether a claim is fairly debatable is not always a question for the jury. In *Knoell*, the insured sued a disability insurer for delay in paying disability benefits, alleging breach of contract and bad faith and seeking punitive damages. The carrier, in processing the claim, had had a round table discussion where more than one person evaluated the status of the claim. The district court held that under Arizona law, the total disability insurance claim was fairly debatable, and thus delay in payment while the insurer investigated was not bad faith conduct. The court noted that when a claim is fairly debatable, the insurance company cannot be liable for acting in bad faith by declining to pay such claim immediately, citing *Lasma Corp. v. Monarch Ins. Co.*, 159 Ariz. 59, 764 P.2d 1118, 1122 (1988). The court also held that the company keeping statistics on resolution of claims and looking to their “bottom line” were reasonable internal procedures that did not

constitute bad faith. This was particularly true given the fact that plaintiff offered no evidence that the carrier's behavior ever resulted in the denial of a legitimate claim.

Young v. Allstate Ins. Co., 296 F. Supp. 2d 1111 (D. Ariz. 2003), held that generally when an insurer challenges claims that are fairly debatable, its belief in fair debatability is a question of fact to be determined by the jury under Arizona law. However, if an insured offers no significantly probative evidence that calls into question the insurer's belief in fair debatability, the court may rule on the issue as a matter of law.

In **Lennar Corp. v. Transamerica Ins. Co.**, 227 Ariz. 238; 256 P.3d 635 (Ct. App. 2011), an insurer filed a complaint seeking a declaratory judgment that it owed no duty to defend or indemnify. The insurer prevailed on summary judgment but the judgment was reversed on appeal. In a subsequent bad faith action, the insurers again moved for summary judgment, arguing that the trial court's initial grant of summary judgment (though later reversed) established that the insurer had a reasonable basis to deny the claim, that the claim was "fairly debatable" as a matter of law, and automatically defeated the insured's bad faith claim. The court refused to hold as a matter of law that the erroneous granting of summary judgment in the insurers' favor created a reasonable basis to deny coverage, and held that whether the insurers acted reasonably in challenging the claims was a question for the jury.

In **Deese v. State Farm Mut. Auto. Ins. Co.**, 172 Ariz. 504, 838 P.2d 1265 (1992), the Arizona Supreme Court held that an insurer may be found liable for bad faith even if it did not breach the contractual provisions of the policy. A breach of an express covenant of the policy is not a prerequisite to the tort of bad faith. In *Deese*, the insurer paid the contractual benefits to which plaintiff was entitled. However, the plaintiff also proved that the insurer systematically reduced claims through the deliberate use of selected chiropractors who predictably recommended a reduction of chiropractic expenses. Plaintiff contended that the insurer's claims review process regarding chiropractic care was a sham. The court held that even though the insurer did not breach its contractual duty to pay benefits, the insured/plaintiff was still entitled to receive the security of knowing that she would be dealt with fairly and in good faith. *Deese* stands for the proposition that even when an insurer pays all contractual benefits due under a policy, the company can still be found in bad faith based upon **the manner** in which any coverage or payment decision was made.

Failing to conduct an adequate investigation may constitute bad faith if further investigation would have disclosed other relevant facts or would have influenced the decision-making process. See **Aetna Cas. & Sur. Co. v. Superior Court**, 161 Ariz. 437, 778 P.2d 1333 (Ct. App. 1989). An insurer's subjective bad faith may be inferred from a flawed investigation or an improper investigation. However, to establish a claim for bad faith or unreasonable failure to investigate, the plaintiff must demonstrate an unreasonable action in processing a claim.

Insurance companies can also be found liable for bad faith if they fail to properly advise their insureds of relevant, beneficial insurance policies. **Nardelli v. Metro. Group Prop. & Cas. Ins. Co.**, 230 Ariz. 592, 277 P.3d 789 (Ct. App. 2012). In *Nardelli*, plaintiffs sued defendant insurer when the insurer insisted on repairing, instead of totaling, plaintiffs' heavily damaged vehicle. At trial

plaintiffs argued that the defendant was liable for bad faith because the insurer failed to alert plaintiffs to two beneficial provisions in the insurance policy, including one for appraisal. The plaintiffs produced evidence that the insurer had internally discussed invoking the appraisal clause but decided against it. The court ruled that this was sufficient for bad faith and held that while an insurer does not have an obligation to explain every fact and provision in a policy, insurers do have a duty to “inform the insured about the extent of coverage and his or her rights under the policy” in a way that is not misleading.

Recently, the Arizona Supreme Court accepted review and is considering the issue of whether it is proper to allow the jury to consider a contract defense such as a waiver to undermine the plaintiff’s showing of bad-faith elements. ***Cavallo v. Phoenix Health Plans, Inc.***, 250 Ariz. 525, 482 P.3d 404 (Ct. App. 2021). There, plaintiffs alleged that the defendant health plan unreasonably denied Mr. Cavallo’s claim for a drug he needed to prevent his MS from relapsing. The health plan argued, in part, that Mr. Cavallo waived the claim by canceling the prior authorization request after it was made and because his provider failed to provide necessary information to initiate and process the claim. The court of appeals upheld the waiver instruction the trial court gave, which told the jury that, “by accepting performance known to be deficient, a party has waived the right to reject the contract on the basis of that performance. If Mr. Cavallo has waived a promised performance, then [Phoenix Health] is no longer bound to perform on that promise and Mr. Cavallo is not entitled to damages for that particular non-performance,” and that the health plan had the burden of proving waiver. Plaintiffs argued such an instruction had no place in a case alleging breach of the covenant of good faith and fair dealing. The health plan argued contract defenses like waiver can apply in bad faith cases and that the instruction did not mislead the jury in to believing that the covenant of good faith and fair dealing could be waived or that waiver constituted an absolute defense. Review was granted on March 1, 2022, and a Supreme Court decision is expected in due course.

Third-Party Bad Faith Standard – “Equal Consideration”

In ***Farmers Ins. Exch. v. Henderson***, 82 Ariz. 335, 313 P.2d 404 (1957), the court established the “equal consideration” test for determining whether an insurance company is liable for bad faith in failing to settle third-party claims against its insured. To be in good faith, an insurer must consider its insured’s interests equally with its own in making a decision whether to settle within policy limits. Failure to settle in good faith renders an insurer liable for the full amount of the judgment, even in excess of the policy limits.

An insurer must “evaluate[] a claim without looking to the policy limits[,] as though it alone would be responsible for the payment of any judgment rendered on that claim, it views that claim objectively, and in doing so renders ‘equal consideration’ to the interests of itself and the insured.” ***General Accident Fire & Life Assurance Corp. v. Little***, 103 Ariz. 435, 442 P.2d 690, 697 (1968).

No intentional or fraudulent motive is necessary for a finding that the insurer has failed to give the required equality of consideration to the interests of the insured. ***State Farm Auto Ins. Co. v.***

Civil Serv. Employees Ins. Co., 19 Ariz. App. 594, 509 P.2d 725 (1973). The insurer “will be liable to its insured for any judgment subsequently entered against the insured in excess of policy limits unless the insurer shows that an application of the equality of consideration test would not have required acceptance of the settlement offer.”

The insurer’s duty to give equal consideration to the interest of its insured may arise even absent a demand or request to settle on the claim if there is a high probability that the recovery could exceed the policy limits. **Fulton v. Woodford**, 26 Ariz. App. 17, 545 P.2d 979 (Ct. App. 1976). In **Fulton**, the court held the duty to give equal consideration arises when a conflict of interest exists between the insurer and the insured. A conflict of interest normally arises when an offer is made by the claimant to settle within policy limits. In the absence of a demand or a request to settle within policy limits, or within the financial means of the insured plus the policy limits, a conflict of interest exists giving rise to the duty to give equal consideration to the interest of the insured where there is a high probability of claimant recovery, and a high probability that such a recovery will exceed policy limits.

Often, third-party claimants (or their attorneys) threaten an insurer with bad faith if the insurer does not respond to a demand within a limited period of time. In **Miel v. State Farm Mut. Auto. Ins. Co.**, 185 Ariz. 104, 912 P.2d 1333 (Ct. App. 1995), the court of appeals held that an insurer who does not respond to a settlement demand within the prescribed time limit does not necessarily act in bad faith. Certain factors must be considered in determining whether the insurer acted in bad faith. The reasonableness of the insurer’s conduct must be judged in light of all the facts surrounding the demand. The length of time that elapsed after the deadline and the reasons plaintiff insisted on a compliance deadline are relevant factors to be weighed in determining whether the insurer acted reasonably. The court also emphasized that there is no cause of action for mere negligence against an insurer who mishandles a file or makes mistakes in handling the file. Liability lies only if the insurer’s conduct amounts to bad faith.

Recently, the Arizona Supreme Court held that under a policy without a contractual duty to defend, the objective reasonableness of the insurer’s decision to withhold consent is assessed from the perspective of the insurer, not the insured. The insurer must independently assess and value the claim, giving fair consideration to the settlement offer, but need not approve a settlement simply because the insured believes it is reasonable. **Apollo Educ. Grp., Inc. v. Nat’l Union Fire Ins. Co. of Pittsburgh, PA**, 250 Ariz. 408, 409–10, 480 P.3d 1225, 1226–27 (2021). There, a directors and officers policy contained no duty to defend, and thus imposed no duty on the insured to cooperate with the insurer’s defense. Instead, the company was to defend itself against any claims. A class action was filed and a settlement reached. The insurer refused to consent to the settlement. The company entered into the settlement, paid out of pocket, then sued the insurer for breach of contract and bad faith. The district court granted the insurer summary judgment. The company appealed. The Ninth Circuit certified to the Arizona Supreme Court the question of how to analyze the breach of contract claim. The Supreme Court answered that the policy language spoke in terms of the insurer’s perspective. It explained that “where the insurer has no control over the litigation, it is more reasonable that the insurer’s perspective, which necessarily includes consideration of the strength of the underlying claim in accord with

its interest in avoiding unnecessary payment, should prevail. Of course, the converse would be true where the insurer has control over the defense. The terms as agreed to by these parties reflects this reasonable understanding of the overall nature and context of the contract.” The court explained the insurer’s obligation as follows:

To act reasonably, the insurer is obligated to conduct a full investigation into the claim. The Court has described the insurer's role as “an almost adjudicatory responsibility.” To carry out this responsibility, the insurer “evaluates the claim, determines whether it falls within the coverage provided, assesses its monetary value, decides on its validity and passes on payment.” *Id.* The company may not refuse to pay the settlement simply because the settlement amount is at or near the policy limits. Rather, the insurer must fairly value the claim. The insurer may, however, discount considerations that matter only or mainly to the insured—for example, the insured's financial status, public image, and policy limits—in entering into settlement negotiations. The insurer may also choose not to consent to the settlement if it exceeds the insurer's reasonable determination of the value of the claim, including the merits of plaintiff's theory of liability, defenses to the claim, and any comparative fault. In turn, the court should sustain the insurer's determination if, under the totality of the circumstances, it protects the insured's benefit of the bargain, so that the insurer is not refusing, without justification, to pay a valid claim.

Under this formulation, an insurer has every incentive to act prudently, both for itself and its insured. An insurer is unlikely to reject a settlement if the objective value of the claim is commensurate with the settlement, for it will likely have to pay out regardless. Should the insurer act unreasonably in rejecting the settlement, the insured may challenge that determination, and may file a bad-faith tort action if circumstances warrant, as Apollo is pursuing here.

250 Ariz. at 414-15, 480 P.3d at 1231-32 (internal citations omitted).

When an insurer is faced with multiple claims in excess of its policy limits, the insurer may meet its duty to equally consider settlement offers by interpleading the limits of the policy. ***McReynolds v. Am. Commerce Ins. Co.***, 225 Ariz. 125, 235 P.3d 278 (Ct. App. 2010). In *McReynolds*, the injured plaintiff filed a \$25,000 offer of judgment, which was equivalent to the amount of the insured’s policy limit. After the carrier unsuccessfully attempted to resolve lien issues with plaintiff’s medical providers, the offer lapsed, and the carrier interpleaded the \$25,000 limits, naming the plaintiff and the lienholders as defendants. At trial, the plaintiff

obtained a \$469,110 judgment. After trial, the insured assigned any potential claims against the carrier to the plaintiff in exchange for a covenant not to execute. The plaintiff sued the carrier for failing to give equal consideration to the insured's interests by failing to accept the offer of judgment. The trial court granted summary judgment in favor of the carrier and plaintiff appealed. The court of appeals upheld summary judgment, holding that "when an insurer is faced with multiple claims in excess of its policy limits . . . an insurer satisfies its duty in such situations when it promptly and in good faith interpleads its policy limits into court, naming all known claimants in the action, and continues to provide a defense to the insured."

Insurers should still use caution when relying on the interpleader opinion. An interpleader is not a guarantee of a full release of the insured (although it should always be requested). The interpleader satisfies the insurer's obligation to indemnify and releases the insurer from liability, but does not necessarily release the insured. The insured might still face personal exposure as to all claims not fully satisfied through the interpleader. Finally, an interpleader does not relieve the insurer of its obligation to defend.

LIABILITY FOR BAD FAITH LITIGATION CONDUCT

An insurer that objects to coverage may not use that as an excuse to disregard its claims-handling responsibilities pending resolution of the coverage issue. *Lennar Corp. v. Transamerica Ins. Co.*, 227 Ariz. 238, 245, 256 P.3d 635 (Ct. App. 2011); *see also Tucson Airport Auth. v. Certain Underwriters at Lloyd's, London*, 186 Ariz. 45, 918 P.2d 1068 (Ct. App. 1996). While Arizona recognizes a "continuing" duty of good faith and fair dealing through the course of litigation, Arizona has not directly addressed whether litigation conduct may be introduced at trial as evidence of bad faith. Courts in many jurisdictions have prohibited the introduction of litigation conduct at trial as evidence of bad faith. *See, e.g., Timberlake Constr. Co. v. U.S. Fid. & Guar. Co.*, 71 F.3d 335 (10th Cir. 1995); *but see White v. W. Title Ins. Co.*, 40 Cal. App. 3d 870, 886, 221 Cal. Rptr. 509, 517, 710 P.2d 309, 317 (1985), superseded by statute. Some courts have admitted such evidence in unique situations. In the jurisdictions that have admitted evidence of post-filing conduct, the evidence was limited to extremely egregious conduct, settlement negotiations, or the *insurer's* conduct rather than the attorney's litigation conduct. Given this unsettled area of the law in Arizona, insurers and their attorneys should use caution once litigation commences, particularly when it comes to settlement negotiations, as this might be later admitted as evidence of bad faith.

DISCOVERY OF MEDICAL EXPERT'S PREVIOUS REPORTS

In *Cheatwood v. Christian Brothers Services*, 2018 WL 287389 (D. Ariz. Jan. 4, 2018), a bad faith case arising from a health benefits claim, the Arizona District Court quashed portions of the Insureds' subpoena to a medical expert which sought: (a) all medical review reports prepared by the medical expert during the last five years, and (b) the number of medical necessity reviews the expert performed for plaintiffs versus defendants during the last five years. The court reasoned that, although evidence of bias may be relevant to a bad faith claim, the expert's past reviews were irrelevant because "they involve[d] facts and circumstances different than the facts

and circumstances involved in this case.” Further, it would be unsurprising if the expert’s reviews were favorable to the insurer because insurers likely seek medical necessity reviews only on questionable claims. Lastly, the number of reviews the expert conducted on plaintiffs versus defendants was irrelevant, according to the court, because the expert did know, at the time he was doing a review, whether it was for a defendant or plaintiff.

INSURER LIABILITY FOR ACTS OF INDEPENDENT ADJUSTING AGENCY

An independent agency hired by an insurance company to investigate a claim owes no independent duty to the insured, and consequently, the independent adjusting agency cannot be held liable to the claimant for bad faith. Instead, the independent adjuster’s conduct is imputed to the insurance company, and the insurance company remains liable to the claimant on the basis of the conduct of the independent adjuster. If the independent adjuster mishandles the claim, the insurance company has the same liability for bad faith as if an employee of the insurance company had mishandled the claim. *Meineke v. GAB Bus. Servs., Inc.*, 195 Ariz. 564, 991 P.2d 267 (Ct. App. 1999). As the court stated in *Walter v. Simmons*, 169 Ariz. at 236, 818 P.2d at 221 (Ct. App. 1991), an insurer’s duty of good faith is non-delegable, and consequently, the insurer remains vicariously liable for the claims processing performed by an independent adjuster.

TPA AND ADJUSTER LIABILITY FOR AIDING AND ABETTING INSURER BAD FAITH

Insureds may not assert bad faith aiding and abetting claims against a TPA (third party administrator) or its adjusters because the duty of good faith and fair dealing arises from the insurance policy (contract), and neither the TPA nor its adjuster has privity of contract with the insured. *Centeno v. Am. Liberty Ins. Co.*, 2019 WL 4849548 (D. Ariz. Oct. 1, 2019). *Centeno* arises from a workers’ compensation claim. The claim was initially accepted and then American Liberty denied the claim because of conflicting information on whether the injury arose from a work accident. Centeno filed an industrial claim and eventually the Industrial Commission of Arizona ruled in her favor and found the claim compensable. Subsequently she sued American Liberty and the TPA for bad faith, and raised aiding and abetting claims against the TPA and its adjuster. The court agreed dismissed the bad faith and aiding and abetting claims against the TPA and adjuster because no contractual relationship existed between the TPA, its adjuster and the insured. The court did note, however, that properly pled, such claims could survive against entities that have no contractual relationship. A viable claim requires an allegation of “some action . . . separate and apart from the facts giving rise” to the bad faith claim against the insurer. In this case, Centeno failed to plead facts separate and apart from those alleged against American Liberty. In the future, plaintiffs’ counsels will certainly heed the court’s warning and plead facts to defeat a motion to dismiss.

PHYSICIAN LIABILITY FOR AIDING AND ABETTING INSURER BAD FAITH

A physician performing an independent medical exam (IME) cannot be held liable for aiding and abetting an insurance carrier in committing bad faith if the physician had no actual or inferred knowledge of the carrier's intent to commit bad faith. **Federico v. Maric**, 224 Ariz. 34, 226 P.3d 402 (Ct. App. 2010). In *Federico*, the insurer retained Dr. Maric to conduct an IME of plaintiff. Dr. Maric found no objective evidence of physical injury or pain and suggested plaintiff was malingering. The insurer denied the plaintiff's claim. The plaintiff sued Dr. Maric, alleging he aided and abetted the insurer's bad faith denial of plaintiff's claim. The trial court granted Dr. Maric summary judgment, and the court of appeals affirmed. To show that Dr. Maric aided and abetted the insurer in committing bad faith, plaintiff had to prove the following elements: (1) the insurance company must commit a tort that causes the plaintiff injury; (2) the defendant must know the primary tortfeasor's conduct constitutes a breach of duty; and (3) the defendant must substantially assist or encourage the primary tortfeasor in the achievement of the breach. Even assuming the truth of plaintiff's allegation that Dr. Maric performed an inadequate IME and knew his report would adversely affect the outcome of plaintiff's claim, there was no evidence that Dr. Maric knew the insurer intended to act in bad faith, nor any evidence of a strategy to assist the insurer in acting in bad faith.

FAILURE TO PAY UNACCEPTED SETTLEMENT OFFER AMOUNT

In a first party case, when there is no dispute as to liability and coverage is not contested, but the amount of the loss is disputed, insurance companies have a duty to promptly pay the undisputed amount of the claim. **Borland v. Safeco Ins. Co., of Am.**, 147 Ariz. 195, 709 P.2d 552 (1985); see also **Filasky v. Preferred Risk Mut. Ins. Co.**, 152 Ariz. 591, 734 P.2d 76 (1987). Failure to do so could constitute bad faith. However, an insurer does not breach the covenant of good faith and fair dealing when it fails to pay, in advance, the amount of an unaccepted settlement offer for personal injuries prior to arbitration and prior to obtaining a complete release. **Voland v. Farmers Ins. Co. of Ariz.**, 189 Ariz. 448, 943 P.2d 808 (Ct. App. 1997). In *Voland*, the claimant made a claim for uninsured benefits. Claimant had more than \$100,000 in UM coverage, but the insurer determined that the fair value of the claim was between \$30,000 and \$40,000. It made an offer of \$30,000. Although claimant's counsel believed the claim far exceeded \$30,000, he demanded that the insurer immediately pay \$30,000 as the "undisputed amount" and further requested that the matter proceed to arbitration over the "disputed value." The insurer refused, and in response, claimant filed a bad faith claim. The court of appeals held that the insurer did not become legally obligated to immediately pay the amount offered for settlement, unless the insured accepts that amount as full and final settlement. An insurer can make a "fair value" offer and not be obligated to tender the amount of that offer merely as a "partial settlement."

The *Voland* court distinguished first party claims that can be "accurately appraised without great difficulty or difference of opinion," from those personal injury claims that are "unique and generally not divisible or susceptible to relatively precise evaluation or calculation." The court

explained that the pain and suffering/general damage elements of a personal injury claim, for example, are inherently flexible and subject to differing and potentially changing evaluations based on various factors. In short, evaluating personal injury claims, and particularly the general damage component is far from an exact science. Oftentimes it is no more precise or predictable than throwing darts at a board.

DISCOVERY OF CLAIMS FILE IN BAD FAITH LAWSUITS

For a complete overview of discovery issues, see Chapter 8.

An insurer's files are critical to the plaintiff in establishing a bad faith claim. Conversely, an insured's files may also be critical in establishing a defense to a bad faith claim. Accordingly, it is crucial that all notations in the file, including phone messages, e-mails and interoffice memos, reflect fairness. It is important to avoid notations that contain sarcastic or derogatory comments. To the extent possible, notations should be kept to factual information, and any analytical comments should demonstrate that they are based on facts, not conjecture, and that the insurer has also considered the claimant's interest and arguments. The attorney-client privilege might not apply, or alternatively, it might be waived in a bad faith action. If an insurer intends to defend the bad faith claim by asserting "advice of legal counsel," the attorney-client privilege is waived. Accordingly, before an insurer defends a bad faith action by claiming "advice of counsel," the insurer should first know and understand what attorney-client communications are being waived. In some cases, disclosure of attorney-client communications can cause more harm than good, and therefore, "advice of legal counsel" might not be the proper defense to the bad faith action.

Where the litigant claiming an attorney-client privilege relies on a subjective and allegedly reasonable evaluation of the law, which necessarily incorporates information the litigant learned from its lawyer, a communication is discoverable and admissible. ***State Farm Mut. Auto. Ins. Co. v. Lee***, 199 Ariz. 52, 13 P.3d 1169 (2000) (what State Farm knew about the law included what it learned from its attorneys, and allowing State Farm to assert the privilege would improperly allow it to use the privilege as both a sword and a shield). Before the court will imply a waiver, it must find that the litigant affirmatively put the privileged materials at issue. The mere denial of the allegations in the complaint, or an assertion that the denial was in good faith, would not amount to an implied waiver.

In ***Twin City Fire Ins. Co. v. Burke***, 204 Ariz. 251, 63 P.3d 282 (2003), the liability carrier refused to settle a claim within its million-dollar-limits when it had opportunities to do so, and it rejected a specific demand from the excess carrier that it accept plaintiff's offer below the million-dollar-limit. The jury subsequently awarded plaintiff \$6 million and the excess carrier settled the claim for \$5.4 million. The excess carrier then sued the liability carrier for bad faith. Based on ***State Farm Mut. Auto. Ins. Co. v. Lee***, the trial Judge ordered the excess carrier to produce its privileged files regarding the underlying claim. The excess carrier filed a special action arguing that it had not waived the attorney-client privilege. The Supreme Court held that the attorney-client privilege protected the excess carrier's communications with its counsel. Distinguishing *Lee*, the

court held that the privilege had not been waived because the excess carrier never injected the advice it had received from its counsel into the bad faith case. Moreover, the excess carrier's conduct was not relevant because the primary carrier's limit had not been exhausted and the excess carrier had not interfered in the underlying case.

In *Assyia v. State Farm Mut. Auto. Ins. Co.*, 229 Ariz. 216, 273 P.3d 668 (Ct. App. 2012), a passenger in a vehicle hit by an uninsured motorist was allowed to recover her attorney's fees in a breach of contract case, despite the fact that the insurer eventually paid the policy limits. The insurer had initially denied the insured's claim for policy limits, but as new information became available during litigation the insurer re-evaluated the claim and tendered the policy limits. The trial court awarded the insured attorney's fees based, in part, on A.R.S. § 12-341.01 which allows the recovery of attorney's fees in "any contested action arising out of a contract." The court of appeals affirmed, noting that the action was contested even though the insurer willingly paid the policy limits. The court held that a matter is contested as long as the defendant "has appeared and generally defends against the claims." As a result of this decision, some plaintiffs have begun making policy limit demands with a time deadline that does not allow for adequate investigation. If the insurer denies the claim, the plaintiff will bring a breach of contract and bad faith suit, disclose new information, and threaten attorney's fees. Thus, insurers must be careful to document requests for additional information necessary to evaluate a claim.

A self-insured corporation also implicitly waives the attorney-client privilege by asserting that its claim adjusters acted reasonably and in the employee's best interest in handling a workers' compensation file. This defense necessarily implicates any advice the corporation receives from defense counsel. *Mendoza v. McDonald's Corp.*, 222 Ariz. 139, 213 P.3d 288 (Ct. App. 2009).

EXPERT OPINION REGARDING INSURER'S STATE OF MIND SHOULD BE EXCLUDED

In *Hunton v. American Zurich Ins. Co.*, 2018 WL 1182550 (D. Ariz. Mar. 7, 2018), an insurance bad faith case arising from a workers' compensation claim, the Arizona District Court excluded an insured's expert opinion that the insurer's alleged "claims handling failures" were "pervasive enough to support the conclusion that upper management had to have known of, and approved, the [alleged] deficient staffing levels, inadequate training, inadequate oversight by middle management, and the ethics-related lapses related to the financial incentives granted to employees." The court reasoned that to allow this expert testimony would be to substitute the expert's opinion for that of the jury, and that the jury was capable of determining whether an insurer acted knowingly for the purposes of a bad faith claim.

PRACTICE TIPS/SUGGESTIONS TO MINIMIZE RISK OF BAD FAITH

An insurer's investigation must be prompt, thorough and reasonable. The insurer must consider facts favorable to the insured's position as well as those facts not favorable to the insured's position. If the insurer fails to perform a balanced and even-handed investigation, it increases the risk of a claim for bad faith. If the insured does not supply the required or requested information, the insurer is not absolved of the duty to fairly investigate the matter.

- Don't jump to conclusions.
- Look at the entire picture.
- Evaluate in an impartial manner.
- Do not rely on unsubstantiated opinion or hearsay.
- Review facts, policy provisions and the law.
- Retain experts, if necessary, and supply them with all material (good and bad) so that their opinions are well based.
- Obtain the advice of counsel for any legal questions.
- Keep an open mind and be willing to conduct further investigation if warranted.

DAMAGES RECOVERABLE IN A BAD FAITH CLAIM

For a complete overview on damages, see Chapter 2.

Contract Damages

Damages for injuries proximately caused by the insurer's conduct are recoverable whether those injuries should have been anticipated or not. **Rawlings v. Apodaca**, 151 Ariz. 149, 726 P.2d 565 (1986). Consequential damages are "those damages caused by a breach of contract...that can reasonably be supposed to be within the contemplation of the parties." **Walter v. Simmons**, 169 Ariz. at 236, 818 P.2d at 221 (Ct. App. 1991) (quoting **Seekings v. Jimmy GMC of Tucson, Inc.**, 130 Ariz. 596, 638 P.2d 210, 215 (1981)). Plaintiff has the burden of proving consequential damages with "reasonable certainty" and if he does not prove them with "precision" a court may refuse them. See **Walter**, 169 Ariz. at 236, 818 P.2d at 221.

Compensatory Damages

Emotional Distress

When an insured buys coverage, he or she is seeking peace of mind. Breach of a covenant by the insurer breaches that peace of mind and an award for emotional distress is allowed. **Rawlings v. Apodaca**, 151 Ariz. 149, 726 P.2d 565 (1986).

Emotional distress damages may be awarded in bad faith cases even though the defendant did not intentionally cause the distress and even though the distress was not severe. **Farr v. Transamerica Occidental Life Ins. Co. of Cal.**, 145 Ariz. 1, 699 P.2d 376 (Ct. App. 1984).

Economic Loss

Economic damages may include those business or personal losses proximately resulting from an insurer's wrongdoing. In addition, attorney's fees may be awarded in first-party bad faith actions pursuant to A.R.S. § 12-341.01. **Dodge v. Fid. & Deposit Co.**, 161 Ariz. 344, 778 P.2d 1240 (1989); **Schwartz v. Farmers Ins. Co.**, 166 Ariz. 33, 800 P.2d 20 (Ct. App. 1990). Attorney's fees can also be awarded in third-party claims. Though attorney's fees may not be awarded as an item of

consequential damages, the Legislature provides for their recovery in A.R.S. § 12-341.01. **Ponderosa Plaza v. Siplast**, 181 Ariz. 128, 888 P.2d 1315 (Ct. App. 1993). See also **Sparks v. Republic Nat'l Life Ins. Co.**, 132 Ariz. 529, 647 P.2d 1127 (1982).

Lost future profits that flow from a breach of contract are recoverable. **McAllister v. Citibank**, 171 Ariz. 207, 829 P.2d 1253 (Ct. App. 1992). However, such an award cannot be based on speculation or conjecture. *Walter, supra*.

Workers' Compensation Case

A plaintiff in a workers' compensation bad faith case is entitled to seek pain and suffering, lost earnings and decrease in future earning capacity, and future medical expenses as long as she can show the injuries resulted from the defendant's bad faith conduct (i.e., delay) and not the original injury. **Mendoza v. McDonald's Corp.**, 222 Ariz. 139, 213 P.3d 288 (Ct. App. 2009).

Punitive Damages

An insurer's breach of covenant of good faith and fair dealing does not automatically entitle the insured to punitive damages. There must be "something more." **Linthicum v. Nationwide Life Ins. Co.**, 150 Ariz. 326, 723 P.2d 675, 679 (1986); **Rawlings v. Apodaca**, 151 Ariz. 149, 726 P.2d 565 (1986). The "something more" required for punitive damages is evidence "that defendant either (1) intended to injure the plaintiff ... or (2) consciously pursued a course of conduct knowing that it created a substantial risk of significant harm to others. This standard is satisfied by evidence that defendant's wrongful conduct was motivated by spite, actual malice or intent to defraud. Defendant's conscious and deliberate disregard of the interests and rights of others also will suffice." **Gurule v. Illinois Mut. Life & Cas. Co.**, 152 Ariz. 600, 734 P.2d 85 (1987); *Walter, supra*.

Punitive damages should be restricted to "only those limited cases of consciously malicious or outrageous acts of misconduct in which punishment and deterrence is both paramount and likely to be achieved." *Linthicum*. There must be both an "evil mind" and "aggravated and outrageous" conduct. A plaintiff must show that the defendant intended to interfere with plaintiff's rights "consciously disregarding the unjustifiably substantial risk of significant harm to [the plaintiff]."

A plaintiff must prove punitive damages by clear and convincing evidence. *Linthicum*; *Rawlings*. Clear and convincing evidence means "that which may persuade that the truth of the contention is highly probable." **Thompson v. Better-Bilt Aluminum Prods. Co.**, 171 Ariz. 550, 557, 832 P.2d 203, 210 (1992). A mere inadequate investigation does not alone support a claim for punitive damages. **Filasky v. Preferred Risk Mut. Ins. Co.**, 152 Ariz. 591, 734 P.2d 76 (1987).

The 14th Amendment due process clause prohibits states from imposing grossly excessive punishment – i.e., punitive damage awards – against a tortfeasor. **BMW of North America, Inc. v. Gore**, 517 U.S. 559 (1996). The factors to consider in determining whether an award of punitive damages is appropriate include: (1) the degree of reprehensibility of the defendant's conduct or defendant's culpability; (2) the relationship between the penalty and the harm to the victim

caused by the defendant's action; (3) the relation between the plaintiff's compensatory damages and the amount of the punitive damages; (4) the difference between civil punitive damages and the criminal sanction which could be imposed for comparable misconduct; and (5) the sanctions imposed in other cases for comparable misconduct. *See also, Cooper Indus. Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424 (2001).

In *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003), the Supreme Court held that out-of-state conduct dissimilar from the acts upon which liability is premised, cannot serve as a basis for punitive damages. A defendant should be punished for the conduct that harmed the plaintiff, not for being an unsavory individual or business. A state cannot punish a defendant for conduct that may have been lawful where it occurred. Nor, as a general rule, does a state have a legitimate concern in punishing a defendant for unlawful acts committed outside the state's jurisdiction.

A plaintiff can also recover punitive damages for improper company-wide practices. *Nardelli v. Metro. Group Prop. & Cas. Ins. Co.*, 230 Ariz. 592, 277 P.3d 789 (Ct. App. 2012). In *Nardelli*, plaintiffs sued the defendant insurer when the insurer decided to repair plaintiffs' heavily damaged vehicle instead of totaling it. At trial, plaintiffs presented evidence of the insurer's aggressive profits campaign in their claims department that urged employees to save money on claims. This campaign included incentive payments based on an adjuster's "claims balance scorecard." The court stated that this profits campaign was evidence that the insurer "acted with conscious disregard of [the plaintiff's] rights and the injury that might result."

Arellano v. Primerica Life Ins. Co., 235 Ariz. 371, 332 P.3d 597 (Ct. App. 2014), potentially increases punitive damages to a 5:1 ratio when an insurer's actions falls in the "middle to high level of reprehensibility." There, a wife sought to obtain life insurance for her husband. At trial, a jury found that Primerica engaged in the following acts: (1) Primerica accepted the plaintiff's application without her signature; (2) the Primerica insurance agent's assured the plaintiff the policy was effective from the time she tendered her initial premium payment and application; (3) the Primerica agent failed to provide the plaintiff with a copy of the insurance application; (4) a Primerica agent forged the plaintiff's initials without her consent to lower the policy amount in an effort to ensure the application's approval; (5) Primerica failed to return the plaintiff's initial premium payment after canceling plaintiff's application. The jury awarded the plaintiff over \$1 million in punitive damages, which constituted a 13:1 ratio. The Arizona Court of Appeals found the 13:1 ratio violated due process. The court, however, found a 5:1 ratio appropriate based on what it described as Primerica's middle to high level of reprehensibility.

Arellano is also significant because it held that A.R.S. § 20-1108 applies to verbal contracts for insurance. Section 20-1108 prohibits the admission of a life or disability insurance application unless the application is attached or made part of the policy. During trial, the court excluded *Arellano's* insurance application, holding that a verbal contract existed between the plaintiff and Primerica. The court of appeals affirmed the trial court's ruling, rationalizing that, while the contract in *Arellano* was based on verbal assurance, Primerica could have easily satisfied the requirements of § 20-1108 by providing the plaintiff with a copy of the application.

McClure v. Country Life Ins. Co., 326 F. Supp. 3d 934 (D. Ariz. 2018), *aff'd* 795 F. App'x 548 (9th Cir. 2020), continues the trend of awarding punitive damage awards in multiples of compensatory damages. In McClure, Country Life issued a disability policy. The insured suffered a concussion while walking at a mall and claimed he could no longer work. He then developed psychiatric problems and was hospitalized after a suicide attempt. Country Life paid benefits for over a year and then terminated the benefits based on an inconclusive psychological evaluation. The insured was thereafter hospitalized again for suicidal ideations. After the insured filed suit, County Life reinstated benefits to the date of the second hospitalization. The jury awarded 1.3 million in compensatory damages and \$5 million in punitive damages.

CLAIMS SETTLEMENT PRACTICES

Arizona has a statute entitled the “Unfair Claims Settlement Practices Act.” A.R.S. § 20-461, together with regulations adopted by the Arizona Department of Insurance, impose significant obligations on insurance carriers doing business in the state.

Both the statute and the regulation are nominally directed at actions committed or performed “with such a frequency to indicate as a general business practice.” They prohibit claims practices such as:

* * *

2. Failing to acknowledge and act reasonably and promptly upon communications with respect to claims arising under an insurance policy.

* * *

4. Refusing to pay claims without conducting a reasonable investigation based on all available information.
5. Failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed.
6. Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear.

* * *

14. Failing to promptly settle claims if liability has become reasonably clear under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage.

* * *

15. Failing to promptly provide a reasonable explanation of the basis in the insurance policy relative to the facts or applicable law for denial of a claim or for the offer of a compromise settlement.

Importantly, the statute specifically provides that it does not create a civil cause of action and is designed solely as an administrative remedy. At least one court has held that the statute and Insurance Department regulations could not be included as a jury instruction in a bad faith case. **Melancon v. USAA Cas. Ins. Co.**, 174 Ariz. 344, 849 P.2d 1374 (Ct. App. 1992). There is, however, nothing to stop a plaintiff’s expert from testifying that the insurer’s “standard of care” is based upon the very same principles as set forth in the Act.

The Director of Insurance is empowered to collect fines and civil penalties for violations. The Department also has the related authority to investigate complaints, and an insurer receiving an inquiry from the Department of Insurance should handle that inquiry with the highest priority, even if the complaint is undeniably without merit.

The rules adopted by the Insurance Department go further than the statute. In addition to further defining the obligations under the unfair claims settlement practices statute, the Department also adopted certain time limits for responding to claims and inquiries. For instance, R20-6-801(E)(1) requires an insurer to acknowledge receipt of the claim within 10 working days unless payment is made within that time. Ten working days are generally the limit for responding to other communications from a claimant “which reasonably suggest that a response is expected.” R20-6-801(E)(3). The insurer is required to complete the investigation of a claim within 30 days after notification, unless the investigation cannot be reasonably completed within that time. R20-6-801(F).

An insurer is required to accept or deny a claim within 15 days after receipt of a properly executed proof of loss and the denial of a claim based upon a specific policy provision or exclusion must be given in writing to the claimant and kept in the claim file. R20-6-801(G)(1)(a).

If the insurer requires more time to determine whether a first party claim should be accepted or denied, the insurer must notify the first party claimant within 15 days after the receipt of the proofs of loss, giving reasons why more time is needed. Every 45 days thereafter, the insurer must send the claimant a letter setting forth the reasons additional time is needed for investigation. R20-6-801(G)(1)(b).

Where negotiations are underway between an insurer and a claimant who is not an attorney nor represented by an attorney, the insurer must give the claimant written notice of the pending expiration of the time limit within 30 days for first party claimants and 60 days for third-party claimants prior to the date on which the limitations period expires. In no event may the insurer continue negotiations during the period the limitations is about to expire without having given such written notice. R20-6-801(G)(4).

On September 20, 2000, the Director of the State Department of Insurance issued Circular Letter 2000-11. The Circular Letter was a response to an ethics opinion issued by the State Bar of Arizona in June of 1999, Opinion No. 99-07, which concluded that an attorney could not ethically negotiate with a non-lawyer public adjuster (licensed adjuster) if that adjuster was not supervised by a lawyer. The letter recognized that a licensed adjuster’s authority was limited to that granted by the Legislature under A.R.S. §§ 20-281 and 20-312. The Circular Letter identified certain general activities that a licensed adjuster is authorized to perform on behalf of an insured, including the gathering of facts relevant to a claim, documenting and measuring damages, determining repair and replacement costs, evaluating coverage and valuation issues, preparing a proof of loss, engaging in settlement negotiations with an authorized representative of the insurer, advising the insured whether to accept an insurer’s offer of settlement and assisting in completing ordinary settlement documentation. The Circular Letter specifically stated that

licensed adjusters were not authorized to initiate or defend court proceedings, prepare or submit pleadings or motions, engage in discovery, or present evidence or legal arguments.

The regulations provide specific obligations for handling first party automobile total losses, replacement automobiles, cash settlements, and subrogation.

The regulations also provide that an insurer, upon receipt of an inquiry from the Department of Insurance respecting a claim, must respond within 15 working days of receipt of the inquiry and furnish the Department with an adequate response to the inquiry. R20-6-801(E)(2). Although the claims settlement statute and the accompanying regulations are aimed at general business practices, several similar complaints against the same insurer, or a particularly difficult case, may result in an investigation by the Department of other files processed by the insurer. For this reason, adequate training on the requirements of the Unfair Claims Settlement Practices Act and adequate documentation of the claim file offers the best opportunity to avoid problems with the insurance department.

EQUITABLE SUBROGATION

Equitable subrogation is a principle of law that permits indemnity, even in the absence of a contract for indemnity, when justice demands that there be such recovery. The principles of equitable subrogation can apply between co-insurers as well as primary and excess insurers. For example, if Joe, insured by ABC Insurance Company, rents a car and allows Tom, insured by XYZ Insurers, to drive the car, Tom might be a permissive user of the car under Joe's policy. Tom would also have coverage under his own policy. Therefore, if Tom was involved in an accident for which he was at fault, both insurers would likely provide coverage for the loss. Assuming the injured person's damages exceeded the minimum limits provided by the rental company, the rental company would then be entitled to tender the driver's defense to the next layer of coverage. If one of the insurers refused to defend and provide indemnification, the insurer providing a defense and indemnification would be entitled to recover its indemnity payments and defense costs in accordance with its pro rata share or in accordance with some other equitable method a court chooses to apply.

Such equitable principles can apply in primary and excess situations. If the primary coverage is \$100,000 and the lawsuit has a value greatly in excess of that amount, the primary and excess insurers should work together in an equitable manner toward the common goal of defending the insured. If they do not, a court could do it for them. Insurers thus should work together to minimize the amount of indemnification required as well as the amount of fees and costs incurred. Otherwise, the court will apply equitable principles in dividing indemnity payments and defense costs between insurers with applicable coverage.

The doctrine of equitable subrogation has been present in Arizona for a number of years. In ***Busy Bee Buffet v. Ferrell***, 82 Ariz. 192, 310 P.2d 817 (1957), the Arizona Supreme Court permitted a "passive" tortfeasor to recover from an "active" tortfeasor the amounts the passive tortfeasor had to pay the injured third person. There, plaintiff Ferrell fell through an open trap door in a

hallway jointly shared by the Busy Bee Buffet and co-tenant Steve Pastis. Pastis had left the trap door to the basement open while he went to find a flashlight. As joint tenants of the hallway, both Busy Bee and Pastis owed a duty to Ferrell to safely maintain the premises. However, as between Busy Bee and Pastis, Pastis was “actively” negligent while Busy Bee was only “passively” negligent. Thus, Busy Bee was entitled to recover from Pastis the full amount of the damages awarded to Ferrell.

INA Ins. Co. of North America. v. Valley Forge Ins. Co., 150 Ariz. 248, 722 P.2d 975 (Ct. App. 1986), followed *Busy Bee* in the insurance context. INA insured an agent who sold a Valley Forge homeowners policy. The homeowner sued the agent for negligently failing to provide sufficient coverage and sued Valley Forge for various theories including breach of contract. The agent tendered his defense to Valley Forge who refused the tender on the grounds that the agent was independently negligent. INA defended the agent who was subsequently dismissed from the suit.

INA then sought to recover its fees and costs incurred in defending the agent from Valley Forge. Valley Forge maintained that it had no obligation to indemnify INA, because the homeowner’s complaint alleged the agent’s independent negligence. The court held that the complaint’s allegations of independent wrongdoing do not control the right to indemnity. It is the actual wrongdoing or lack of it that determine the right to indemnification. Because Valley Forge had to indemnify the agent, it also had to indemnify INA, standing in the shoes of the insured agent, for the fees and costs expended to defend the agent.

In ***Hartford Accident & Indem. Co. v. Aetna Cas. & Sur. Co.***, 164 Ariz. 286, 792 P.2d 749 (1990), an excess insurer was allowed to maintain a bad faith claim against a primary insurer for the latter’s failure to settle within policy limits. Aetna was the primary carrier with policy limits of \$25,000. Although it had an opportunity to settle the underlying lawsuit for \$15,000, Aetna refused. Subsequently, the case went to trial, resulting in a jury verdict of \$140,000. The court held that Hartford, the excess insurer, was subrogated to the rights of the insured, and had a cause of action against the primary insurer for bad faith failure to settle within the policy limits.

The court said an excess insurer is also committed to indemnifying the insured. As such, the excess insurer “steps into the shoes” of the insured for purposes of the existing contractual relationship with the primary insurer. Thus, the excess insurer has standing to sue the primary insurer for any bad faith conduct in the handling of the insured’s case.

An excess insurer should not have to pay a judgment if the primary insurer caused the excess judgment by a bad faith failure to settle within primary limits. We hold, therefore, that an excess carrier is subrogated to the rights of the insured and has a cause of action against the primary insurer for bad faith failure to settle within policy limits. This right is derivative of the contract between the insured and the primary carrier.

Id. at 291, 792 P.2d at 754. Allowing such an action, said the court, serves an important public policy of encouraging settlements. Otherwise, the primary insurer would have little incentive to settle when an excess insurer is available to cover any amount of the primary insurance limits

without fear of recourse. See also *Twin City Fire Ins. Co. v. Burke*, 204 Ariz. 251, 63 P.3d 282 (2003).

An excess carrier's equitable subrogation claim will fail, however, if the primary insurer's conduct did not amount to bad faith. Additionally, a judgment in excess of the primary policy limits will not automatically result in an excess carrier's right to recover from the primary carrier unless the excess carrier can prove bad faith on the part of the primary carrier.

In *Knightbrook Ins. Co. v. Payless Car Rental System Inc.*, 243 Ariz. 422, 409 P.3d 293 (2018), the Arizona Supreme Court held that Arizona's equitable indemnity law does not incorporate the First Restatement of Restitution § 78, which conflicts with Arizona's general equitable indemnity principles. Arizona indemnity law requires that an insurer *actually owe* the discharged duty to recover from a third party under equitable indemnification. In contrast, § 78 requires the "mere *justifiable belief* that [the insurer] faced a 'supposed obligation' for which [the indemnitor] bore the greater responsibility." In so ruling, the Court noted that it was "troubled that § 78 could preclude an indemnitor from raising viable defenses to the underlying claim.

EQUITABLE CONTRIBUTION BETWEEN INSURERS

Equitable contribution is similar to equitable subrogation. While equitable subrogation usually occurs between excess and primary carriers, claims for equitable contribution arise between two or more carriers providing the same or similar layer of coverage. In *American Cont'l Ins. Co. v. American Cas. Co. of Reading, PA*, 183 Ariz. 301, 903 P.2d 609 (Ct. App. 1995), the court held that one insurer may recover its contribution to the plaintiff's damages from another insurer whose insured was never named as a party in the underlying lawsuit, provided that the insurer seeking contribution is able to establish the negligence of the mutual insured.

In *American Continental*, a hospital nurse improperly administered injections to a patient which rendered the patient a quadriplegic. The patient filed a medical malpractice action against the hospital and the hospital's "employees and/or agents," though the nurse was never specifically named as a defendant. American Continental Insurance Company, Inc. (ACIC) issued a hospital liability insurance policy to the hospital. Under this policy, the term "insured" included the hospital and its employees. The policy obligated ACIC to defend and indemnify all insureds against medical malpractice claims. The individual nurse who committed the negligent act also had her own personal professional liability policy issued by American Casualty Company (American). The ACIC policy and the American policy both provided primary coverage and contained "other insurance" clauses which allocated liability between insurance companies when concurrent coverage existed.

ACIC defended the hospital and the nurse, and it invited American to also participate in the defense and settlement of the suit. American refused because the nurse was not specifically named as a defendant to the lawsuit. ACIC eventually settled the underlying action and then sued American for recovery for a portion of the defense costs and settlement payment. American

argued that it was not obligated to contribute any defense costs or settlement money to ACIC because American's named insured, the nurse, was never sued in the underlying action.

The court rejected this argument and held that equitable contribution between insurers is available and permissible, even if the mutually named insured is not actually named as a party in a lawsuit. Although a claim for indemnity might require that the mutual insured be named a party in the lawsuit, the same is not true for equitable contribution. Equitable contribution is based upon the relationship of two insurers insuring the same risk. Three elements must be satisfied to establish a claim for equitable contribution: (1) the two insurers must insure the same risk; (2) neither insurer can be the primary insurer; and (3) the loss sustained must be caused by the risk insured against. *See also Mutual Ins. Co. of Ariz. v. American Cas. Co. of Reading, Penn.*, 189 Ariz. 22, 938 P.2d 71 (Ct. App. 1996), *superseded by statute on other grounds, as stated in Jangula v. Ariz. Prop. And Cas. Ins. Guar. Fund*, 207 Ariz. 468, 88 P.3d 182 (Ct. App. 2004).

If you have questions regarding the information in this chapter, please contact the authors or any JSH attorney.

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CHAPTER 8: INSURANCE BAD FAITH DISCOVERY

An insurance company commits bad faith when it (1) intentionally (2) denies, fails to process, or fails to pay a claim (3) without a reasonable basis for such action. **Ness v. Western Sec. Life Ins. Co.**, 174 Ariz. 497, 500, 851 P.2d 122, 125 (Ct. App. 1992) (quoting **Brown v. Superior Court**, 137 Ariz. 327, 336, 670 P.2d 725, 734 (1983)). “The bad faith cause of action arises only when all three of these elements are present.” *Ness*, 174 Ariz. at 500, 851 P.2d at 125. An insured must prove that the insurer acted intentionally, not inadvertently or mistakenly, and that the insurer dealt unfairly or dishonestly with the insured’s claim or failed to give fair and equal consideration to the insured’s interests. See **Rawlings v. Apodaca**, 151 Ariz. 149, 726 P.2d 565 (1986); **Hawkins v. Allstate Ins. Co.**, 152 Ariz. 490, 733 P.2d 1073 (1987). Despite the high standard of proving bad faith, Arizona recognizes bad faith claims can exist even in the absence of a breach of contract. **Deese v. State Farm Mut. Auto. Ins. Co.**, 172 Ariz. 504, 838 P.2d 1265 (1992).

The standard for punitive damages in bad faith cases is higher. In order to claim punitive damages, plaintiffs must establish that the true motive of an insurer’s claim denial was unreasonable and that the insurer acted with an evil mind; that the insurer intended to injure the insured or consciously pursued a course of conduct knowing that it created a substantial risk of significant harm to the insured. Evil mind is usually established by circumstantial evidence, which generally is gleaned from the claim files. See, e.g., **Hawkins v. Allstate Ins. Co.**, 152 Ariz. 490, 733 P.2d 1073, 1081 (1987) (holding that evidence of insurer’s routine practice of unjustifiably reducing amount offered for claims was sufficient evidence of “evil mind” to support claim for punitive damages).

Previously, requests for discovery had to be relevant or reasonably calculated to lead to the discovery of relevant or admissible evidence. **State Farm Mut. Auto. Ins. Co. v. Superior Court**, 167 Ariz. 135, 138, 804 P.2d 1323, 1326 (Ct. App. 1991). Under the recent revisions to Arizona Rule of Civil Procedure 26(b), however, the standard for discovery is whether the request is “proportional to the needs of the case,” which requires parties to consider the importance of the issues, the amount in controversy, and the parties’ access to information. Parties must also take into account the parties’ resources and whether the burden and expense outweighs the likely benefit.

The unique characteristics of a bad faith claim raise numerous discovery issues, including production of proprietary and confidential information, which must be individually assessed in each case. The following illustrates the various types of information that may be discoverable in an insurance bad faith claim.

DISCOVERY OF CLAIMS FILES

In an insurance bad faith case, the insurance claims file “constitutes the only source of information relevant to whether the insurer has a good faith basis for its decision.” **McClure v.**

Country Life Ins. Co., 2017 WL 3719880 (D. Ariz. Aug. 29, 2017). **Brown v. Superior Court**, 137 Ariz. 327, 670 P.2d 725 (1983), set forth guidelines the court should use in determining whether documents in an insurer’s claim files are protected or must be disclosed. In *Brown*, the insureds filed claims with their insurer for property damage and loss of earnings. The insurer paid the property damage portion of the claim, but not the loss of earnings claim. Thereafter, the Browns filed a bad faith action alleging breach of the implied covenant of good faith and fair dealing in the investigation and denial of the loss of earnings claim. During discovery, the insurer objected to producing its entire claims file in handling both the property damage and loss of earnings claim. The insurer asserted that the files were created in anticipation of litigation and also contained impressions, conclusions, opinions and other legal theories of attorneys which were entitled to absolute protection. The court looked at the following factors in determining whether the documents would be protected:

- the nature of the event that prompted preparation of the document and whether it is likely to lead to litigation;
- whether the document was prepared by a party or a representative;
- whether the document was routinely prepared in the course of the insurer’s business; and
- whether the document was prepared in relation to the existence of claims or negotiations.

The court held that all documents prepared after the date the insurer wrote to the plaintiffs denying coverage were “prepared in anticipation of litigation” and therefore qualifiedly protected. Consequently, those documents would need to be produced only upon a showing of “substantial need.” There, the “substantial need” requirement was satisfied because a claims file is a “unique, contemporaneously prepared history of the company’s handling of the claim; in an action such as [bad faith] the need for the information in the file was not only substantial, but overwhelming ... [and] the substantial equivalent of this material cannot be obtained through other means of discovery.”

Finally, the court addressed whether the materials in the claims file containing the impressions, conclusions, opinions or other legal theories of the insured’s attorneys were entitled to absolute protection. The court held that when mental impressions and the like are directly at issue in a case (such as a bad faith lawsuit), no absolute protection under the discovery rules is warranted. *Id.* at 337, 670 P.2d at 735; *see also Raygarr LLC v. Employers Mut. Cas. Co.*, 2020 WL 919443 (D. Ariz. Feb. 26, 2020) (discussing use of claim log notes in ruling on contested motion for summary judgment.); **ACS Int’l Prod. LP v. State Auto. Mut. Ins. Co.**, 2022 WL 1406688 (D. Ariz. May 4, 2022) (same.)

DISCOVERY OF FINANCIAL INFORMATION

***Prima Facie* Case of Punitive Damages Required**

Plaintiffs often seek to discover financial information regarding the insurance company to support a punitive damages award. Documents related an insurer's financials are not relevant in determining if the insurer breached the duty of good faith and fair dealing during the adjustment of the claim, but may be relevant to a punitive damage claim. In *Arpaio v. Figueroa*, 276 P. 3d 513, 229. Ariz. 444 (Ct. App. 2012), the court held that financial information regarding a defendant is not discoverable until a *prima facie* case of punitive damages has been established. The trial court "should determine, as soon as is reasonably possible, whether at a discovery hearing or pretrial conference, if a party has made a *prima facie* showing in support of punitive damages, 'through discovery, by evidentiary means or through an offer of proof.'" Even if a *prima facie* case of punitive damages has been established, courts will limit the scope of financial discovery to only the financial information that may be relevant to an award of punitive damages.

Interview Summaries

Undue Hardship Required

In *Longs Drug Store v. Howe*, 134 Ariz. 424, 657 P.2d 412 (1983), Farmers Insurance Company undertook an investigation concerning the termination of a company's employee. As part of the investigation, Farmer's took recorded statements of the employees. Copies of these statements were provided to the in-house attorney and reviewed by him. Those statements formed the basis for legal advice he gave to the company. The discharged employee sought the statements and interview summaries from the investigation.

The court held that the recorded statements were within the qualified protection of Arizona's "work product" doctrine. However, like the materials in *Brown*, the court held that the plaintiff had a substantial need for the materials and was unable without undue hardship to obtain the substantial equivalent materials by other means. But the court did not require disclosure of the investigator's interview summaries, since they contained the investigator's subjective mental impressions and opinions. The court held that such material would be protected from discovery in all cases except those in which the insurer's state of mind was directly at issue (such as a bad faith action). *Id.*

***Ex parte* Communications**

In *Duquette v. Superior Court*, 161 Ariz. 269, 778 P.2d 634 (Ct. App. 1989), the court held that defense counsel in a medical malpractice case may not engage in *ex parte* communications with the plaintiff's treating physicians without the plaintiff's consent. The court reasoned that the advantages of the informal *ex parte* procedure are clearly outweighed by the dangers such conduct presents to the physician-patient relationship, and the pressures such communication places on both the physician and attorney participants. The court remanded the case to the trial

court to determine whether defense counsel had obtained information through the *ex parte* interviews that could not have been obtained by formal discovery and to fashion an appropriate remedy if this had occurred.

The *Duquette* rule does not apply to treating physicians who are employees of a corporate defendant that is itself a defendant in a medical malpractice action. ***Phoenix Children's Hosp., Inc. v. Grant***, 228 Ariz. 235, 238, 265 P.3d 417, 421 (Ct. App. 2011). A hospital has a right to discuss a plaintiff/patient with its own employees because of the employment relationship; and that right is not dependent upon the implied waiver arising from the filing of a malpractice lawsuit. *Id.* at 239, 421. Therefore, *Duquette* and the physician-patient privilege do not bar informal communications between a defendant hospital and/or its counsel and treating physicians employed by the hospital.

DISCOVERY OF COMMUNICATIONS WITH AN EXPERT WITNESS

A lawyer who communicates with an expert witness concerning the subject matter of the expert's testimony foregoes work-product protection even if the expert also plays a consulting role. Communications during consultation are not privileged if the expert later becomes a testifying witness. ***Emergency Care Dynamics, Ltd. v. Superior Court***, 188 Ariz. 32, 932 P.2d 277 (Ct. App. 1997). Here, the defendants in an antitrust/breach of contract action subpoenaed the file of the plaintiff's antitrust expert. Plaintiff objected and moved to quash the subpoena, arguing the file contained hypotheses, mental impressions, and litigation strategies that counsel had explored with the expert in his consulting role, prior to determining that the expert would testify. The trial court denied plaintiff's motion, ordered production of the expert's file, and declined to review the file in camera to determine if the entire file was discoverable. The court of appeals affirmed. Arizona courts support free-ranging, skeptical cross-examination of expert witnesses and open discovery to probe the groundwork for their opinions. This includes examining the source of the expert's knowledge and information, any alleged bias, and the expert's relationship with the hiring party and counsel. A party has an interest in exploring whether an expert's theories originated with the hiring lawyer, and such information can be obtained only through open discovery.

The court distinguished between consulting and testifying experts, prohibiting discovery from the former except under exceptional circumstances. But the same protection does not apply to an expert who acts as both a consultant and an expert witness. The court reasoned that disputes over which information was discoverable and which was not would immensely burden the courts. Thus, counsel who want to maintain the work product privilege for consulting experts must hire a separate expert to testify. *See also Arizona Indep. Redistricting Comm'n v. Fields*, 206 Ariz. 130, 75 P.3d 1088 (Ct. App. 2003) (by designating consulting experts as testifying experts, the IRC waived any legislative privilege attaching to communications with those experts or any materials reviewed by them and relating to the subject of the experts' testimony).

In ***Arizona Minority Coal. for Fair Redistricting v. Arizona. Indep. Redistricting Comm'n***, 211 Ariz. 337, 358, 121 P.3d 843 (Ct. App. 2005), the court of appeals clarified that *Fields* "stands for the

proposition that the legislative privilege is waived when a consultant has been designated as the party's expert and 'will' testify as an expert." Thus, a party who has named a consultant as an expert can reinstate the privilege by removing that designation before expert opinion evidence is offered by producing a report, responses to discovery, or expert testimony.

DISCOVERY OF CLAIMS HANDLING MANUALS

Relevance of Manuals

In *Miel v. State Farm Mut. Auto. Ins. Co.*, 185 Ariz. 104, 912 P.2d 1333 (Ct. App. 1995), the claimant sued the tortfeasor's automobile liability insurer and claims adjuster for breach of contract, negligence, and bad faith in connection with delay, following a time-limited settlement demand letter which was misplaced. The trial court admitted into evidence two articles from an in-house State Farm newsletter discussing the handling of excess liability claims, and a portion of State Farm's general claims manual relating to the handling of such claims. The manual noted that the failure to keep an insured informed of settlement offers can constitute bad faith. State Farm argued the evidence was irrelevant and, even if relevant, the prejudicial effect far outweighed any relevance. The court of appeals disagreed, and held that both the articles and the claims handling manual were relevant. They addressed the company's policies and procedures for handling these claims, which the claims adjuster did not follow. Other courts in Arizona have followed a similar approach. *White Mountain Cmty. Hosp. Inc. v. Hartford Cas. Ins. Co.*, 2014 WL 6885828 (D. Ariz. Dec. 8, 2014) ("Given the broad scope of discovery established by the Federal Rules of Civil Procedure, the argument that the [internal best practices standards] are irrelevant fails."); *Finkelstein v. Prudential Fin. Inc.*, 2022 WL 604884 (D. Ariz. Mar. 1, 2022) (allowing production of training manuals for relevant period of time.)

DISCOVERABILITY OF PERSONNEL FILES AND PROFITABILITY GOALS

In *Zilisch v. State Farm Mut. Auto. Ins. Co.*, 196 Ariz. 234, 995 P.2d 276 (2000), a claimant seeking underinsured motorist coverage sued State Farm for first party bad faith. The claimant had been injured as a passenger in an automobile accident. Her attorney prepared a settlement demand package and forwarded it to the adjuster demanding policy limits. The adjuster reviewed the claim and confirmed the nature and permanency of the claimant's injuries, requested additional medical information from the claimant, contacted the treating physicians, and received a report from claimant's treating physician setting forth the permanent nature of her injury.

The adjuster denied the claim on the ground that the amount claimant received from her liability coverage fully compensated her for her injuries. The claim was then reassigned to another claims representative who determined that the value of the claim was more significant than State Farm had initially evaluated. The adjuster made another offer to settle the claim, which was rejected. The matter ultimately went to arbitration, which resulted in a judgment in excess of the policy limits. Claimant sued State Farm alleging it breached its duty of good faith and fair dealing by deliberately refusing to pay policy limits, when it knew the claim exceeded that amount. As part of the discovery process, State Farm had to disclose personnel files, which revealed that State

Farm had payment goals for its claims personnel, and that promotions and salary increases were based upon reaching those goals. Plaintiff used this evidence at trial to establish both bad faith and punitive damages.

The court of appeals acknowledged that the use of this type of evidence could establish improper claims practices; and the supreme court emphasized that if an insurer acts unreasonably in the manner in which it processes a claim, it can be held liable for bad faith even if it did not breach the policy provisions.

Similarly, in *Nardelli v. Metro. Grp. Prop. & Cas. Ins. Co.*, 230 Ariz. 592, 277 P.3d 789 (Ct. App. 2012), the plaintiffs presented evidence that at the time they made their claim, MetLife had “instituted an aggressive company-wide profit goal,” and it had impressed upon its claims employees, including the employees who processed the plaintiffs’ claim, “that they were to decide every aspect of every claim” based on meeting that profit goal. Furthermore, claims employee compensation was tied to the average amount paid on claims. Therefore, the court allowed discovery of certain parts of personnel files and profitability goals to support plaintiff’s theory of the case.

In *Ingram v. Great American Ins. Co.*, 112 F.Supp.3d 934 (D. Ariz. 2015), the plaintiff sought production of employee materials in a worker’s compensation bad faith suit. The court, relying in *Zilisch*, found the potential probative value of the information contained in the employee records outweighed any privacy concerns. Furthermore, evidence regarding whether the insurer “set arbitrary goals for the reduction of claims paid” and whether “the salaries and bonuses paid to claims representatives were influenced by how much the representatives paid out on claims” was relevant to whether the insurer acted reasonably and knew it. The court also found unreasonable any “expectation that assessments of work performance and any financial incentives to minimize payments on claims would be kept private.” The court did allow the insurer to redact personal and sensitive information of the employees. *Finkelstein v. Prudential Fin. Inc.*, 2022 WL 604884 (D. Ariz. Mar. 1, 2022) (compelling production of personnel files for individuals who had more than a “de minimis” involved in the decision making level of the claim.)

DISCOVERY OF SIMILAR CLAIMS OR CLAIMS FILES

Nationwide Search Burdensome

In *State Farm Mut. Auto. Ins. Co. v. Superior Court*, 167 Ariz. 135, 804 P.2d 1323 (Ct. App. 1991), the court criticized plaintiffs for serving overly broad and burdensome discovery requests demanding information regarding other lawsuits against State Farm around the country. Although discovery rules should be construed liberally, there is a limit on relevance which requires plaintiff to narrowly tailor their inquiry to meet the facts of the case. Requiring State Farm to undertake a nationwide search was unduly burdensome because it would require State Farm to review 175,000 claims per year from Arizona and millions of similar claims nationally.

Random Sample of Files

In *Schwartz v. Farmers Ins. Co. of Arizona*, 166 Ariz. 33, 800 P.2d 20 (Ct. App. 1990), plaintiff sued Farmers for first party bad faith concerning an automobile property damage claim concerning the cash value of a car involved in an accident. The claimant had purchased a Porsche for \$13,895, and it was totally destroyed in a collision 3-½ months after the purchase. Farmers utilized a computerized service known as AutoTrak to assess the value of automobiles. Various rating factors were placed into the system along with the vehicle's mileage, and the system would then value the vehicle. The AutoTrak system valued the Porsche at \$9,042. Relying upon this value,

Farmers offered the claimant \$11,000 as the actual cash value to settle the claim. The settlement was rejected and a breach of contract and bad faith suit ensued. The claimant sought to introduce all of Farmers' total loss files to demonstrate an alleged misuse of the AutoTrak valuation. In response, Farmers provided 78 randomly selected total loss files, and acknowledged that it was a random sample of AutoTrak's reports for total loss claims processed through the Farmers Phoenix Regional Office. The randomly selected reports were admitted into evidence as business records, and helped Farmers establish that it did not act in bad faith in the adjustment of the claim.

DISCOVERY OF OTHER BAD FAITH CLAIMS

In *Miel v. State Farm Mut. Auto. Ins. Co.*, 185 Ariz. 104, 912 P.2d 1333 (Ct. App. 1995), a third party bad faith case, the plaintiff at trial posed a question to the State Farm representative about other bad faith cases. The court of appeals held the question was proper and material to the plaintiff's proposition that State Farm's failure to pay the demanded policy limit was not an isolated incident but rather one of several incidents. The court allowed the evidence of prior similar claims as relevant to the bad faith claim, citing *Hawkins v. Allstate Ins. Co.*, 152 Ariz. 490, 733 P.2d 1073 (1987).

DISCOVERY OF MEDICAL EXPERT'S PREVIOUS REPORTS IN BAD FAITH CASE

In *Cheatwood v. Christian Brothers Services*, 2018 WL 287389 (D. Ariz. Jan. 4, 2018), a bad faith case arising from a health benefits claim, the defendant insurer sought to quash a subpoena issued on a non-party physician requesting previous medical examinations and exhaustive financial information about the physician. The court partially quashed the subpoena, holding that the other medical reviews were "not likely to lead to evidence of bias, largely because they involve facts and circumstances different from the facts and circumstances involved in this case." The court also denied a request for a number of medical reviews performed for plaintiffs as opposed to defendants in the last five years.

DISCOVERY OF PRIVILEGE LOG AND WAIVER OF ATTORNEY-CLIENT PRIVILEGE

Beliefs Based Upon Attorney-Client Communications

In *State Farm Mut. Auto. Ins. Co. v. Lee*, 199 Ariz. 52, 13 P.3d 1169 (2000), a class of 1,000 policyholders sued State Farm for bad faith, alleging improper denial of “stacked” underinsured and uninsured motorists claims. Before denying the claim, State Farm claims managers had, among other things, obtained counsels’ view of the meaning of the relevant policies, statutes and case law. Plaintiffs therefore sought to discover the communication between State Farm’s claim managers and counsel regarding the denial of the underinsured and uninsured claims. State Farm objected to disclosing the communications based upon the attorney-client privilege. The trial court ordered State Farm to produce the information because its claim managers had, in whole or in part, relied upon the advice of counsel in deciding to deny coverage.

The supreme court, in a three-to-two decision, held that when an insurance company in a bad faith case relies on and advances as a claim or defense a subjective and allegedly reasonable evaluation of the law that incorporates its lawyer’s communications to it, the communication is discoverable and admissible. Because State Farm asserted that its actions were reasonable based on what it learned about the applicable law from counsel, State Farm waived the attorney-client privilege. All of the communication between counsel and State Farm was therefore discoverable and admissible. Compare *Twin City Fire Ins. Co. v. Burke*, 204 Ariz. 251, 63 P.3d 282 (2003) (insurer did not impliedly waive the attorney-client privilege because the carrier did nothing to make its counsel’s advice relevant to its case).

Mendoza v. McDonald’s Corp., 222 Ariz. 139, 213 P.3d 288 (Ct. App. 2009), applied *Lee* to the worker’s compensation arena. McDonald’s claimed the attorney-client privilege and started redacting adjusters’ notes regarding Mendoza, who then sought to compel McDonald’s to produce the entire claim file, including the redacted material. Mendoza contended that McDonald’s’ ICA attorneys regularly influenced and directed McDonald’s’ claims decisions and, by representing that its actions were subjectively reasonable while also asserting its privilege, McDonald’s was able to hide the real reasons for its decisions.

The court of appeals agreed. An insurer’s implied waiver of the attorney-client privilege is not limited to cases in which the company claims its actions were reasonable based on its subjective evaluation of the law. In the bad faith context, when an insurer raises a defense based on factual assertions that, either explicitly or implicitly, incorporate the advice or judgment of its counsel, it cannot deny an opposing party the opportunity to discover the foundation for those assertions in order to contest them. And because McDonald’s affirmatively asserted its actions in investigating, evaluating, and paying Mendoza’s claim were *subjectively* reasonable and taken in good faith, McDonald’s placed at issue their subjective beliefs and directly implicated the advice received from ICA counsel. The attorney-client privilege, if it applied, would shield from Mendoza the very evidence she would need to challenge the company’s representations that its adjusters subjectively believed their actions were reasonable and taken in good faith.

In *Everest Insurance Company v. Rea*, 236 Ariz. 503, 342 P.3d 417 (Ct. App. 2015), plaintiffs claimed that the insurance company acted in bad faith by entering into a settlement agreement that exhausted the liability coverage of an Owner Controlled Insurance Program. The insurer argued it reached the settlement decision in good faith based on its subjective beliefs regarding the relative merits of the various available courses of action, which it formed after consulting with counsel. The superior court ruled that this defense impliedly waived the attorney-client privilege and ordered the insurer to produce otherwise privileged documents.

The court of appeals reversed in a split decision, holding that waiver will be implied only when a party affirmatively asserts it was acting in good faith because it relied on such advice for its own evaluation and interpretation of the law. The majority interpreted *State Farm Mut. Auto. Ins. Co. v. Lee*, 199 Ariz. 52, 13 P.3d 1169 (2000), to mean that for waiver to apply, a party must affirmatively claim its conduct was based on its understanding and advice of counsel, rather than merely stating that it consulted with and received advice from counsel. The majority rejected the argument that the insurer waived the privilege by defending itself on subjective reasonableness grounds following consultation with counsel.

In *Sell v. Country Life Insurance Company*, 189 F. Supp. 3d 925 (D. Ariz. 2016), the court considered whether the insurer willfully violated the discovery rules by asserting that the attorney client privilege and work-product doctrine applied to, among other things, correspondence between an in-house attorney and claims adjuster. Specifically, the court addressed whether draft denial letters and notes written on the drafts were protected from disclosure in the bad faith lawsuit. Relying on Arizona substantive law, the court said that for the communication to be privileged, it must be made to or by the lawyer for the purpose of securing or giving legal advice, must be made in confidence, and must be treated as confidential, citing *Samaritan Foundation v. Goodfarb*, 176 Ariz. 497, 501, 862 P.2d 870, 874 (1993). In addition, under A.R.S. § 12–2234(B), attorney-client communications are protected from disclosure if the communication is either (1) for the purpose of providing legal advice to the entity or employer or to the employee, agent or member, or (2) for the purpose of obtaining information in order to provide legal advice to the entity or employer or to the employee, agent or member.

The court rejected the insurer’s assertion of privilege, stating that the insurer “simply withheld such communications solely because a company attorney was named on the email.” The court also ruled that there were other willful discovery violations, including the failure to preserve and produce relevant materials in response to requests for production, and presenting false deposition and hearing testimony. As a result, the court struck the answer and entered default against the insurer.

In *Robert W. Baird & Co. Inc. v. Whitten*, 224 Ariz. 121, 418 P.3d 894 (Ct. App. 2017), a client sued attorneys who prepared documents for a transaction. The attorneys argued that subsequent attorneys were comparatively at fault for the client’s damages. The court held that the first attorneys did not waive the privilege for the client’s subsequent attorneys. Applying the *Hearn* test, the appellate court held that the attorney defendants (who were not the privilege holders), rather than the client, put the privileged information at issue by arguing that the client

and others were at fault. The court confirmed the Arizona rule that a privilege holder must affirmatively inject attorney-client communications into a case to waive the attorney-client privilege.

In *United Specialty Ins. Co. v. Dorn Homes Inc.*,³³⁴ F.R.D. 542 (D. Ariz. 2020), the district court analyzed whether an advice of counsel defense waives attorney work-product protected documents the attorney did not communicate to the insurer client. The court held that the insurer must disclose the documents--even if they had not been communicated to the insurer--if the insurer waived the attorney client privilege by asserting an advice of counsel defense. The court reasoned that permitting the work-product documents to remain privileged would ignore “the potential for litigation abuses, and erects too much of an impediment to the truth seeking process. The court also ordered production of work-product documents created after the declaratory action was filed, rejecting the insurer’s argument that once it filed its declaratory judgment complaint, the attorney’s thought process changed from “advice of counsel” to litigation strategy. Important to that ruling, however, was the fact that the claims adjusting process was still ongoing when the litigation was filed.

In *Jalowsky v. Provident Life Insurance*, 2020 WL 3492554 (D. Ariz. June 25, 2020), the district court rejected attempts to obtain unredacted audit trail logs which contained information protected by the attorney-client privilege. The court reasoned that the identity of the individual accessing the information was discoverable but not the “description” of the work, which would intrude in privileged communications.

Communications with Expert Might Waive Privilege

In *Hunton v. Am. Zurich Ins. Co.*, 2017 WL 3712445 (D. Ariz. Aug. 29, 2017), the insurer’s expert testified in a deposition that he did not know why the insurer denied a claim after receiving a medical examination favorable to the plaintiff, but speculated the reason “was a discussion [the claims adjuster] had with counsel the day she accepted it.” The court held that the insured, through “the testimony and opinion of its bad faith expert, has put the subjective beliefs of the claims adjuster directly at issue, and those beliefs implicate the advice she received” from the insurer’s attorney. By electing to defend the case on the subjective reasonableness of the adjuster’s actions, the insurer placed those actions at issue, and found an implied waiver of the attorney-client privilege.

Untimely Prepared Privilege Log

When objecting to production of materials on the basis of attorney-client privilege, it is essential to prepare a privilege log identifying what is being withheld. Failure to timely produce a privilege log can lead to a waiver of the attorney-client privilege. *Burlington N. & Santa Fe Ry. Co. v. U.S. Dist. Ct. for the Dist. of Mont.*, 408 F.3d 1142 (9th Cir. 2005). *Burlington* makes clear that that there is no “per se waiver rule that deems a privilege waived if a privilege log is not produced within Rule 34’s 30-day time limit.” Instead, *Burlington* encourages courts to engage in a “holistic reasonableness analysis” and make a case-by-case determination based on various factors,

including the delay in producing the privilege log, the magnitude of the document production, and the degree to which the assertion of privilege enables the adverse party to evaluate whether the withheld documents are privileged. If the delay in producing the log was not a “tactical manipulation of the rules and discovery process,” courts are hesitant to find a waiver of the privilege. *Labertew v. Chartis Prop. Cas. Co.*, 2018 WL 1876901 (D. Ariz. Apr. 19, 2018).

Failure to Raise Attorney-Client Privilege

In *Scottsdale Ins. Co. v. Superior Court*, 59 Cal. App. 4th 263, 69 Cal. Rptr. 2d 112 (Cal. App. 1997), the insurer filed a declaratory judgment action regarding coverage. The insured served discovery requests on the insurer. The insurer objected, but failed to raise the attorney-client privilege objection, though that objection was raised later. The California Court of Appeal held that the company’s failure to expressly raise the attorney-client privilege objection in the initial response waived the privilege.

Attorney-Client Communications from Work Computer

In *Scott v. Beth Israel Med. Ctr. Inc.*, 17 Misc.3d 934, 847 N.Y.S.2d 436 (2007), a New York court held that e-mail messages between a doctor and his attorney regarding the doctor’s termination, sent from the doctor’s work e-mail, were not protected by attorney-client privilege or the attorney work-product doctrine. The doctor had filed a breach of contract action against his employer and a related entity after he was terminated. When he discovered that defendants possessed e-mails pertaining to the litigation that he sent to his attorney from his work e-mail, he sought a protective order to have the e-mails returned to him.

Denying the motion, the court first reviewed defendants’ e-mail policy, which stated that the employees had no privacy rights with regard to e-mails sent using their communications systems and defendants had the right to access such communications at any time and without prior notice. The court said that such a policy is the equivalent of “the employer looking over your shoulder each time you sent an e-mail” so that otherwise privileged communications – those between an attorney and client for the purpose of seeking legal advice – are not privileged because they were not made in confidence. Attorney-client privilege does not protect workplace e-mails if (1) the company has a policy banning personal use, (2) the company monitors employees’ emails, (3) third parties are allowed access to these e-mails, and (4) the employee had notice of these policies. Here, the attorney-client privilege was waived because plaintiff and his attorney did not take reasonable precautions to prevent inadvertent disclosure. Further, the e-mails’ *pro forma* provision stating that it may be confidential was insufficient to overcome defendants’ e-mail policy.

DISCOVERY OF RESERVES

A.R.S. § 20-516 provides:

An insurer shall maintain reserves that place a sound value on its liabilities under its policies, annuities, and subscriber contracts. The reserves shall not be

less than the amount, estimated and consistent with the provision of this title, necessary to assure the payment of the insurer's unpaid policy holder and contract holder obligations, whether those obligations are reported or reported together with the expenses adjustment or settlement of the obligations.

FIRST PARTY CLAIMS

Relevance of Reserve Information

In insurance bad faith cases, policyholders often seek information pertaining to loss reserves to show “what [the insurer] actually knew and thought, and what motives animated its conduct, which are critical areas of inquiry in bad faith cases and fully fair game for discovery.” *W. Sur. Co. v. United States*, 2018 WL 6788665 (D. Ariz. Dec. 26, 2018). Arizona courts have come out both ways on the issue of whether reserve information is permitted discovery.

In *Metropolitan Life Insurance Co. v. Ogandzhavona*, 2013 WL 1442581 (D. Ariz. 2013), a doctor sued her insurer, MetLife, for bad faith following a dispute about the disability benefits MetLife owed the doctor. The doctor “requested that MetLife provide her with reserve information relating to her claims,” and MetLife objected, arguing reserve information was irrelevant to the doctor’s bad faith claim. The court stated that “[c]entral to the relevance (or lack thereof) of reserve information in a given case is the method of calculation. If the insurers can show their calculations do not include analysis of the factual or legal merits of the insured’s specific claim, but instead rely on automatic factors, then the relevance of reserve information diminishes significantly. On the other hand, courts have granted motions to compel production of reserve information when the insurers have failed to produce evidence that the reserve arithmetic does not include analysis of the claim’s merit.” MetLife had “shown that it does not analyze the factual and legal merit of a claim when it sets and adjusts the reserve amount,” and therefore the court denied the doctor’s request for reserve information. *Finkelstein v. Prudential Fin. Inc.*, 2022 WL 604884 (D. Ariz. Mar. 1, 2022) (reserve information not discoverable when it was set on generally applied factors versus claim specific information.)

In *United Specialty Ins. Co. v. Dorn Homes Inc.*, 334 F.R.D. 542 D. Ariz 2020), the defendant policyholder sought production of the reserve information because it was “wholly relevant” to the bad faith claims. The court analyzed the testimony of the claims adjusters to determine how the reserves were set and whether they were set “automatically.” Overruling the insurer’s objections, the court found that the reserves were calculated based on the factual or legal merits of the insured’s specific claim, and therefore were discoverable in the case.

Reserve Information as an Admission

A district court in California—a state with a statutory reserve requirement similar to Arizona’s—stated, “[t]he legislature ... established reserve policy. For this reason alone, a reserve cannot accurately or fairly be equated with an admission of liability or the value of any particular claim.” *In Re Couch*, 80 B.N.R. 512, 517 (S.D. Cal. 1987), citing *Union Carbide v. Travelers Indemnity Company*, 61 F.R.D. 411, 413 (W.D. Pa. 1973.)

In *J.C. Assocs. v. Fid. Guar. Ins. Co.*, 2003 WL 1889015 (D.D.C. 2003), the court held that discovery of reserve information was not relevant to the litigation, and could not be used as an admission in the circumstances presented in the case. Reserve information might be proof of bad faith if an insured claims the insurer failed to offer a settlement within policy limits or denied coverage, thereby subjecting the insured to a judgment in excess of the policy amount. *See, e.g., Athridge v. Aetna Cas. Ins. & Sur. Co.*, 184 F.R.D. 181 (D.D.C. 1998). When the question relates to coverage, however, the reserve information could be considered an admission only if it qualified as a confession by the insurer of potential liability despite its claim of no coverage. If other considerations drove the setting of the reserve, or its amount was dictated by state law or tax considerations, it becomes ambiguous and uncertain as to whether the setting of a reserve becomes an admission that can be used against the insurer. The court held that a reserve figure is not an admission unless it is in fact an assessment of liability, rather than the product of State Law or regulation, or driven by tax or other financial considerations. As a result, the court prohibited plaintiff from obtaining copies of the reserve information.

THIRD PARTY CLAIMS

In *American Prot. Ins. Co. v. Helm Concentrates Inc.*, 140 F.R.D. 448 (E.D. Cal. 1991), plaintiff brought a declaratory judgment action claiming its policy did not cover the insured’s claimed losses due to the failure of machinery within its manufacturing plant. The defendant plant owner filed a counterclaim and third party claims against American Motorist Insurance Company Inc. and Lumbermen’s Mutual Casualty Company. All of the insurers provided coverage under separate policies issued as part of an “all-risk” package policy. The court considered a motion to compel disclosure of information in American Protection’s files relating to the reserves established on the claims at issue. American Protection objected on the grounds such information was not relevant. In considering whether an insurer acted in bad faith in denying its duty to defend under a third party liability policy, the fact that it established a reserve particularly for litigation costs is probative on the issue of whether there is a potential for liability. Thus, when an insurer, by its actions, acknowledges the potential for liability and fails to attempt to settle a claim against its insured, and/or fails to defend, reserve information is relevant to the issue of good faith.

DISCOVERY OF CONTRACT BETWEEN INSURER AND INDEPENDENT ADJUSTER

The duty of good faith and fair dealing is non-delegable, and an insurer cannot bring a claim of negligence against an independent insurance adjuster who owes the insured no duty of care. However, Arizona courts have found that where an “insurer and its agent are engaged in a joint venture...each is jointly and severally liable with the other for a bad faith refusal to pay,” notwithstanding an absence of “proof of profit and loss sharing and...joint right to control.” Most recently, a court compelled production of any contracts, promotional materials, and proposals exchanged between an insurer and independent contractor. *Ingram v. Great Am. Ins. Co.*, 112 F. Supp. 3d 934, 940 (D. Ariz. 2015). The court held that the substance of these documents could be relevant to whether the independent adjuster advertised more aggressive claims handling to promote business with the insurer, or whether the insurer promised financial benefits to the independent adjuster in return for lowering costs by paying out fewer claims. *See also Finkelstein v. Prudential Fin. Inc.*, 2022 WL 604884, (D. Ariz. Mar. 1, 2022) (finding a master services agreement between insurer and vendor relevant to the case.)

DISCOVERY SANCTIONS

Evidentiary Hearing Requirement

In *Wayne Cook Enter., Inc. v. Fain Props. Ltd P’ship*, 196 Ariz. 146, 993 P.2d 1110 (Ct. App. 1999), the trial court dismissed plaintiff’s action because plaintiff’s counsel supplemented his disclosure five weeks before trial with a single document the defendant characterized as “relevant to the heart of the case.” Defendant asserted that the document’s late disclosure was an outrageous violation of the plaintiff’s disclosure obligations and sought sanctions. Relying on Rule 37(d) (if a party or attorney knowingly fails to timely disclose damaging and/or unfavorable information, the imposition of serious sanctions, including dismissal of the claim or defense may result), the court dismissed the action. It reasoned that plaintiff’s attorney had violated discovery rules, and his failure to explain why gave rise to a strong inference that the failure to disclose was deliberate. The court of appeals reversed. The sanction of dismissal is warranted only when the court makes an express finding that a party, as opposed to his counsel, has obstructed discovery and the court has considered and rejected lesser sanctions as a penalty. The imposition of such strong sanctions requires an evidentiary hearing and findings on these critical issues.

Prejudice Relative to Timing of Trial

In *Zimmerman v. Shakman*, 204 Ariz. 231, 62 P.3d 976 (Ct. App. 2003), plaintiff’s case was dismissed for failing to disclose. The case had been set for trial, and in the parties’ joint pretrial statement, each party objected to the other’s exhibits and witnesses as non-disclosed. The case was tentatively settled but an agreement was never entered with the court. The court set another cutoff date for disclosures. Plaintiff filed its supplemental list of witnesses and exhibits when they were due. Defendant filed a motion in limine and for sanctions, stating he had not received the requested disclosures and documents from plaintiff. Plaintiff did not respond to the motion, and the trial court granted the motion in limine. Defendant then immediately filed a motion to dismiss

the complaint, arguing that the granting of the motion in limine meant that plaintiff could not prove his claims at trial. The trial court granted the motion and dismissed the case.

The court of appeals reversed. The policy behind the disclosure rules is not to create a “weapon for dismissing cases on a technicality.” And while any failure to follow the disclosure rules may lead to some form of sanctions, there is little reason to completely bar the use of evidence when no trial or case dispositive motion is pending. If trial is imminent, on the other hand, the possibility of prejudice will increase. In such case, the trial judge has considerable latitude in determining whether good cause has been shown for a late disclosure. If good cause is lacking, a reasonable sanction might be to bar the evidence not previously disclosed. Here, since the plaintiff had already disclosed witnesses and exhibits, the court said trial could proceed, limited to the evidence that had been disclosed.

Protective Orders

When disclosing confidential and proprietary information in a bad faith case, it is important to analyze whether you need to protective order. A protective order can prevent the disclosure of the documents and testimony in other matters, including other cases handling by the attorney. *Jalowsky v. Provident Life and Accident Insurance Co.*, 2020 WL 8184343, (D. Ariz. June 18, 2020) provides an example. In this case, the attorney representing the policyholder sought to use documents obtained in another case against the insurer. The district court rejected the attempt, finding there was no exception in the original protective order in which the documents were obtained to allow them to be used in another matter, even though the documents were relevant to the case. Rather, the protective order stated the documents “may be used only in connection with the case at bar, and may not be disclosed for other purposes.”

Business Audits/Computer Audits

In *Finkelstein v. Prudential Fin. Inc.*, 2022 WL 604884 (D. Ariz. Mar. 1, 2022), the district court denied the insured’s request for financial audits because the insured did not explain how the request was proportional to the needs of the case. The court also denied a request to perform an audit of the computer claims handling system. The court reasoned that the insured failed to “specific, concrete evidence of concealment or destruction of evidence” in order to access a computer system maintaining claim information.

Additional Bad Faith Discovery

In addition to the discovery discussed above, trends in bad faith law show that Plaintiffs often request additional items during the course of discovery, including but not limited to, audit trails, leakage memorandums, market conduct reports, combined loss ratios, organizational charts, advertisement materials, and underwriting guidelines. Although there are no reported decisions specifically addressing the discoverability of these items, we have litigated many cases in which these requests are made. If faced with a situation where counsel is requesting these materials, or have questions regarding retention or discoverability of these materials pre-suit, please feel free to contact us so that we may guide you through the process. Each bad faith case is unique, and limiting the potential discovery can not only reduce the scope of discovery, but also lead to better results at mediation or trial.

If you have questions regarding the information in this chapter, please contact the author.

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CHAPTER 9: GENERAL AUTO INSURANCE

LIABILITY INSURANCE IS MANDATORY

Arizona requires all motor vehicles in the state to be insured. The policy must (1) be issued by an insurance carrier authorized to transact business in Arizona (2) for the benefit of the person named in the policy as the insured.

A.R.S. § 28-4009 requires an owner's policy to: (1) designate all motor vehicles covered by the policy, and (2) insure the named insured and any other person using the vehicle with the express or implied permission of the named insured. Policies issued or renewed after June 30, 2020 must cover liability for damages arising out of the ownership, maintenance or use of the motor vehicle within the United States or Canada, subject to the following limits:

- \$25,000 for bodily injury or death of one person in any one accident;
- \$50,000 for bodily injury or death of two or more persons in any one accident; and
- \$15,000 for damage or destruction of property of others in any one accident.

By agreement in writing between the named insured and the insurer, the policy may exclude from the definition of "insured" any person or persons designated by name when operating a motor vehicle. The enforceability of a named driver exclusion pursuant to the statute is discussed in more detail below.

In Arizona, and a majority of states, the change of ownership of the insured vehicle automatically terminates automobile liability coverage. Arizona adopted this rule in *Hults v. Pash*, 161 Ariz. 506, 779 P.2d 821 (Ct. App. 1989). In *Hults*, prior to the loss at issue, the named insured of an Aetna policy sold the listed vehicle to another. In ruling that coverage was extinguished when the insured sold the car subject to an installment payment contract, the Arizona court of appeals ruled that the sold vehicle was no longer "your car" as required by the policy. The court also quoted Aetna's similar "change of interest" clause ("Your rights and duties under this policy may not be assigned without our written consent"), in determining that coverage did not exist due to the change in the insured risk.

COVERAGE AND REASONABLE EXPECTATIONS

In *Darner Motor Sales v. Universal Underwriters Ins. Co.*, 140 Ariz. 383, 682 P.2d 388 (1984), the Arizona Supreme Court formulated the "reasonable expectations" doctrine as a method for interpreting and determining the validity of standardized "boilerplate" language in insurance contracts. The court held that under certain circumstances an insured could offer evidence of oral representations made by the insurer's agent to show that (1) the "dickered deal" was

different from the terms of the insurance contract, and (2) the insured had a “reasonable expectation” of coverage based on such oral representations.

In *Gordinier v. Aetna Cas. & Sur. Co.*, 154 Ariz. 266, 742 P.2d 277 (1987), the Arizona Supreme Court expanded the reasonable expectations doctrine. The court reversed summary judgment for the insurer regarding a policy exclusion for non-resident family members. The court concluded that Arizona courts must interpret insurance contracts in light of the objective reasonable expectations of an average insured. These are the circumstances when Arizona courts will not enforce even unambiguous boilerplate terms in a standardized insurance contract:

- The contract terms, although not ambiguous, could not be understood by a reasonably intelligent consumer who tried to read the policy;
- The insured did not receive full and adequate notice of the term in question, and the provision is either unusual or unexpected, or one that emasculates apparent coverage;
- Some activity that can be reasonably attributed to the insurer would create an objective impression of coverage in the mind of a reasonable insured; and
- Some activity reasonably attributable to the insurer has induced a particular insured reasonably to believe that he has coverage, although such coverage is expressly and unambiguously denied by the policy.

In *State Farm Mut. Auto. Ins. Co. v. Dimmer*, 160 Ariz. 453, 773 P.2d 1012 (Ct. App. 1988), the declarations page provided liability coverage of \$50,000 for each person and \$100,000 for each accident. However, a policy provision limited bodily injury coverage for an insured’s family member to the liability limits required by law (then 15/30). Mrs. Dimmer was injured while riding as a passenger in the family car her husband, the insured, was driving. Mrs. Dimmer filed a claim with State Farm for \$50,000. State Farm did not pay the \$50,000 claim because the household exclusion clause in the contract limited liability coverage to \$15,000. The court of appeals applied the *Gordinier* factors and determined that an average insured in the Dimmers’ position would reasonably have expected liability protection in the amount of \$50,000 for an automobile negligence claim against Mr. Dimmer, including Mrs. Dimmer. The court found the household exclusion unenforceable against the insured because of its technical wording and inconspicuous location within the policy, and because it reduced the coverage ostensibly granted by the declarations page. Pursuant to the reasonable expectations doctrine, Mrs. Dimmer was entitled to \$50,000 in liability coverage.

Fortunately, subsequent Supreme Court decisions have reaffirmed the point originally made in *Darner* that “reasonable expectations” must be something more “than the insured’s fervent hope of coverage following a loss.” A clearly worded exclusion will still be enforced unless the insured can establish one of the factors described in *Gordinier*. See, e.g., *Philadelphia Indem. Ins. Co. v. Barerra*, 200 Ariz. 9, 21 P.3d 395 (2001).

WHICH STATE’S LAW WILL APPLY: THE PLACE OF RESIDENCE, THE PLACE OF CONTRACT OR THE PLACE OF LOSS?

This question will usually be resolved by a conflicts of law analysis. In tort and contract situations, conflicts of law questions are usually, although not always, governed by the laws of the state in which the tort occurred or the contract was executed. However, other factors are considered, such as the place of loss, the contacts with the place of loss, and whether it is reasonable to expect the parties to litigate the case in the place where the loss occurred. Generally, conflicts issues will be resolved on a case by case basis and will depend on the facts and circumstances in each case.

Beckler v. State Farm Mut. Auto. Ins. Co., 195 Ariz. 282, 987 P.2d 768 (Ct. App. 1999), provides an example of the factors considered in choice of law questions. In *Beckler*, the issue was whether Nebraska or Arizona law applied to stacking of uninsured motorist coverage. The Becklers had several vehicles licensed in their state of residence, Nebraska, with separate State Farm policies issued on the vehicles. The Becklers’ son brought one vehicle, a jeep, to Arizona to attend college and while in Arizona, was struck as a pedestrian by an uninsured vehicle. State Farm paid the uninsured limits from one of the other policies and filed a declaratory judgment action to preclude the Becklers from also receiving the UM benefits on the vehicle in Arizona. The parties stipulated that Arizona law would permit stacking and Nebraska law would not. The court found it most significant that the insured risk (the jeep) was located in Arizona and that Arizona was the principal location of the risk, for nine months per year. The court stated that applying Arizona law would further Arizona’s interest in providing a greater recovery for the injured party.

A POLICY OBTAINED BY FRAUD OR MISREPRESENTATION BINDS THE INSURER UP TO THE MINIMUM LIMITS

A.R.S. § 28-4009(C)(5)(a) provides that in the event of an accident, no violation of the policy shall defeat or void the policy **up to the limits required by law** (25/50). Every motor vehicle liability policy is subject to this provision – even if the policy does not expressly provide so. ***Midland Risk Mgmt. Co. v. Watford***, 179 Ariz. 168, 876 P.2d 1203 (Ct. App. 1994). But any additional coverage under the policy (over 25/50) is not subject to the provisions of the statute. See A.R.S. § 28-4009 (D) (formerly A.R.S. § 28-1170(G)); ***Farmers Ins. Co. of Arizona v. Young***, 195 Ariz. 22, 985 P.2d 507 (Ct. App. 1998).

Prudential v. Estate of Rojo-Pacheco, 192 Ariz. 139, 962 P.2d 213 (Ct. App. 1997), reaffirmed that when the policyholder has been fraudulent and his policy provides for more coverage than the minimum, the insurer might have to pay only the minimum. But once the insurer decides to cancel coverage because the policyholder misrepresented information in his application, the insurer must give the policyholder notice by mail 10 days before coverage is cancelled. A.R.S. § 20-1632. In *Prudential*, the court said the notice requirement applies only to policies in effect more than 60 days. Compare A.R.S. § 28-4009(C)(5)(a) and A.R.S. § 20-1109.

THE “NAMED DRIVER” EXCLUSION

A.R.S. § 28-4009(A)(3) provides that the owner’s policy of liability insurance may “[b]y agreement in writing between a named insured and the insurer...exclude as insured a person or persons designated by name when operating a motor vehicle.”

In *State Farm Auto Ins. Co v. Dressler*, 153 Ariz. 527, 738 P.2d 1134 (Ct. App. 1987), the court, interpreting former A.R.S. § 28-1170(B)(3) in conjunction with the language of State Farm’s named driver exclusion clause, concluded that the exclusion clause was valid and relieved State Farm of liability for claims resulting from the excluded driver’s operation of the insured vehicle. State Farm was not obligated to defend or indemnify the excluded driver for her negligence or the named insured for negligently entrusting the vehicle to the excluded driver.

A named driver exclusion might be enforceable or unenforceable, depending upon reasonable expectations of the insured. *State Farm Mut. Auto Ins. Co. v. Falness*, 178 Ariz. 281, 872 P.2d 1233 (1994). But a named driver exclusion is not valid and enforceable under former A.R.S. § 28-1170(B)(3) unless the exclusion is in writing and signed by the insured. *Transportation Ins. Co. v. Bruining*, 186 Ariz. 224, 921 P.2d 24 (1996). Strict adherence is required. A verbal understanding or a unilateral “confirmation letter” by the insurer to the insured is not sufficient. Moreover, if a named driver exclusion expires with the policy on a certain date, another fully executed named driver exclusion must be completed upon policy renewal.

THE HOUSEHOLD EXCLUSION

“Household exclusions” exclude coverage under the liability portion of an auto policy when a family member is injured by the negligence of another family member driving the insured vehicle. The insurer’s main concern is familial collusion – namely, the negligent family member assisting the injured family member in securing a judgment and recovering proceeds. Attorneys representing insureds have argued for many years that to the extent it is the state’s policy to allow tort claims to be asserted in the intra-family setting, the household exclusion frustrates the state’s purpose by allowing liability insurers to deny coverage, or limit coverage, when a tort claim is being asserted. Household exclusions are not against Arizona public policy. *Arceneaux v. State Farm Mut. Auto. Ins. Co.*, 113 Ariz. 216, 550 P.2d 87 (1976). But they might be unenforceable in light of the insured’s reasonable expectations. *See, e.g., Gordinier v. Aetna Cas. & Sur. Co.*, 154 Ariz. 266, 742 P.2d 277 (1987) (because the policy was difficult to understand and took away coverage the Gordiniers might have thought they had, the household exclusion clause could be unenforceable; court remanded for determination of whether policy’s limitations were brought to the insured’s attention); *State Farm Mut. Auto. Ins. Co. v. Dimmer*, 160 Ariz. 453, 773 P.2d 1012 (Ct. App. 1988) (upholding validity of household exclusion, but finding it unenforceable based upon the insured’s reasonable expectations); *Pruett v. Farmers Ins. Co. of Arizona*, 175 Ariz. 447, 857 P.2d 1301 (Ct. App. 1993) (household exclusions can be challenged on the basis of the insured’s reasonable expectations); *Averett v. Farmers Ins. Co. of Arizona*, 177 Ariz. 531, 869 P.2d 505 (1994) (remanding to the trial court to determine whether the household exclusion was enforceable in light of reasonable expectations doctrine). The reasonable expectations doctrine,

however requires that the insurer have “reason to believe” the insured would not have agreed to the exclusion. In a trial concerning the reasonable expectations doctrine, the jury must be so instructed. *State Farm Fire & Cas. Ins. v. Grabowski*, 214 Ariz. 188, 150 P.3d 275 (Ct. App. 2007)

Handling Claims Presented by The Insured’s Family Members

Household exclusion clauses are generally enforceable and can limit coverage to the statutory minimum amount. *Averett v. Farmers Ins. Co. of Arizona*, 117 Ariz. 531, 869 P.2d 505 (1994). However, an insured is likely to claim he expected his family members to be covered up to the full limits of the liability coverage. Any claim involving a family member/household resident should be flagged for immediate investigation. The investigation should consist of a telephonic or personal interview of the named insured, and the interview should be recorded.

Prior to the interview, the insured should be advised that the caller is a claims representative from the insurance carrier. Routine questions about the accident, the vehicle operator, passengers and known injuries should be asked. Following these preliminary questions about liability issues and potential claims, the discussion should then turn to the policy’s benefits:

- The adjuster should confirm certain information with the insured, including: the name of the insured’s agent, when the policy was purchased and how the insured received the policy (in person or by mail).
- The insured should be told that he has liability coverage which protects him against damages claims made by others in the amount of the available coverage, for example, 100/300/50. The insured should then be asked if he understands this policy provision.
- The insured should be told that for claims made against him by family members/household residents who were in the insured vehicle, the maximum protection afforded by the policy is the minimum amounts required by Arizona law, or 15/30/10.
- The insured should be told that his family member(s)/household resident(s) can recover under the policy for injuries up to \$15,000 per person with a maximum of \$30,000 for two or more family members/household residents making a claim against an insured driver.
- The insured should be asked if he understands that the household exclusion provision is part of his policy.
- If the insured says he understands the foregoing to be a part of his policy, the discussion should turn to other applicable coverages such as medical payments coverage and collision coverage. Claim handling procedures can also be explained.
- If the insured states he does not understand the amounts of coverage provided for family members/household residents under the policy, the insured should be told that the amounts are set forth in the policy. The insured should be asked if he/she received

contrary information, and if so, what the information was, when it was received, and from whom.

The answers given during the interview can help determine whether the household exclusion applies and limits coverage for the particular accident.

“PERMISSIVE USE”

As is noted above, Arizona has adopted an omnibus insurance coverage statute, which requires all automobile policies to cover the named insured as well as anyone using the vehicle with express or implied permission of the insured. A.R.S. § 28-4009(A). The omnibus statute is to be construed broadly to favor coverage for permissive drivers. *Hille v. Safeco Ins. Co. of Am.*, 25 Ariz. App. 353, 354, 543 P.2d 474, 475 (1975). Whether a person has permission to drive a vehicle is generally a “question of fact to be determined by the trier of fact.” *Id.* The party claiming coverage under an insurance policy has the burden of establishing, under the facts and circumstances, that the driver of the vehicle had the requisite permission. *Home Ins. Co. v. Keeley*, 20 Ariz. App. 200, 202, 511 P.2d 213, 215 (1973).

In determining whether an actor’s conduct is within the scope of permission, Arizona courts have adopted the “minor deviation rule.” Under that rule, a permissive driver may extend the scope of use beyond the express or implied grant initially provided, as long as the use remains within the scope of the permission granted. *James v. Aetna Life & Cas.*, 26 Ariz. App. 137, 546 P.2d 1146 (1976). Under this rule, if the actor’s use of a vehicle is not a gross, substantial, or major deviation from the permission granted in a particular circumstance, even though the use may be a deviation, protection is still afforded to the actor under the omnibus clause. A deviation is considered material or major if the deviation is substantial in terms of duration, distance, time or purpose. Thus, a slight deviation will not change a permitted use into a non-permitted use. The justification for the minor deviation rule is that it furthers the purpose of the financial responsibility laws to protect the driving public from financial hardship caused by automobiles driven by financially irresponsible persons.

THE “UNDERAGE EXCLUSION”

A liability policy’s exclusion of coverage for underage drivers is invalid at least to the extent of the minimum liability coverage limits (currently \$25,000 per person / \$50,000 per accident). *Principal Cas. Ins. Co. v. Progressive Cas. Ins. Co.*, 172 Ariz. 545, 838 P.2d 1306 (Ct. App. 1992) (invalidating policy provision excluding liability coverage for unlicensed drivers because the exclusion would leave the public unprotected).

THE “INTENTIONAL ACTS EXCLUSION”

The intentional acts exclusion precludes coverage of an injury caused when the insured intentionally acts wrongfully with a purpose to injure. *Transamerica Ins. Group v. Meere*, 143 Ariz. 351, 649 P.2d 181 (1984). The intentional acts exclusion does not apply, however, when an

insured acts intentionally, but the act unintentionally results in wrongful conduct. ***Phoenix Control Sys., Inc. v. Ins. Co. of N. Am.***, 165 Ariz. 31, 796 P.2d 463 (1990). The intentional acts exclusion upholds the public policy designed to prevent an insured from acting wrongfully with the security of knowing that his insurance company will pay for the damages.

In ***Republic Ins. Co. v. Feidler***, 178 Ariz. 528, 875 P.2d 187 (Ct. App. 1993) (“*Feidler I*”), the Arizona court of appeals dealt with the interrelationship between intoxication and the enforcement of an intentional acts exclusion. Generally, there is a conclusive presumption of intent to injure when the insured commits an act “virtually certain to cause injury.” For example, striking another person in the face or stabbing another person with a knife are the types of acts that ordinarily justify a conclusive presumption that the insured intended to harm the other person. However, this conclusive presumption of intent to injure does not apply when the insured lacks the “mental capacity to act intentionally.” An insured’s intoxication might deprive him of the mental capacity to act intentionally. Accordingly, where the insured is intoxicated, his “mental capacity to act intentionally” is a factual question and the conclusive presumption of intent to cause injury does not apply.

The *Feidler* court also held that “reckless,” as defined by the Arizona criminal statutes, is not the equivalent of “intentional” for purposes of an intentional acts exclusion. Under the criminal code, an intoxicated person can act recklessly. But intoxication can still deprive the insured of the mental capacity necessary to form an intent to injure (the standard necessary to exclude coverage under an intentional acts exclusion).

THE FAMILY PURPOSE DOCTRINE

A.R.S. § 28-3160 states that the parent, guardian or responsible person who signs an application for a minor’s instruction permit is not jointly and severally liable for the minor’s negligent or willful misconduct, if proof of financial responsibility is maintained. Nevertheless, the Family Purpose Doctrine states that the head of the household who furnishes a motor vehicle to a member of the household, is jointly and severally liable with the household member to whom the vehicle is furnished. The household member to whom the vehicle is furnished need not be a minor. The Family Purpose Doctrine is alive and well in Arizona. ***Country Mut. Ins. Co. v. Hartley***, 204 Ariz. 596, 65 P.3d 977 (Ct. App. 2003) (A.R.S. § 28-3060 does not abrogate or limit liability arising under the Family Purpose Doctrine); ***Young v. Beck***, 227 Ariz. 1, 251 P.3d 380 (2011). In *Young*, the Becks provided their son, Jason, with a SUV subject to some limitations. Specifically, he was not allowed to taxi his friends around town. One night, while driving friends home, Jason was involved in an accident. The Becks argued that the family purpose doctrine should not apply because their son’s use of the vehicle was outside the scope of their permission. The court rejected this argument and held that the family purpose doctrine “does not require that a parent give permission for every possible route taken or deviation made by a family member while operating the vehicle...To hold otherwise would enable parents to minimize themselves from liability by imposing general, unrealistic, or unenforced limitations on their child’s use of the vehicle.”

For the Family Purpose Doctrine to apply, there must be a family with sufficient unity so that there is a head of the family; the motor vehicle involved must have been furnished by the head of the family to a family member; the vehicle must have been used by the family member with the express or implied consent of the head of household; and, the vehicle was furnished for a family purpose. *Blocher v. Thompson*, 169 Ariz. 182, 818 P.2d 167 (Ct. App. 1991). The Family Purpose Doctrine applies to general and special damages; punitive damages are not imputed to the head of the household. *Jacobson v. Superior Court In and For Maricopa County*, 154 Ariz. 430, 743 P.2d 410 (Ct. App. 1987).

POLICY LIMITS APPLICABLE

Loss of consortium claims are typically deemed to be derivative of the injured person's claim, and thus the single limit of the policy and not the aggregate limit applies. A different standard applies to negligent infliction of emotional distress claims. In *State Farm Mut. Auto. Ins. Co. v. Connolly*, 212 Ariz. 417, 132 P.3d 1197 (Ct. App. 2006), the court held that a negligent infliction of emotional distress claim was not derivative and therefore was compensable under the aggregate limit. To state a claim for negligent infliction of emotional distress, a plaintiff must have been in the zone of danger and must prove a physical injury resulting from the shock of witnessing an injury to a closely related person.

The person claiming negligent infliction of emotional distress need not witness injury to another person to recover. It is sufficient if the claimant's shock or mental anguish, manifested by physical injury, results from a threat to the claimant's personal security. In *Quinn v. Turner*, 155 Ariz. 225, 745 P.2d 972 (Ct. App. 1987), for example, a child was standing with his mother beside a parked car when another car crashed into it. The child was entitled to recover for his emotional distress, because he was only a few feet from the point of impact. The emotional distress must be manifested in some physical way.

RENTAL CARS

General Coverage Requirements

In 2012, the legislature amended A.R.S. 28-2166, the statute dealing with rental cars. The amendment changed the legal responsibilities of vehicle rental companies when their renters are involved in accidents. Before 2012, the statute required rental companies to procure minimum liability insurance, or be self-insured, in the amount of \$15,000/person, \$30,000/accident and \$10,000/property damage. This coverage was primary to any other available insurance coverage for damages caused by a renter. The statute also expressly stated that a rental company was not an insurer, and had no obligation to provide a defense after it had tendered its limits to the insured party or the next available coverage for the renter.

Amended A.R.S. 28-2166 still requires protection of the public, although in various forms, in accordance with the Financial Responsibility Act. The statute requires an owner renting cars to: (1) procure public liability insurance with limits of 15/30/10 with an insurance company approved

by the department of insurance and financial institutions (the statute has not yet raised the minimum insurance requirements as they have been for private vehicle owners); or (2) furnish the Department of Transportation satisfactory proof of self-insurance. The policy or self-insurance must also cover the liability of the renter to a passenger unless the owner gives the renter a written notice that it does not provide coverage for a passenger.

The rental car company's policy, or its self-insurance, is primary unless it states the following in the rental or lease agreement: "The owner does not extend any of its motor vehicle financial responsibility or provide public liability insurance coverage to the renter, authorized drivers or any other driver." This language must be in at least ten point bold type, or in the terms of the master agreement maintained with a renter, and affirmatively acknowledged by the renter. If a reservation is made online, the disclosure must be made in a conspicuous manner. However, if the renter purchases public liability insurance from the rental car company in the 15/30/10 limits which covers the renter and authorized drivers against liability, it is designated by the statute as primary coverage.

Importantly, if the rental car company provides the requisite language that it is not providing any liability coverage, it is nevertheless required to provide primary coverage and a legal defense if the renter does not have any other liability coverage available and applicable, or the rental car company has not fully and accurately provided to the third party claimant the contact information for the person who rented the car. Otherwise, the rental car company must respond to the third party claim within twenty days following notification of a third party claim.

The statute continues to provide that in those situations in which it must furnish primary coverage, the rental car company has no obligation to provide a defense to the renter once it has paid its coverage limits if the renter has no other liability coverage available and applicable to the loss. When the rental car company does provide a defense, if there is excess coverage, the company must continue to provide a defense, and cannot tender the defense to the excess carrier without the written agreement of the excess insurer. If the excess insurer accepts the tender of defense, it is not responsible for any costs incurred by the rental car company before the tender is accepted. Interestingly, the statute now provides that where the rental car company has no obligation to provide primary coverage, its insurance, or self-insurance, is excess.

The statute continues to provide that the rental car company has the right to bring a lawsuit against the renter if it pays damages arising out of the operation of the rental vehicle by an unauthorized driver. This right of subrogation against the renter does not apply in any other situations.

Duty to Defend

A rental car company owes a duty to defend unless there is a coverage defense. This duty can apply to the person who rented the car, or to someone driving the car with the renter's permission. A.R.S. § 28-2166 defines "renter" to include "any person operating a motor vehicle with permission of the person who has rented it." This is important because the mandatory insurance obligations placed upon rental companies apply to liability coverage for the "renter's"

alleged negligence. Therefore, the liability insurance applies to any person driving the car with the permission of the person whose name is actually on the rental contract.

This precludes rental car companies and/or their insurers from denying coverage for damages an unauthorized driver causes to a third party. Even if the rental insurance contract excludes coverage for liability arising out of the acts of an unauthorized driver, such clause would be against Arizona law based upon A.R.S. § 28-2166.

As before the amendment to Section 28-2166, there is a significant liability risk in the event the rental car company fails to respond or present a defense to a third party claim when required to do so. Interpreting a prior version of this statute, the Arizona Supreme Court held that a rental company was itself an insurer for all intents and purposes, indicating that a rental company that failed to meet its obligations as an insurer, including its obligation to defend and indemnify a renter, could be subject to a bad faith action. The legislature later amended the statute, explicitly stating that a rental company was not an insurer. The most recent amendment, however, removes this language. This again raises a question as to the rental company's status as an insurer or merely a guarantor of the policy limits, and whether it can be subject to a bad faith action if it fails to defend a renter when required by the statute. This will likely be the subject of future litigation.

To limit liability exposure and avoid the obligation to defend, rental companies will need to confirm that their renters have current and applicable liability insurance. They should also evaluate claims efficiently, and promptly forward a renter's contact and insurance information when notified of the complaint.

UM/UIM Coverage for Rental Cars

A.R.S. § 20-259.01 provides that insurers may make UM/UIM coverage available to rental and common carriers. It is not required.

If UM/UIM coverage is offered and accepted by the rental car company, and the renter also has his own policy providing UM/UIM, the renter may stack his/her UM/UIM coverage. A "set-off" or "other insurance" provision is invalid to the extent the insured is not fully compensated for his/her injuries. *Rashid v. State Farm Mut. Auto. Ins. Co.*, 163 Ariz. 270, 787 P.2d 1066 (1990); *Croci v. Travelers Ins. Co.*, 163 Ariz. 346, 788 P.2d 79 (1990).

Exclusions

A rental policy probably cannot exclude liability coverage for an unauthorized driver, an under-aged driver or for some other violation of the rental agreement, including driving under the influence. *Philadelphia Indem. Ins. Co. v. Barerra*, 200 Ariz. 9, 21 P.3d 395 (2001). The legislative purpose of A.R.S. § 28-2166 is to protect the public from economic damages caused by persons operating rental vehicles. *Lowry v. Tucson Diesel, Inc.*, 17 Ariz. App. 348, 498 P.2d 160 (1972); *State Farm Mut. Auto. Ins. Co. v. Agency Rent-A-Car, Inc.*, 139 Ariz. 201, 677 P.2d 1309 (Ct. App.

1983). As a result, any exclusion or provision in the rental policy that is contrary to the legislative purpose will probably be held unenforceable.

In *Consol. Enters., Inc. v. Schwindt*, 172 Ariz. 35, 833 P.2d 706 (1992), for example, Schwindt rented a car from Budget and was specifically advised that he could not allow his daughter, who was under the age of 21, to drive the car. Schwindt allowed his daughter to drive the car, and her negligent driving caused an accident. Budget paid the third-party victim in excess of \$10,000 for property loss and personal injuries and then sued Schwindt to recover its payment to the third-party under a breach of contract theory. The Arizona Supreme Court held that nothing in former A.R.S. § 20-324 permits such a claim for breach of contract. Budget, required by statute to insure Schwindt and all permissive users against their negligence, could not avoid risk by inserting restrictive clauses in its rental agreement that removed its statutory requirements. Apparently in response to *Schwindt*, the legislature changed the rental car statute to specifically provide rental car companies/owners with a right of subrogation against the renter for damages arising out of unauthorized operation of the vehicle. This is the only right of subrogation available against a renter when a non-authorized driver's use of a vehicle results in damage to the rental car owner. A.R.S. § 28-2166(D)(2).

Subrogation

A.R.S. § 28-2166(D) contains the only right of subrogation for a rental car company. A rental car company/owner has a right of subrogation against the renter when the owner's damages are caused by a person operating the vehicle and is not authorized to do so by the written rental agreement, and when the damages arise out of the unauthorized operation of the vehicle.

Negligent Entrustment

A rental car company can be held responsible for the negligence of its renters under a theory of negligent entrustment. The plaintiff must show that the "defendant owned or controlled the motor vehicle concerned and gave the driver permission to operate the vehicle." *Lumbermens Mut. Cas. Co. v. Kosies*, 124 Ariz. 136, 138, 602 P.2d 517, 519 (Ct. App. 1979). The jury must also find that the defendant's conduct was the legal and proximate cause of the alleged injury. *Tellez v. Saban*, 188 Ariz. 165, 171, 933 P.2d 1233, 1239 (Ct. App. 1996).

Negligent entrustment is not restricted to cases in which the owner entrusts a vehicle to one known to be incompetent or inexperienced. *Tellez*, 188 Ariz. at 171, 933 P.2d at 1239. It can also apply where the "third person's known character or the peculiar circumstances of the case are such as to give the actor good reason to believe that the third person may misuse [the instrumentality]." *Id.* In *Tellez*, a rental car company knowingly rented a car to an individual who did not have a driver's license. The rental agency did not inquire as to why the renter could not provide a valid license. If it had inquired, it would have discovered that the individual's license had been revoked for a DUI conviction. In light of these facts, a jury could find that the rental car company's negligence was a proximate and legal cause of the renter's accident.

If you have questions regarding the information in this chapter, please contact the author or any JSH attorney.

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CHAPTER 10: UNINSURED AND UNDERINSURED MOTORIST COVERAGE

Uninsured (UM) and Underinsured (UIM) motorist coverage provides insurance coverage if an at-fault party does not have insurance, or does not have enough insurance to cover the insured/victim's damages. A.R.S. § 20-259.01 states that an insurer must offer in writing both uninsured and underinsured motorist coverage to their insureds up to the liability limits in the policy. The statute also states that an offer need not be made in the event of reinstatement of a lapsed policy or the transfer, substitution, modification or renewal of an existing policy. Any previously valid UM/UIM rejection or purchase decision remains valid until the insured makes a written request to the insurer for the addition of, or increase to, the amount of coverage.

Because A.R.S. § 20-259.01 requires insurers to offer uninsured and underinsured coverage, Arizona courts have held that where such insurance is offered to and purchased by the insured, policy exclusions limiting that coverage are invalid. See *Spain v. Valley Forge Ins. Co.*, 152 Ariz. 189, 731 P.2d 84 (1987) (holding invalid an insurer's contractual provision offsetting the available UM coverage by amounts already recovered under the liability coverage of the same policy; insured was entitled to both \$100,000 liability coverage and \$100,000 UM coverage); *Employers Mut. Cas. Co. v. McKeon*, 159 Ariz. 111, 765 P.2d 513 (1988) (named driver exclusion was invalid; insured was entitled to recover full amount of UM coverage purchased, even though that amount exceeded the statutory minimum); *Higgins v. Fireman's Fund Ins. Co.*, 160 Ariz. 20, 770 P.2d 324 (1989) ("other insurance exclusion" is void when insurer offers and insured purchases underinsured coverage).

In essence, once optional coverage is purchased in Arizona, it is subject to the same "public policy" considerations as mandatory coverage. That public policy in the UM/UIM context is to protect victims of financially irresponsible drivers. *Lowing v. Allstate Ins. Co.*, 176 Ariz. 101, 859 P.2d 724 (1993). Arizona courts will carefully scrutinize any attempt to limit uninsured or underinsured coverage.

OFFER OF UM/UIM MOTORIST COVERAGE

Prior to 1997, A.R.S. § 20-259.01 required every insurer writing motor vehicle liability policies to offer, by written notice, uninsured and underinsured motorist coverage. In 1997, the Legislature amended A.R.S. § 20-259.01 to require insurers to describe the coverages afforded and reasons an insured should consider accepting or rejecting such benefits. In 1998, the Legislature again amended A.R.S. § 20-259.01 restoring it back to its pre-1997 version. Today, insurers may utilize a form prescribed by the Director of the Department of Insurance to meet the requirements of the statute. See A.R.S. § 20-259.01(A) and (B).

An insurer's failure to make the required offer will result in the inclusion of UM/UIM benefits in the policy by operation of law in amounts equal to the insured's bodily injury liability limits. See

generally *State Farm Mut. Auto. Ins. Co. v. Ash*, 181 Ariz. 167, 888 P.2d 1354 (Ct. App. 1995). The offer does not need to contain an explanation of the nature of the UIM coverage.

Several cases have analyzed the statutory requirement that an insurer offer UIM coverage to insureds purchasing liability policies. In *Ball v. American Motorist Ins. Co.*, 181 Ariz. 124, 888 P.2d 1311 (1995), the Arizona Supreme Court held that an employer, as the named insured under an automobile fleet policy, could not waive the statutory requirement that the insurer extend a written offer of UIM coverage. And in *State Farm Mut. Auto. Ins. Co. v. Ash*, 181 Ariz. 167, 888 P.2d 1354 (Ct. App. 1995), the court held that the insurer must offer UIM coverage; the insurer need not prove that the insured either received the offer nor expressly rejected it. Further, although A.R.S. § 20-259.01 requires automobile insurers to offer insureds the option to purchase additional UM/UIM coverage in limits up to those they choose for their bodily injury liability coverage, it does not require an insurer to obtain written rejection of UIM coverage from an insured. *Blevins v. Gov't Employees Ins. Co.*, 227 Ariz. 456, 258 P.3d 274 (Ct. App. 2011).

In *Lawrence v. State Farm Mut. Auto. Ins. Co.*, 184 Ariz. 145, 907 P.2d 531 (Ct. App. 1995), the court of appeals held that an insurer must make an offer of UIM coverage when a new named insured, such as a spouse, is added to the policy, holding that such an addition is more than a mere “modification” of the contract.

The court in *Progressive Cas. Ins. Co. v. Estate of Palomera-Ruiz*, 224 Ariz. 380, 231 P.3d 384 (Ct. App. 2010), held that an offer of UIM/UM coverage must be conveyed by written notice and that the recording of a telephone conversation between the insurer and insured was insufficient. The plain meaning of the words “written notice” in A.R.S. § 20-259.01(B) required the offer of UM/UIM coverage to be communicated in writing. The failure to do so resulted in UM/UIM coverage being imputed into the policy.

Ballesteros v. American Standard Ins. Co., 226 Ariz. 345, 248 P.3d 193 (2011), held that the offer requirement did not require insurers to provide Spanish-language forms to Spanish speakers. Providing a Department of Insurance-approved form written in English provides sufficient notice in accordance with the statute.

In *Newman v. Cornerstone*, 237 Ariz. 35, 344 P.3d 337 (2015), the Arizona Supreme Court held that written notice offering UIM coverage did not need to include a UIM premium quote as part of an offer of coverage. The statute merely requires insurers to “make available” by “written offer” UIM coverage in an amount not less than the liability limits for bodily injury and death under A.R.S. § 20-259.01(B). The court held that the statute does not require the insurer to convey all material terms of the proposed insurance contract to an insured. Moreover, whether an offer of UM/UIM coverage has been made does not depend on the insured’s understanding of the terms being offered but rather on whether a reasonable person would understand that accepting the offer would bind the insurer to provide the coverage. Although the court recognized that the cost of the coverage might be useful information for an insured to have, the statute does not require that such information be provided.

As noted above, A.R.S. § 20-259.01(B) requires insurers to *offer* uninsured and underinsured motorist coverage to their insureds. In *Wilks v. Manobianco*, 237 Ariz. 443, 352 P.3d 912 (2015), the Arizona Supreme Court held that an insured who rejected UM/UIM on a DOI-approved form may still sue the insurance agent for negligently failing to obtain UIM coverage the insured requested and the agent agreed to procure. The Wilkses contacted an insurance agency seeking full insurance coverage for the two vehicles they owned. The agency obtained a State Farm policy for the Wilkses, which included uninsured motorist and underinsured motorist coverage. The Wilkses then changed insurance companies, obtaining a policy that also included UM and UIM coverage. A year later, Mrs. Wilks returned to the agency, asking for the same coverage she had previously had, that is, “full coverage” including UM and UIM coverage. The agency again obtained coverage through State Farm, assuring Mrs. Wilks she would have the same coverage she previously had. Mrs. Wilks ultimately signed a number of documents at the agency’s office without reading them, including a Department of Insurance (“DOI”) approved form that selected UM but not UIM coverage. Four years later, an underinsured motorist rear-ended Mrs. Wilks and State Farm denied her claim based on the form she had signed declining UIM coverage. The Wilkses sued the agency for negligence in failing to obtain the requested UIM coverage.

The court held that compliance with A.R.S. § 20-259.01(B) did not bar common law negligence claims against an insurance agent. The court noted that the statute only refers to “insurers” and does not mention “insurance agents.” Had the legislature wanted the statute to cover insurance agents, it could have explicitly included agents within the statute’s scope. It did not, and therefore the statute only applies to insurers.

The court also discussed the distinction between an insurer’s *offer* of UM/UIM and the agent’s *procurement* of the requested coverage. A.R.S. § 20-259.01(B) establishes a method by which insurers may satisfy their statutory obligation to make UM/UIM available by a written *offer*. When an insured completes a DOI-approved form, fact questions are eliminated concerning “whether UM/UIM coverage was sufficiently offered” and “whether the terms of the offer were understood.” Thus, factual inquiries related to an insurer’s *offer* are barred. However, the statute does not eliminate factual inquiries regarding other types of negligence, including claims that the agent failed to *procure* the UIM coverage requested.

The court also held that Mrs. Wilks’ failure to read the DOI-approved form she signed despite its bold print “**WARNING**” and instruction to “read carefully before signing” was an issue for the jury to consider in assessing whether Mrs. Wilks was comparatively negligent. Additionally, a jury could consider the agent’s compliance with A.R.S. § 20-259.01(B) as evidence that the agent acted reasonably under the circumstances.

As a result of the *Wilks* case, the Arizona legislature modified A.R.S. § 20-259.01 in 2016 and partially overturned the *Wilks* decision. The statute was modified again in 2019 and 2020 and it now states that an insurance producer that uses a DOI approved form satisfies the insurance producer’s standard of care in both offering and explaining the nature and applicability of uninsured and underinsured motorist coverage. The statute also now requires that the insured’s

policy declarations page **must** be sent to the named insured and this will constitute the final expression of his or her decision to purchase or reject uninsured or underinsured coverage and this will be valid for all persons insured under the policy. The other change clarified that an offer form is not required to be sent when an insured purchases UM and UIM limits equal to his or her bodily injury limits. Specifically, A.R.S. § 20-259.01 has added the following language to its UM and UIM subsections (A) and (B):

“Every insurer writing automobile liability or motor vehicle liability policies shall make available to the named insured thereunder and by written notice offer the named insured and at the request of the named insured shall include within the policy uninsured motorist coverage that extends to and covers all persons insured under the policy, in limits not less than the liability limits for bodily injury or death contained within the policy. The offer of limits to a named insured or applicant shall be made on a form approved by the director. An insurance producer that uses such a form in offering uninsured [underinsured] motorist coverage satisfies the insurance producer’s standard of care in offering and explaining the nature and applicability of uninsured [underinsured] motorist coverage. The policy declarations page must be sent to the named insured, constitutes the final expression of the named insured’s decision to purchase or reject uninsured [underinsured] motorist coverage and is valid for, extends to and covers all persons insured under the policy. An offer form is not required where the named insured purchases such coverage in an amount equal to the limits for bodily injury or death contained in the policy.”
Horses

A horse is not an underinsured vehicle. *Uhrhammer v. State Farm Mut. Auto. Ins. Co.*, 167 Ariz. 508, 808 P.2d 1260 (Ct. App. 1991) (insured had an accident with a horse and was unable to recover under his UIM policy).

AUTOMOBILE USED IN DRIVE-BY SHOOTING

UM coverage does not apply to a passenger in a car who was shot by the driver of an uninsured car in a drive-by shooting. In *Ruiz v. Farmers Ins. Co.*, 177 Ariz. 101, 865 P.2d 762 (1993), the court analyzed whether the gunshot wound was an injury arising out of the operation, maintenance, or use of an uninsured vehicle and held that a causal relationship did not exist between the injury and the use of the car.

Similarly, passengers in a vehicle shot by someone outside of the vehicle were not entitled to UM coverage because the incident did not involve an injury “arising from the ownership, maintenance or use of a car or other motor vehicle.” *Benevides v. Arizona Prop. & Cas. Ins. Guar. Fund*, 184 Ariz. 610, 911 P.2d 616 (Ct. App. 1995).

“HIT AND RUN,” “MISS AND RUN,” AND “UNIDENTIFIED” VEHICLES

An unidentified accident-causing motorist is an “owner or operator of an uninsured motor vehicle” within the meaning of A.R.S. § 20-259.01, and therefore, all automobile liability policies must afford coverage for injuries received from unidentified motor vehicles. *Lowing v. Allstate*

Ins. Co., 176 Ariz. 101, 859 P.2d 724 (1993). A “hit and run” vehicle or a “miss and run” vehicle which causes injuries is an “uninsured motor vehicle” for purposes of UM coverage. No physical contact is required with the insured vehicle for UM coverage to exist, and any “physical contact” requirement is void as against public policy.

A.R.S. § 20-259.01(M) provides that if an insured makes a claim under uninsured or underinsured motorist coverage based on an accident that involved an unidentified motor vehicle and no physical contact with the motor vehicle occurred, then the insured must provide evidence “corroborating” a claim that an unidentified motor vehicle caused the accident. Corroborative evidence is defined as any testimony, fact or evidence which strengthens and adds weight or credibility to the insured’s representations about the accident. In *Scruggs v. State Farm Mut. Auto. Ins. Co.*, 204 Ariz. 244, 62 P.3d 989 (Ct. App. 2003), the court of appeals held that an affidavit and report from an accident reconstructionist were “additional” evidence that satisfied the statute’s corroboration requirement. The insured’s statement at the scene of the accident, however, would not have satisfied the requirement. In *Progressive Classic Ins. v. Blaud*, 212 Ariz. 359, 132 P.3d 298 (Ct. App. 2006), the court of appeals held that a motorcyclist met the corroboration requirement for submitting his UIM claim by providing an expert accident reconstructionist who opined that his motorcycle was hit by another vehicle’s tire tread propelled into him rather than the motorcyclist merely running over the tread. The court further stated that this does not establish coverage under the policy. Rather, it only satisfied the “corroboration” requirement to submit the claim. *Id.* at 364, 132 P.3d at 303.

BOARDING A BUS

Students waiting to board a bus who were injured when an uninsured motorist collided with the bus were insured parties under an uninsured motorist provision of the public school motor vehicle policy. *Chavez v. Arizona Sch. Risk Retention Trust, Inc.*, 227 Ariz. 327, 258 P.3d 145 (Ct. App. 2011). The court in *Chavez* held that students were insured parties under the policy because at the time of the accident, the bus was functioning to protect the safety of the students by having its “lights and hazards” on and the students were “using” the bus’s safety features to board the bus for purposes of A.R.S. § 28-4009(A)(2).

RELATIVES RESIDING IN AN INSURED’S HOUSEHOLD

UIM coverage applies to relatives residing in the insured’s household. *Mendota Ins. Co. v. Gallegos*, 232 Ariz. 126, 302 P.3d 651 (Ct. App. 2013). In *Mendota*, the court addressed whether an individual was entitled to underinsured motorist coverage under his brother’s insurance policy. The brother’s insurance policy provided underinsured motorist coverage to his family members including related individuals who also resided in his household. The central issue in this case was whether the individual resided in his brother’s household. The court stated that the existence of a household is demonstrated by the totality of the circumstances. A household: 1) contemplates a close-knit group of individuals who treat each other like family, and deal with each other intimately and informally, 2) contemplates a connection to a shared dwelling place where its members develop and maintain their close-knit, intimate, and informal relationships,

and 3) contemplates a settled or permanent status; it requires a degree of permanency and intention to integrate into the family unit and remain a member for more than a mere transitory period.

EXCLUSIONS

Statute: A.R.S. § 20-259.01

The provisions of the UM/UIM statute are considered a part of every insurance policy. *Ins. Co. of N. Am. v. Superior Court In & For Cnty. of Santa Cruz*, 166 Ariz. 82, 800 P.2d 585 (1990). Exclusions and limitations on UM/UIM coverage are generally invalid unless contemplated by statute. *Lowing v. Allstate Ins. Co.*, 176 Ariz. 101, 859 P.2d 724 (1993).

What Can Be Excluded

Non-Permissive User

Vehicles operated by a non-permissive user (as distinguished from an “excluded” user) can be excluded.

Commercial UIM Policy and Family and Friends

A commercial UIM policy does not extend to family and friends. See *Cullen v. Koty-Leavitt Ins. Agency, Inc.*, 216 Ariz. 509, 168 P.3d 917 (Ct. App. 2007) *aff'd in part, vacated in part sub nom. Cullen v. Auto-Owners Ins. Co.*, 218 Ariz. 417, 189 P.3d 344 (2008) (holding that a plaintiff, injured while riding in a third party’s automobile, could not recover UIM benefits because the named insured was a company; to recover benefits under a UIM policy, the policy’s named insured must be an individual and the claimant must be residing in that individual’s household).

Resident Relatives who own their own vehicle

An exclusion for a family member who lives with the named insured but owns his or her own motor vehicle not insured under the policy is valid if the policy definition of “relative” excludes such a person as an “insured” under the policy. *Beaver v. American Family Mut. Ins. Co.*, 234 Ariz. 584, 324 P.3d 870 (Ct. App. 2014). Daughter lived with named insured dad who had his own American Family auto policy which would normally cover daughter. Daughter was injured on a motorcycle that she owned but was not covered under the dad’s policy. The policy provided that an “insured person” included relatives living with the named insured, but excluded a relative who owned their own motor vehicle. The court held that the “Relative” definition under the American Family policy was not void under the Underinsured Motorist Act (A.R.S. § 20-259.01). As daughter owned the motorcycle, she was not considered a “relative” and thus not an “insured person” under her dad’s policy and not entitled to UIM coverage.

Off-Road Vehicles

An exclusion for off-road vehicles used for off-road activity is valid, and the driver of such a vehicle will not be considered an uninsured motorist. *W. Am. Ins. Co. v. Pirro*, 167 Ariz. 437, 808 P.2d 322 (1990). However, UM coverage does apply to an off-road vehicle when used on a public road. For a definition of “public road,” see *Gittings v. Am. Family Ins. Co.*, 181 Ariz. 176, 888 P.2d 1363 (Ct. App. 1994) (“those areas which a reasonable person using the highway, having cognizance of all pertinent road signs and markings, would consider to be intended for vehicular travel, including the berm or shoulder of the highway if the same is improved for vehicular traffic”).

Public Conveyance

Vehicles used as public conveyances (taxis) or rented to others or used in a business primarily to transport property or equipment can be excluded. Since the UM/UIM statute does not require UM/UIM coverage when an insured uses a vehicle as a public conveyance, a UM/UIM provision in a policy issued for a taxi, which excluded coverage for injuries sustained to people in “any auto while being used as a public conveyance,” was valid with respect to injuries sustained by a taxi driver in an accident with an uninsured motorist. *Warfe v. Rocky Mountain Fire & Cas. Co.*, 121 Ariz. 262, 589 P.2d 905 (Ct. App. 1978).

Personal Auto Policies for Accidents Occurring in Business/Commercial Vehicles

The UIM statute allows an insured’s personal policy to exclude UIM for an insured who has an accident while driving a business/commercial vehicle. *Gambrell v. IDS Property Cas. Ins. Co.*, 238 Ariz. 165, 357 P.3d 1221 (Ct. App. 2015). Gambrell was driving a milk semi-tractor for his employer when he was involved in an accident with another driver. He received \$15,000 from the other driver and \$100,000 UIM from his employer’s policy. Gambrell sought an additional \$100,000 from his personal auto IDS policy. IDS denied UIM coverage because Gambrell was driving a business vehicle at the time of the accident. The policy provided for UIM coverage while occupying a “private car or utility car, or as a pedestrian.” The semi-tractor he was driving did not fit that definition. Gambrell sued for breach of contract and bad faith. The trial court granted IDS summary judgment and the court of appeals affirmed. Subsection (C) of A.R.S. § 20-259.01 makes the offer of UIM optional for vehicles used in business primarily to transport property or equipment. While UM/UIM is portable, A.R.S. § 20-259.01(C) is a legislatively-enumerated exception. The court held that the insurer’s denial of coverage was not an exclusion or limitation on UIM coverage; rather the policy simply did not provide it.

Punitive Damages

There is no UM/UIM coverage for punitive damages unless the policy specifically states there is such coverage. *State Farm Mut. Auto. Ins. Co. v. Wilson*, 162 Ariz. 247, 782 P.2d 723 (Ct. App. 1989), *approved as modified*, 162 Ariz. 251, 782 P.2d 727 (1989).

What Cannot Be Excluded

Government Vehicles

A policy provision limiting UM/UIM coverage to statutory minimum coverage for an accident involving a government owned vehicle is invalid. *Transportation Ins. Co. v. Martinez*, 183 Ariz. 33, 899 P.2d 194 (Ct. App. 1995).

Territorial Limitations

Public policy dictates that uninsured motorist coverage must be territorially co-extensive with liability coverage. Thus, territorial limitations restricting uninsured motorist coverage, but not liability coverage, to the United States and Canada are void as against public policy. *Bartning v. State Farm Fire & Cas. Co.*, 162 Ariz. 344, 783 P.2d 790 (1989).

“Owned But Not Insured” Exclusion Is Invalid

An insured can select the UM/UIM from any policy under which he is covered, regardless of whether he was occupying any of them at the time of the accident. *Calvert v. Farmers Ins. Co.*, 144 Ariz. 291, 697 P.2d 684 (1985); see A.R.S. § 20-259.01 (H). A policy provision that excludes UM/UIM coverage to an insured while occupying a vehicle he owns but which is not insured by that carrier is invalid. *Calvert v. Farmers, supra; Higgins v. Fireman’s Fund Ins. Co.*, 160 Ariz. 20, 770 P.2d 324 (1989). However, under a corporation’s business automobile policy, the corporation’s president was insured only while occupying a covered auto, and was, therefore, not entitled to UIM coverage under the policy when injured in a non-covered auto. *American States Ins. Co. v. C&G Contracting, Inc.*, 186 Ariz. 421, 924 P.2d 111 (Ct. App. 1996).

“Named Driver” Exclusion Is Invalid for UM/UIM Coverage

A liability policy may exclude a specific individual from liability coverage. *Employers Mut. Cas. Co. v. McKeon*, 159 Ariz. 111, 765 P.2d 513 (1988). However, this does not apply to UM coverage. The exclusion applies only to liability coverage, regardless of whether the policy has a “named driver exclusion.” The excluded driver has UM/UIM coverage in the full amount of coverage specified under the policy and is not limited to 15/30 (unless that is the policy limit). *Employers Mut., supra*. Although this case deals with UM coverage, the rationale is equally applicable to UIM coverage.

“Furnished for Regular Use” Exclusion

A “furnished for regular use” exclusion in an underinsured motorist policy is void as against public policy. *State Farm Mut. Auto. Ins. Co. v. Duran*, 163 Ariz. 1, 785 P.2d 570 (1989).

REASONABLE EXPECTATIONS DOCTRINE

In Arizona, the reasonable expectations doctrine is a rule of construction that enables courts to negate boilerplate terms of an insurance agreement that take away coverage provided elsewhere in the contract. *Gregorio v. GEICO Gen. Ins. Co.*, 815 F. Supp. 2d 1097 (D. Ariz. 2011). The Arizona Supreme Court recognized the doctrine in *Darner Motor Sales v. Universal Underwriters Ins. Co.*, 140 Ariz. 383, 682 P.2d 388 (1984), and the doctrine was expanded in *Gordinier v. Aetna Cas. & Surety Co.*, 154 Ariz. 266, 273, 742 P.2d 277, 284 (1987). These are the circumstances when Arizona courts will not enforce even unambiguous boilerplate terms in a standardized insurance contract:

The contract terms, although not ambiguous, could not be understood by a reasonably intelligent consumer who tried to read the policy;

The insured did not receive full and adequate notice of the term in question, and the provision is either unusual or unexpected, or one that emasculates apparent coverage;

Some activity that can be reasonably attributed to the insurer would create an objective impression of coverage in the mind of a reasonable insured; and

Some activity reasonably attributable to the insurer has induced a particular insured reasonably to believe that he has coverage, although such coverage is expressly and unambiguously denied by the policy.

The doctrine does not operate to add coverage, however, where such coverage is nowhere stated in the policy. Thus, courts cannot invoke the doctrine to create a new bargain without any basis in the written terms of the agreement. *Gregorio*. Furthermore, the insured has the burden to prove that the insurer “had ‘reason to believe’ that the signing party would not have accepted a particular term” in the policy if the signing party had known of the term. *State Farm Fire & Cas. In. Co. v. Grabowski*, 214 Ariz. 188, 150 P.3d 275 (Ct. App. 2007).

UM v. UIM

Uninsured (UM) and underinsured (UIM) motorist coverages are separate and distinct and apply to different accident situations. A.R.S. § 20-259.01(H). UM coverage applies to cover bodily injury or death caused by an uninsured motorist. A.R.S. § 20-259.01(E). An uninsured motorist includes a motorist whose liability insurer is, or becomes, insolvent. A.R.S. § 20-259.01(D). Underinsured motorist coverage provides coverage for a person if the sum of the limits of liability under all bodily injury or death liability bonds and liability insurance policies applicable at the time of the accident is less than the total damages for bodily injury or death resulting from the accident. See A.R.S. § 20-259.01(G).

Arizona courts have held that UM coverage guarantees coverage up to the statutory minimum amount. UIM coverage, if accepted, is not limited to the statutory minimum amount. ***Mancillas v. Arizona Prop. & Cas. Ins. Guar. Fund***, 182 Ariz. 389, 897 P.2d 691 (Ct. App. 1994); ***Porter v. Empire Fire & Marine Ins. Co.***, 106 Ariz. 274, 475 P.2d 258 (1970). Therefore, an insured injured in an automobile accident caused solely by the negligence of another, and who receives less than the statutory minimum for his injuries due to the splitting of the other's liability insurance among the injured parties, is entitled to UM benefits for the difference between the compensation from the liability insurer and the statutory minimum. This was true even after the advent of UIM coverage, and applied even where UIM coverage was offered and rejected. However, the Arizona Court of Appeals held that, when UIM coverage was available, the insured could only recover from UIM and was not entitled to recover from UM coverage even if the amount received from the tortfeasor's liability insurance was less than the statutory minimum. ***State Farm Mut. Auto. Ins. Co. v. Cobb***, 172 Ariz. 458, 837 P.2d 1193 (Ct. App. 1992).

In response to *Mancillas* and *Porter*, in 1996 the Arizona Legislature amended A.R.S. § 20-259.01 to exclude a person insured under a liability policy that complies with A.R.S. § 28-1170 (currently A.R.S. §§ 28-4001, 4009). Any payment made under the bodily injury liability portion of a liability policy insuring the motor vehicle that caused bodily injury or death, regardless of the number of persons receiving payments, precludes any payment under UM coverage based on the fault of the person insured under the motor vehicle liability policy. A.R.S. § 20-259.01(F). The statute thus eliminates UM coverage where the insured receives any amount from the tortfeasor's liability coverage, even if the amount received does not meet the statutory minimum due to division among injured parties. This would apply whether UIM insurance is available or not, so long as the negligent party was insured under a motor vehicle policy that complies with A.R.S. §§ 28-4001, 4009 (formerly A.R.S. § 28-1170). Therefore, an injured party must have UIM coverage in order to satisfy any deficiency in recovery under the liability policy. See ***Taylor v. Travelers Indem. Co.***, 198 Ariz. 310, 9 P.3d 1049 (2000).

PRIMARY/EXCESS ISSUES

In general, A.R.S. § 28-4010(A) (formerly A.R.S. § 28-1170.01) provides that if two or more policies of valid and collectible liability insurance apply to the same motor vehicle involved in the loss, it will be presumed that the policy in which the motor vehicle is described or rated as an owned automobile shall be primary and the insurance afforded by any other policy or policies shall be excess. A.R.S. § 28-4010 was enacted in an attempt to reduce the amount of litigation over which policy is primary.

AUTOMOTIVE BUSINESS

If a vehicle is being driven by someone engaged in an automotive business at the time of the accident, the policy covering that business is primary, and the car owner's policy is excess, regardless of what the policies say. A.R.S. § 28-4010. See also ***Jackson v. Nationwide Mut. Ins. Co.***, 228 Ariz. 197, 265 P.3d 379 (Ct. App. 2011) (holding that individual could recover damages under a mechanic's business auto policy but that the business owner's liability policy was a

commercial general liability policy not intended to be the first or only source of automobile liability insurance coverage and thus UM coverage could not be imputed to it).

If the vehicle is being driven by its owner, the owner's policy is primary and the automotive business policy is excess, regardless of what the policies say. *See* A.R.S. § 28-4010.

Other Than Automotive Business

In all situations other than those involving an automotive business, if two policies cover the same vehicle for an accident, the policy that names the vehicle involved in the accident is primary and any other policies that have coverage are excess, regardless of what the policies say. A.R.S. § 28-4010; *State Farm Mut. Auto. Ins. Co. v. Fireman's Fund Ins. Co.*, 149 Ariz. 230, 717 P.2d 909 (Ct. App. 1985), *approved as modified*, 149 Ariz. 179, 717 P.2d 858 (1986).

Umbrella Policy

An excess liability policy used to be subject to the Uninsured Motorist Act. *Ormsbee v. Allstate Ins. Co.*, 176 Ariz. 109, 859 P.2d 732 (1993). However, the Legislature eliminated this requirement on policies issued after January 1, 1994. *See* A.R.S. § 20-259.01(L).

Comprehensive General Liability

A comprehensive general liability (CGL) insurance policy that also provided automobile liability coverage by specific endorsement used to be subject to the requirements of the Uninsured Motorist Act. *St. Paul Fire & Marine Ins. Co. v. Gilmore*, 168 Ariz. 159, 812 P.2d 977 (1991). However, the legislature eliminated this requirement on policies issued after January 1, 1994. *See* A.R.S. § 20-259.01(L).

A comprehensive general liability insurance policy's limitation of coverage where workers' compensation is available does not relieve a UM carrier of coverage. The Uninsured Motorist Act does not permit such a limitation of UM coverage. *Farmers Ins. Co. v. USF&G*, 185 Ariz. 125, 912 P.2d.1354 (1995).

If a business elects UM/UIM coverage, it may have different coverage limits for different employees. *Carden v. Golden Eagle Ins. Co.*, 190 Ariz. 295, 947 P.2d 869 (1997).

STATUTE OF LIMITATIONS AND SUBROGATION

Time Limitation

Pursuant to A.R.S. § 12-555, a person may make an uninsured motorist claim by giving written notice to the insurer within three years after the date of the accident. Additionally, the insured may still assert a claim within three years after the earliest of: (1) the date the insured knew that the tortfeasor was uninsured, (2) the date the person knows or should know that coverage was

denied by the tortfeasor's insurer, or (3) the date the person knew or should have known of the insolvency of the tortfeasor's insurer.

In an underinsured motorist claim, the insured must give written notice of intent to pursue a claim within three years after the date of the accident AND make a claim with the tortfeasor's insurer or file an action within the applicable statute of limitations; an may still make a claim within three years after the date the person knows or should have known that the tortfeasor has insufficient liability limits.

Claims Reporting Requirements

An insurer can enforce a "prompt notice of claim" requirement in the policy as long as the insurer is able to establish some prejudice caused by the late reporting. *State Farm Mut. Auto. Ins. Co. v. Tarantino*, 114 Ariz. 420, 561 P.2d 744 (1977). The insurer bears the burden of establishing prejudice, *Maryland Cas. Co. v. Clements*, 15 Ariz. App. 216, 487 P.2d 437 (1971), and delay alone is not enough to establish prejudice. *Globe Indem. Co. v. Blomfield*, 115 Ariz. 5, 562 P.2d 1372 (Ct. App. 1977).

Subrogation

Pursuant to A.R.S. § 20-259.01(I), an insurer that makes payments to its insured for injuries caused by an uninsured motorist is subrogated in the name of the insured against the uninsured motorist for reimbursement for the UM payments made. An insurer may also file a claim for subrogation against the ancillary or domiciliary receiver of an insolvent insurer. See A.R.S. § 20-673(D). An insurer does not, however, have a right of subrogation against the insured of an insolvent carrier or against the Guaranty Fund. See A.R.S. § 20-673(A). Also, an insurer has no right to be subrogated to any proceeds the insured might recover from any party other than the uninsured motorists who caused the accident. *State Farm Mut. Auto Ins. Co. v. Janssen*, 154 Ariz. 386, 742 P.2d 1372 (Ct. App. 1987). Finally, there is no subrogation allowed against an underinsured motorist.

Limitation of Actions for Subrogation

In *Safeway Ins. Co. v. Collins*, 192 Ariz. 262, 963 P.2d 1085 (Ct. App. 1998), the court of appeals held that an insurer seeking subrogation was required to file a claim within two years after the accident giving rise to that claim. This holding created an obvious dilemma for the insurer since that time period could theoretically pass before an insurer actually makes a payment on an uninsured motorist claim. In apparent response to this dilemma, the Legislature enacted A.R.S. § 12-555(D), which now allows the insurer to bring its subrogation claim within two years after the date the insurer first makes payment to the insured under the uninsured motorist coverage.

PORTABILITY

UM Coverage

UM coverage follows the insured, regardless of whether or not the insured is occupying the insured vehicle, or any vehicle at all. If the insured has UM coverage, and the insured is injured by an uninsured motorist, coverage applies. The insured can select which UM coverage he wishes to apply from any of his policies. See A.R.S. § 20-259.01(H). Furthermore, the “owned but uninsured” exclusion is invalid. **Calvert v. Farmers Ins. Co.**, 144 Ariz. 291, 697 P.2d 684 (1985).

UIM Coverage

Like UM coverage, UIM coverage also follows the insured, regardless of what vehicle is involved. The insured can choose which UIM coverage he wishes to apply from any of his policies. See A.R.S. § 20-259.01(H). Again, the “owned but uninsured” exclusion is invalid. **Higgins v. Fireman’s Fund Ins. Co.**, 160 Ariz. 20, 770 P.2d 324 (1989).

Stacking

UM/UIM on UM/UIM, Different Companies - Permissible

UM policies from different companies that cover the insured for an accident (such as the driver’s policy and the insured’s personal policy), can be stacked. A set-off provision or “other insurance” provision is invalid. **Rashid v. State Farm Mut. Auto. Ins. Co.**, 163 Ariz. 270, 787 P.2d 1066 (1990); **Croci v. Travelers Ins. Co.**, 163 Ariz. 346, 788 P.2d 79 (1990).

UIM on UIM, Different Companies – Permissible

Two vehicle accident. Car A is negligent and pays its full liability limits to passenger in Car B, who then recovers the full UIM limits from the policy covering Car B (as an additional insured under that policy). Passenger can also recover from his own UIM coverage up to the full amount of damages. A set-off provision or “other insurance” provision is invalid. **Brown v. State Farm Mut. Auto. Ins. Co.**, 163 Ariz. 323, 788 P.2d 56 (1989).

UM/UIM on UM/UIM, Same Company – Generally Not Permissible

When an insured has two policies with the same company, an “other insurance clause” in the policy is valid to prevent the insured from stacking the UM benefits from one policy on the UM benefits from the other policy. **Brown v. State Farm**, *supra*; A.R.S. § 20-259.01. Additionally, a husband and wife are considered to be a single insured and are not entitled to stack UIM coverage contained in separate policies issued by the same insurer. **State Farm Mut. Auto. Ins. Co. v. Lindsey**, 180 Ariz. 456, 885 P.2d 144 (Ct. App. 1994) (“*Lindsey I*”). The same analysis, based on community property principles, should apply to UM coverage as well. However, *Lindsey I* was reversed by the Arizona Supreme Court in **State Farm Mut. Auto. Ins. Co. v. Lindsey**, 182 Ariz.

329, 897 P.2d 631 (1995) (“*Lindsey II*”). The Supreme Court held that State Farm’s “other vehicle exclusion” was ineffective to prevent stacking of coverage of three policies because the provisions did not track the language of the “anti-stacking” statute, A.R.S. § 20-259.01(F) (now (H)). Since then, the court of appeals has affirmed summary judgment in favor of an insurer, upholding an anti-stacking provision in an uninsured motorist policy. ***Farmers Ins. Co. v. Voss***, 188 Ariz. 297, 935 P.2d 875 (Ct. App. 1996) (reaffirming that insurers can enforce anti-stacking provisions in their policies as long as the policy language incorporates the anti-stacking provisions contained in the uninsured motorists statute, and clearly advises the insured of the right to choose the applicable policy in the event of a claim). See A.R.S. § 20-259.01 (H).

In a 2016 unpublished ruling, however, the Arizona district court permitted stacking UIM on UIM from different insurers who claimed they were under “common management.” In ***Delaney v. Depositors Insurance Company***, CV-15-02532-PHX-ROS, the insured attempted to stack UIM from two different insurance policies and companies. One policy was issued by AMCO Insurance Company while the other policy was issued by Depositors Insurance Company. AMCO and Depositors were affiliated companies under the common management of Nationwide Insurance Company. AMCO paid its UIM limits and then the insured made a UIM claim with Depositors. Depositors denied coverage based upon the anti-stacking language in its policy. The court held the anti-stacking language was ineffective because the word “us” meant “the company providing this insurance” and not other insurance companies under a “common management.”

The Arizona court of appeals similarly held that the anti-stacking language in a particular policy was ineffective to preclude payment from an “affiliated insurer” in ***Hanfelder v. GEICO Indemnity Company*** 244 Ariz. 475, 422 P.3d 579 (Ct. App. 2018). There, Hanfelder had a UIM auto policy with GEICO Casualty Company and a separate UIM motorcycle policy with GEICO Indemnity Company. GEICO Casualty paid its UIM limits and Hanfelder made a UIM claim to GEICO Indemnity. GEICO Indemnity denied the claim based upon the anti-stacking language in its policy. Hanfelder sued GEICO Indemnity seeking UIM coverage under its policy. The anti-stacking language in the GEICO Indemnity policy provided “If separate policies or coverages with **us** are in effect for you or any person in your household, they may not be combined to increase the limit of our liability for a loss; however, you have the right to select which policy or coverage is to be applicable for the loss.” (emphasis added) The GEICO Indemnity policy did not define the word “us.” However, the policy used the word “we” to refer to “the Company named in the declarations,” which was only “GEICO Indemnity.” The court reasoned that it “defies common sense to construe the word “us” to include both GEICO Casualty and GEICO Indemnity when the word “we” only refers to one company- “GEICO Indemnity.”

Moreover, the court found that GEICO Indemnity’s policy did not incorporate the definition of “insurer” in the anti-stacking statute, A.R.S. § 20-259.01(H), which includes “every insurer within a group of insurers under a common management.” GEICO Indemnity could have drafted its policy “to apply to all separate policies or coverages purchased from any GEICO affiliate but did not do so.”

UIM on UM, Same Company – Not Permissible

When the policy has paid the full UM limits, the insured cannot recover an additional amount under that policy's UIM coverage. See A.R.S. § 20-259.01(H); *Evenchik v. State Farm Ins. Co.*, 139 Ariz. 453, 679 P.2d 99 (Ct. App. 1984).

UIM on UIM, Same Company – Not Permissible

A.R.S. § 20.259.01(G) states that, to the extent an injured party's total damages exceed the total applicable liability limits, UIM coverage is applicable to the difference. Accordingly, if the injured party receives any amount from the tortfeasor's liability policy, even if less than the statutory minimum, the insured may only collect from UIM coverage, and is not entitled to any UM benefits. *State Farm Mut. Auto. Ins. Co. v. Cobb*, 172 Ariz. 458, 837 P.2d 1193 (Ct. App. 1992).

UM/UIM on Liability Limits

When an accident involves two negligent motorists, a passenger can collect from the liability policy of the driver of his car, and can also collect from the same policy's UM/UIM coverage for the negligence of the other driver, if the driver of the other car is uninsured or underinsured. *Spain v. Valley Forge Ins. Co.*, 152 Ariz. 189, 731 P.2d 84 (1987).

In policies covering only one vehicle, a guest passenger cannot stack UIM coverage and liability coverage in the same policy. See *Duran v. Hartford Ins. Co.*, 160 Ariz. 223, 772 P.2d 577 (1989) (holding that an injured passenger in one vehicle accident who recovered the full liability limit under the policy covering that vehicle could not stack liability and UIM coverage under the same policy so as to increase the name insured's liability coverage). This exclusion was upheld in *Demko v. State Farm Mut. Auto. Ins. Co.*, 204 Ariz. 497, 65 P.3d 446 (Ct. App. 2003). Demko, a passenger in his own vehicle, was injured after the vehicle rolled over in a single vehicle accident. The vehicle was being driven by Parker, a permissive driver, and her negligence was the sole cause of the accident. Demko had one policy which afforded \$100,000 in liability limits and a separate policy which provided \$100,000 in underinsured limits. After receiving the liability limits from his policy and the underinsured limits from his other policy, he was paid \$50,000 from Parker's liability policy for a total of \$250,000 in payments. Demko then made a claim for Parker's \$50,000 underinsured limits as well. The court granted summary judgment for State Farm holding that under Parker's policy, UIM coverage is excluded for any vehicle covered under the liability coverage of the policy. The court of appeals affirmed, holding that the passenger was not entitled to "stack" Parker's UIM coverage onto her liability coverage. UIM coverage is not intended to expand a tortfeasor's liability insurance limits. The court cited *Duran v. Hartford Ins. Co.*, 160 Ariz. 223, 772 P.2d 577 (1989) (Duran I), which held that when the allegation of being "underinsured" is predicated on insufficient liability coverage from the same policy, underinsured coverage may not be "stacked" so as to in effect increase liability coverage. The court did, however, permit the insured passenger to receive the full \$100,000 liability limits from his State Farm policy that insured his vehicle, plus the full \$100,000 UIM limits of another State Farm policy he had on a different vehicle.

An exception exists if a plaintiff is unable to recover the tortfeasor's full policy limits. In such cases, the plaintiff may "bridge the gap between the amount paid and the full amount recoverable under the liability policy." **Taylor v. Travelers Indem. Co.**, 198 Ariz. 310, 9 P.3d 1049 (2000). In *Taylor*, Mrs. Taylor was injured in an accident resulting from the negligence of her driver/husband. The Taylors had liability and underinsured motorist coverage Travelers, with combined single limits of \$300,000. Although Mrs. Taylor's injury claim exceeded \$300,000, she recovered only \$183,500 of liability because the limits were split with other claimants. The court allowed Mrs. Taylor to recover under the UIM portion of her policy to "bridge the gap" between her reduced recovery and the liability limits of her policy. In so holding, the *Taylor* court stated that this was not an impermissible "stacking" of coverages.

The Arizona Supreme Court in **Am. Family Mut. Ins. Co. v. Sharp**, 229 Ariz. 487, 277 P.3d 192 (2012), held that the anti-stacking provision of A.R.S. § 20-259.01 (H) prohibited an insurer from denying UIM to its named insured on the ground that she was already partially indemnified under the liability coverage of a separate policy issued to her husband by the same company. In *Sharp*, wife was injured in a single-vehicle accident while riding as a passenger on a motorcycle driven by her husband. The Sharps had purchased two separate policies from the same insurer, one for the motorcycle, with husband as the named insured; and one for a car, with wife as the named insured. After the accident, the insurer paid wife the full limit of the liability insurance under the motorcycle policy but denied her claim for UIM under the car policy. The court disagreed. *Duran I* and *Taylor* were distinguishable because those cases did not involve different coverages under multiple policies and did not apply subsection (H). The court acknowledged that Sharp could not have received UIM coverage under the motorcycle policy because she recovered the full liability limits under that policy. But the court "disagreed with the notion that 'the legislature intended that an insured injured in her own car by another insured could be denied the UIM coverage she had purchased[,]'" and held: "That point is even more pronounced if, as occurred here, the UIM claimant is injured on a spouse's vehicle that is insured under its own policy, from which she received the liability limit, but no UIM coverage, and then seeks UIM coverage under a separate policy for which she paid a premium." *Id.* at 493, ¶ 20, 277 P.3d at 198.

The court concluded that "[b]y claiming UIM coverage under the [car][p]olicy, from which she received no liability or other payment, Sharp is not seeking to duplicate recovery or receive more than she purchased." *Id.* As the court noted, "liability insurance is distinct from first-party UIM coverage. ... An insured who purchased coverage against two separate risks, each of which occurred, generally may recover under both coverages" *Id.* at 492, 277 P.3d at 197.

An unpublished court of appeals decision and a district court case have created another exception. Even in a one-vehicle, one-policy accident, the insured passenger may receive full bodily injury liability benefits plus UIM from the same policy if the policy covers more than one vehicle. See **Hoelbl v. GEICO General Ins. Co.**, 2012 WL 5589909 (Ariz. Ct. Appeals, November 15, 2012); **GEICO General Ins. Co. v. Tucker**, 71 F. Supp. 3d. 985 (D. Ariz., 2014). The reasoning is that the insured paid more than one UIM premium and should be able to take advantage of "one of them" if the bodily injury liability benefits he purchased were insufficient to cover his injuries.

Guaranty Fund

An insured can stack UM coverage from an insolvent insurer's policy on other UM coverage from another insurance policy up to the total amount of damages. See *Arizona Prop. & Cas. Ins. Guar. Fund v. Herder*, 156 Ariz. 203, 751 P.2d 519 (1988) (holding that a passenger who recovers UM limits from the driver's policy can then recover the UM limits from the guaranty fund up to the total damages, based on his own insolvent policy).

OFFSETS

UIM Offset for Liability Bonds and Insurance

Underinsured motorist coverage is defined as "coverage for a person [when] the sum of the limits of liability under all bodily injury or death liability bonds and liability insurance policies applicable at the time of the accident is less than the total damages." See A.R.S. § 20-259.01(G). Accordingly, an insurer is entitled to an offset for all amounts paid pursuant to all such bonds or policies. Moreover, where a liability insurer agrees with its insured to pay the full amount of any judgment or settlement, thereby effectively eliminating the applicable liability limit, then that insured is no longer an "underinsured" motorist. *Hamill v. Mid-Century Ins. Co.*, 225 Ariz. 386, 238 P.3d 654 (Ct. App. 2010).

Workers' Compensation Offset

In the context of UIM claims, the Arizona Supreme Court struck down a workers' compensation offset provision. *Cundiff v. State Farm Mut. Auto. Ins. Co.*, 217 Ariz. 358, 174 P.3d 270 (2008). In *Cundiff*, State Farm claimed that amounts previously recovered by its insured in the form of workers' compensation benefits offset a UIM arbitration award. However, the court held that workers' compensation was not "liability insurance" within the meaning of the statutory definition of UIM coverage. The court's analysis was focused primarily on the statutory definition of UIM coverage and did not overrule prior authority, which upheld the validity of a workers' compensation benefits offset when applied to UM benefits. See *Terry v. Auto-Owners Ins. Co.*, 184 Ariz. 246, 908 P.2d 60 (Ct. App. 1995).

Med-Pay Offset

A policy provision that offsets the amounts paid under the med-pay portion of the policy from the amount paid under the UM coverage is valid as long as the insured is fully compensated. A non-duplication endorsement is valid to prevent double recovery for medical payments. *Schultz v. Farmers Ins. Grp. of Companies*, 167 Ariz. 148, 805 P.2d 381 (1991).

However, in *Miller v. American Standard Insurance Company of Wisconsin*, 795 F.Supp.2d 1144 (D. Ariz. 2010), the court followed the reasoning in *Cundiff* and held that med-pay benefits could not be used to offset UIM payments. The court found that med-pay did not constitute "liability

coverage” and thus, it could not be used to offset UIM payments even if it resulted in duplicate recovery. *Id.* at 1149.

LIENS

Workers’ Compensation

Workers’ compensation liens do not attach to UM/UIM coverage, even when the guaranty fund has picked up the coverage. *Martinez v. State Workman’s Comp. Ins. Fund*, 163 Ariz. 380, 788 P.2d 113 (Ct. App. 1990). *See also Cundiff v. State Farm, supra.*

Health Care Provider

The lien of a health care provider does not extend to UM/UIM claims. *See* A.R.S. § 33-931(B).

Arizona Health Care Cost Containment System (AHCCCS)

AHCCCS is entitled to a lien with respect to charges for hospital or medical care and treatment of an injured person for which the administration or a contractor is responsible on any and all claims of liability or indemnity for damages accruing to the person to whom hospital or medical service is rendered or to the legal representative of such person on account of injuries giving rise to such claims and which necessitated such hospital or medical care and treatment. A.R.S. § 36-2915(A). However, the lien amount is calculated on what the plan pays and not on the total medical expenses. *See Sw. Fiduciary, Inc. v. Arizona Health Care Cost Containment Sys. Admin.*, 226 Ariz. 404, 249 P.3d 1104 (Ct. App. 2011) (AHCCCS, which had a Medicaid lien on settlements that automobile accident victims received from tortfeasors, could recover no more than that portion of the settlements which represented recovery of payments that AHCCCS actually made on behalf of the victims, less a deduction for legal expenses).

EXHAUSTION OF LIABILITY LIMITS

The court of appeals has answered the question of whether an underinsured carrier must consider a UIM claim when the insured settles for less than the tortfeasor’s liability limits and if so, what credit the UIM carrier receives. In *Country Mut. Ins. Co. v. Fonk*, 198 Ariz. 167, 7 P.3d 973 (Ct. App. 2000), the insured settled her claim against the tortfeasor for less than the available liability policy limits. The insured then made a claim to her carrier for payment under the UIM coverage following which a declaratory judgment action was filed by the company on the basis of its policy language requiring exhaustion of liability bonds or policies before UIM coverage applies. The court held that exhaustion was not required if the insured’s damages exceeded the liability coverage, but the UIM carrier was entitled to an off-set for the full amount of liability coverage available to the insured.

DERIVATIVE CLAIMS

Consortium

Claims for derivative damages such as loss of consortium are not bodily injuries within the meaning of underinsured motorist coverage. In *Green v. Mid-America Preferred Ins. Co.*, 156 Ariz. 265, 751 P.2d 581 (Ct. App. 1987), the victim died in an automobile accident. The family's insurance policy provided underinsured motorist coverage in the amount of \$100,000 for each person and \$300,000 for each accident. The decedent's wife and two children were not allowed to also recover \$100,000 each under the underinsured motorist portion of the policy. Furthermore, since the survivors' injuries derived from the bodily injury to only one person, the plaintiffs' decedent, the "each person" rather than the "each accident" limit of the policy applied. See also *Campbell v. Farmers Ins. Co.*, 155 Ariz. 102, 745 P.2d 160 (Ct. App. 1987).

Wrongful Death

In *Herring v. Lumbermen's Mut. Cas. Co.*, 144 Ariz. 254, 697 P.2d 337 (1985), the survivors in a wrongful death action claimed they each had a bodily injury claim separate from the victim, and thus were each entitled to a per person limit of the UM coverage. The Arizona Supreme Court rejected this argument. Since the claimants' claims were not separate "bodily injury" claims, the claimants were entitled to only the one per person limit for the decedent's bodily injury. Thus, in wrongful death claims, the per person policy limit of UM/UIM applies based upon the injured person's or decedent's bodily injury, regardless of many wrongful death beneficiaries make claims arising from the death. The per occurrence limit is not applicable. *Herring v. Lumbermen's Mut. Cas. Co.*, *supra*, (UM); *Green v. Mid-America*, *supra* (UIM).

An insured cannot collect from his own UM/UIM coverage for loss of consortium or for the wrongful death of another person. The coverage must come from a policy covering the person who actually received the bodily injuries. *Bartning v. State Farm Fire & Cas. Co.*, See 164 Ariz. 370, 793 P.2d 127 (Ct. App. 1990).

In 1998, the Legislature limited the right to bring a wrongful death claim against uninsured and underinsured motorist coverages. If an insured covered under UM or UIM coverages is killed in an accident, recovery under the policy is limited to surviving spouse, parents or children (A.R.S. § 12-612) who are also surviving insureds under the same coverages of the policy. See A.R.S. § 20-259.03.

The court of appeals in *Bither v. Country Mut. Ins. Co.*, 226 Ariz. 198, 245 P.3d 883 (Ct. App. 2010), held that the clear legislative mandate of A.R.S. § 20-259.03 is to preclude recovery of UM benefits by a statutory beneficiary who is not also an insured under the policy. However, while A.R.S. § 20-259.03 limits recovery under a policy to surviving spouses, parents or children who are also surviving insured under the same coverages of the policy, a mother can recover for the death of her son killed in a collision with an underinsured motorist, despite not being a named insured on the policy since she was an "insured" within the definition of the policy. *State Farm Mut. Auto. Ins. Co. v. White*, 231 Ariz. 337, 295 P.3d 435 (Ct. App. 2013).

CHOICE OF LAW

In the absence of a provision in the policy providing for a choice of law, Arizona courts follow the RESTATEMENT (SECOND) OF CONFLICT OF LAWS for UM/UIM coverage issues. In **Beckler v. State Farm Mut. Auto. Ins. Co.**, 195 Ariz. 282, 987 P.2d 768 (Ct. App. 1999), opinion corrected, 196 Ariz. 366, 997 P.2d 1195 (Ct. App. 2000), the court applied the most significant relationship test from the Restatement to determine which state's law applied. In *Beckler*, the insured son's parents resided in Nebraska, the policies were issued in Nebraska, the five cars in the household were licensed in Nebraska and primarily garaged in Nebraska. However, the court applied Arizona law to permit stacking because the son was attending college in Arizona with one of the insured vehicles and State Farm's agent understood that the principal location of the particular vehicle (the insured risk) was going to be in Arizona.

ARBITRATION

Many automobile insurance policies contain provisions requiring the arbitration of disputes for uninsured and underinsured motorist claims. Arizona public policy favors arbitration as a means of resolving a controversy. **Allstate Ins. Co. v. Cook**, 21 Ariz. App. 313, 519 P.2d 66 (1972). A provision in a written contract requiring arbitration for any controversy arising between the parties is generally valid, enforceable and irrevocable. See A.R.S. § 12-1501. The authority of the arbitrator is limited to issues specified in the arbitration clause. *Allstate Ins. Co. v. Cook*. Trial de novo appeal provisions do not violate public policy and are therefore enforceable. **Liberty Mut. Fire Ins. Co. v. Mandile**, 192 Ariz. 216, 963 P.2d 295 (Ct. App. 1997).

In a UM arbitration, the insureds waived their right to object to the arbitrator's partiality because their objections were untimely. **Fisher v. USAA**, 245 Ariz. 270, 427 P.3d 791 (Ct. App. 2018). The Fishers were aware of the alleged relationship between the arbitrator and USAA's counsel before the arbitration hearing, yet they did not raise an objection either before or during the hearing. Instead, they waited to challenge the arbitrator's impartiality after he handed down an unfavorable award. Also, the arbitrator did not breach his duty to disclose non-trivial relationships with parties and clients, where no evidence in the record supported the insureds' contention that a business relationship existed between the arbitrator and the insureds' counsel. Mere service as an arbitrator in other matters involving a party's counsel is not sufficient to trigger a presumption of partiality. The Fishers did not allege that the arbitrator had an interest in the outcome of the arbitration or that he had a relationship with either party.

TYPES OF INJURIES NOT COVERED

Contact with HIV-infected blood while providing emergency medical care to a victim of an automobile accident, without contracting HIV itself, is not a bodily injury as defined by UIM coverage. **Transamerica Ins. Co. v. Doe**, 173 Ariz. 112, 840 P.2d 288 (Ct. App. 1992) (rescuers who suffered no physical injury, sickness, disease or substantial pain as a direct result of exposure to HIV were unable to recover under the UIM policy).

ATTORNEY'S FEES AND COSTS

Attorney's fees were recoverable in an UM/UIM claim dispute that sounded in contract and not tort, pursuant to A.R.S. § 12-341.01(A). *Assyia v. State Farm Mut. Auto. Ins. Co.*, 229 Ariz. 216, 273 P.3d 668 (Ct. App. 2012). There, the tort was merely a trigger for the contractual duty and the action would not have existed but for the contract.

SETTLEMENT OF UM/UIM CLAIMS/BAD FAITH

See Chapter 7 for a discussion of bad faith claims.

In Arizona, there is an implied covenant of "good faith and fair dealing" in all insurance contracts. Each party is "bound to refrain from any action which would impair the benefits which the other had the right to expect from the contract or the contractual relationship." *Voland v. Farmers Ins. Co. of Arizona*, 189 Ariz. 448, 943 P.2d 808 (Ct. App. 1997), citing *Rawlings v. Apodaca*, 151 Ariz. 149, 154, 726 P.2d 565, 570 (1986). The tort of bad faith arises when an insurer "intentionally denies, fails to process or pay a claim without a reasonable basis." *Noble v. National Am. Life Ins. Co.*, 128 Ariz. 188, 190, 624 P.2d 866, 868 (1981). However, bad faith is not established by mere negligence or inadvertence. An "insurer must intend the act or omission and must form that intent without reasonable or fairly debatable grounds." *Rawlings v. Apodaca, supra*. Thus, an insurer acts in bad faith when it unreasonably investigates, evaluates or processes a claim and either knows it is acting unreasonably or acts with such reckless disregard that such knowledge may be imputed to it. *Nardelli v. Metro. Grp. Prop. & Cas. Ins. Co.*, 230 Ariz. 592, 277 P.3d 789 (Ct. App. 2012), citing *Zilisch v. State Farm Mut. Auto. Ins. Co.*, 196 Ariz. 234, 995 P.2d 276 (2000).

In *Voland v. Farmers Ins. Co. of Arizona*, 189 Ariz. 448, 943 P.2d 808 (Ct. App. 1997), the court of appeals held that the implied covenant of good faith and fair dealing does not require a UM carrier to pay in advance the amount of an unaccepted settlement offer which fully covers all aspects of a UM claim including special and general damages.

In *Zilisch v. State Farm*, the court held that whether an insurer knowingly acts unreasonably in regards to an insured's claim for underinsured motorist benefits is a question for the jury in a bad faith suit.

The Arizona Supreme Court in *Deese v. State Farm Mut. Auto. Ins. Co.*, 172 Ariz. 504, 838 P.2d 1265 (1992), reaffirmed that a breach of an express covenant is not a necessary prerequisite to an action for bad faith. It further held that a plaintiff may sue for bad faith and breach of contract simultaneously and need not prevail on the contract claim in order to prevail on the bad faith claim, provided the plaintiff "proves a breach of the implied covenant of good faith and fair dealing."

Finally, in ***Nardelli v. Metro***, the court upheld a punitive damages award for bad faith because the insurer had acted with a conscious disregard for the insured's rights and the injury that might result.

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CHAPTER 11: MEDICAL PAYMENTS BENEFITS

Medical payments coverage is not mandatory in Arizona. For the most part, the insurer is free to define coverage as it sees fit. Med pay coverage, however, is not fault based. The insurer need only pay for reasonable medical expenses. The coverage is generally very broad (vast number of people in an array of situations).

WHAT IS COVERED BY MEDICAL PAYMENTS BENEFITS

Med pay coverage applies only to reasonable and necessary medical expenses, and does not include expenses charged by untrained or unlicensed health care providers. *Sanfilippo v. State Farm Mut. Auto. Ins. Co.*, 24 Ariz. App. 10, 535 P.2d 38 (1975). The definition of untrained or unlicensed healthcare provider is subject to interpretation. For example, osteopathic and chiropractic assistants may administer therapy because they are supervised by licensed healthcare professionals. *State Farm Mut. Auto Ins. Co. v. Arizona Bd. of Chiropractic Examiners*, 187 Ariz. 526, 931 P.2d 426 (Ct. App. 1996). In *State Farm*, the court noted that “[t]he statutory landscape has changed dramatically since *Sanfilippo*” and “undercut its rationale.” Specifically, “the legislature has shifted from a posture where health care services, such as physical therapy, could be provided only by licensed individuals to one where such services can be provided by licensed individuals and supervised assistants of those individuals who are themselves subject to regulation by licensing boards.”

WHO IS COVERED FOR MEDICAL PAYMENTS BENEFITS

Who is covered for med pay benefits is largely dependent on the policy’s definition of an insured, but most policies typically provide coverage to the named insured and members of the named insured’s family when they are:

- In their own car named in policy;
- Driving a non-owned car;
- Riding as a passenger in any other car;
- Walking as a pedestrian and struck by another vehicle; or
- Riding a bicycle and struck by another vehicle.

Other individuals are typically covered when:

- Riding as passengers in car of named insured designated under the policy; and
- Riding in non-owned car driven by named insured or member of named insured’s family.

CREDIT FOR MEDICAL PAYMENTS BENEFITS AGAINST LIABILITY COVERAGE

In a third-party claim situation, where there is no privity of contract between the third-party claimant and the liability insurer, med pay benefits may be credited against any liability benefits to be paid to the third-party claimant. This must, however, be clearly stated within the med pay policy provision.

An unambiguous policy provision crediting medical expense payments toward a recovery against the liability coverage is valid and effective. Credit for med pay benefits against liability proceeds is not against public policy because med pay coverage is not mandatory; thus, the third-party claimant is entitled to collect his medical expenses only one time from a liability insurer, regardless of whether those medical expenses are paid under liability coverage or med pay coverage. ***Caballero v. Farmers Ins. Group***, 10 Ariz. App. 61, 455 P.2d 1011 (1969).

A tortfeasor's insurer is not a collateral source. Consequently, when medical expenses are paid in advance by the tortfeasor's insurer, there may be no right to recovery under the insured's own med pay coverage if it would lead to double recovery. ***Sahadi v. Mid-Century Ins. Co.***, 132 Ariz. 422, 646 P.2d 307 (Ct. App. 1982).

In a first-party claim situation, such as a claim under UM or UIM coverage, med pay benefits may be credited against liability benefits only where there is a non-duplication endorsement and the insured is fully compensated. Where there is no non-duplication endorsement or the insured would not be fully compensated, there is no right to offset med pay benefits from liability coverage. Thus, where medical expenses are paid by a tortfeasor's insurer, excess coverage under an injured party's own insurance policy will be denied even if judgment against the tortfeasor was reduced by the amount of medical expenses paid with med pay benefits., since those medical expenses could not be recovered from the tortfeasor, having been previously paid by the tortfeasor's insurer. *Id.*

In ***Schultz v. Farmers Ins. Group of Co.***, 167 Ariz. 148, 805 P.2d 381 (1991), the court found a non-duplication endorsement valid so long as it does not deprive the insured of full recovery for her loss. Here, the insured made a claim under her uninsured motorist (UM) and med pay coverages. The med pay coverage contained a provision for an offset against other coverage applicable to the loss. After paying medical expenses, Farmer's notified its insured it would apply the non-duplication endorsement to offset this amount against the UM benefits otherwise payable. The court held this was valid, so long as the coverage provided fully compensated the claimant. The test, therefore, is whether applying the endorsement denies full recovery for the insured's loss. To the extent applying such an endorsement deprives an insured of full recovery, it is unenforceable. However, a non-duplication endorsement is enforceable if it does not interfere with the insured's right to full recovery for her loss. This is true regardless of whether the endorsement is stated as a reduction of a required coverage or as a reduction of an optional coverage.

Cundiff v. State Farm Mut. Auto. Ins. Co., 217 Ariz. 358, 174 P.3d 270 (2008), came to the opposite conclusion where the insurer tried to offset the insured's worker's compensation benefits from an underinsured motorist (UIM) coverage arbitration award. The UM/UIM statute allows only liability insurance benefits to offset UIM coverage, and worker's compensation is not liability insurance. In reaching its conclusion, *Cundiff* distinguished **Schultz v. Farmers Ins. Group**, 167 Ariz. 148, 805 P.2d 381 (1991). Specifically, in *Schultz*, the court held that an insurer may offset UM benefits by the amount paid under medical payments coverage in order to prevent double recovery, so long as the insured receives full compensation for damages incurred. *Cundiff* declined to follow *Schultz*, however, for the reason that it involved an offset to UM, not UIM, benefits. The court explained that the statutory definition of UM coverage expressly provides that such coverage is **"subject to the terms and conditions of that coverage,"** see A.R.S. § 20–259.01(E), while the UIM statutory provision does not contain a similar limitation, see A.R.S. § 20–259.01(G). See also A.R.S. § 20–259.01.H ("Uninsured and underinsured motorist coverages are separate and distinct..."). Instead, the UIM statutory provision specifically states that the total applicable liability limits are the only amounts that may be deducted from the insured's total damages when calculating UIM coverage. *Id.* Thus, the court held that *Schultz's* reasoning did not apply in the UIM context. See also **Miller v. American Standard Ins. Co. of Wisconsin**, 759 F.Supp.2d 1144 (D. Ariz. 2010) (holding that because the med pay endorsement provision is not "liability" coverage, it cannot be used to offset UIM payments).

NOTE: The collateral source rule may prevent credit where the third-party claimant is also a named insured, i.e., wife suing husband over automobile accident.

While the courts in the above cases gave insurance companies wide latitude in determining what provisions governed the payment of medical expense benefits, the court in **Salerno v. Atl. Mut. Ins. Co.**, 198 Ariz. 54, 6 P.3d 758 (Ct. App. 2000), limited this principle when addressing a policy provision mandating that claims be brought within one year. The court held that absent actual prejudice, filing a late notice of claim will not bar recovery.

LIENS FOR AMOUNTS IN EXCESS OF \$5,000 – A.R.S. § 20-259.01(J)

An automobile insurer that makes a payment under the medical payments coverage of the policy on behalf of an insured for an accident occurring after December 31, 1998 may assert a lien against any amount paid to the insured in excess of \$5,000. In order to perfect the lien, the insurer must, within 60 days of making payment, record the lien in the office of the county recorder in the county in which the accident occurred. Within five days of recording the lien, the insurer must also mail a copy of the lien to the insured and to each person, firm, and corporation and their insurance carriers alleged to be liable for the damages. This provision of A.R.S. § 20-259.01(J) does not give an insurer making payments under medical payments coverage a right of subrogation independent of the filing of the lien.

Healthcare Provider Lien Enforcement Against Med Pay Benefits

A.R.S. § 33-931(A) provides that:

Every individual, partnership, firm, association, corporation or institution or any governmental unit that maintains and operates a health care institution or provides health care services in this state and that has been duly licensed by this state, or any political subdivision or private entity with ambulances operated, licensed or registered pursuant to title 36, chapter 21.1, is entitled to a lien for the care and treatment or transportation of an injured person. The lien shall be for the claimant's customary charges for care and treatment or transportation of an injured person. **A lien pursuant to this section extends to all claims of liability or indemnity, except health insurance and underinsured and uninsured motorist coverage** as defined in section 20-259.01, for damages accruing to the person to whom the services are rendered, or to that person's legal representative, on account of the injuries that gave rise to the claims and that required the services. (emphasis added).

In *Ansley v Banner Health Network*, 248 Ariz. 143, 459 P.3d 55 (2020), the Arizona Supreme Court held A.R.S. § 33-931(A) unconstitutional to the extent it allowed the hospitals to secure payment from third-party tortfeasors for the difference between Medicaid's reimbursement and the hospitals' actual costs. The court reasoned that the federal Medicaid provisions prohibiting balance billing preempted the application of this Arizona statute. 248 Ariz. at 152, 459 P.3d at 64 ("42 C.F.R. § 447.15 expressly provides that '[a] State plan must provide that the Medicaid agency must limit participation in the Medicaid program to providers who accept, as payment in full, the amounts paid by the agency plus any deductible, coinsurance or copayment required by the plan to be paid by the individual.' As we noted in *Abbott*, this amounts to a categorical prohibition against balance billing.").

Citing *Ansley*, plaintiffs in *Grunwald v. Scottsdale Healthcare Hospitals*, 252 Ariz. 141, 499 P.3d 329 (Ct. App. 2021), argued that a hospital's lien for amounts in excess of the hospital contract amount with their insurer was also void. The appellate court upheld the hospital liens, however, because there the hospital was effectively an HMO which is not subject to A.R.S. § 33-931(A).

Prior to *Ansley*, the court of appeals held that med pay benefits are subject to a healthcare provider's lien because the term "health insurance" does not include med pay benefits under an auto policy. *Dignity Health v. Farmers Insurance Company of Ariz.*, 247 Ariz. 39, 444 P.3d 743 (Ct. App. 2019) Credit for Medical Payments Coverage Against Judgments

A.R.S. § 12-2302(B) provides as follows:

If judgment is entered against a defendant by whom or on whose behalf an advance payment has been made and in favor of a plaintiff to whom or for whose benefit an advance payment has been made, such defendant shall be entitled to a reduction of the amount of damages awarded to such plaintiff equal to the amount or value of such advance payments as may be found by the court to have been made. However, in no event shall a person who has made such advance payments be entitled to reimbursement for amount paid

in excess of the damages awarded to such plaintiff or in the event such plaintiff fails to recover judgment in his favor.

In *Bustos v. W.M. Grace Dev.*, 192 Ariz. 396, 966 P.2d 1000 (Ct. App. 1997), the court of appeals held that A.R.S. § 12-2302 applies to payments that a defendant's insurer makes to a plaintiff pursuant to a no-fault medical payment provision of defendant's policy. The plaintiff in *Bustos* argued that the defendant was not entitled to a credit because the defendant's insurance policy had no provision for offsetting no-fault medical payments against liability payments. The court disagreed, reasoning that while the plaintiff was a beneficiary under the defendant's insurance contract, the payment was made voluntarily on behalf of defendant because she had purchased a policy that provided no-fault coverage. The statute does not distinguish between liability payments and no-fault medical payments. Instead, A.R.S. § 12-2301(1) defines "advance payment" as "any money or other thing of value voluntarily paid or provided before trial, as compensation...." By the statute's plain language, the defendant was entitled to a credit for the advance payment made to the plaintiff pursuant to the no-fault medical payment provision of the defendant's insurance policy. This holding furthers the purpose of A.R.S. § 12-2302 to encourage potential defendants to advance payments to assist plaintiffs in meeting their immediate needs, without having to either admit liability or pay twice for the same injury.

"OTHER INSURANCE" CLAUSES

Two Arizona cases have addressed "other insurance" clauses in the med pay context and reached different conclusions. The crux of each court's analysis was the "ambiguity" of the clause, and not whether the clause violated public policy.

In *Aetna Cas. & Sur. Co. v. Scott*, 107 Ariz. 609, 491 P.2d 463 (1971), the Supreme Court held that an "other insurance" clause was ambiguous and unenforceable. This meant the "other insurance" clause was ineffective to make Aetna's medical payments coverage excess over other collectible insurance. Consequently, the claimant was permitted to collect the full amount of his medical expenses under two separate insurance policies issued by two separate insurance carriers. In essence, the claimant was allowed to "aggregate" medical pay benefits.

In *Almagro v. Allstate Ins. Co.*, 129 Ariz. 163, 629 P.2d 999 (Ct. App. 1981), the court of appeals held that an "other insurance" clause was unambiguous, valid and enforceable. As a result, the "other insurance" clause was effective to make Allstate's medical payments coverage excess over other collectible insurance. Consequently, pursuant to Allstate's "other insurance" clause, the court held that Allstate's med pay coverage would apply only after the primary insurance was exhausted.

COORDINATION OF BENEFITS

In *Samsel v. Allstate Ins. Co.*, 204 Ariz. 1, 59 P.3d 281 (2002), the Supreme Court held that an insured was entitled to reimbursement from his/her medical payments coverage even if this resulted in duplicate recovery from another source such as health insurance. There, the plaintiff

incurred medical bills from an automobile accident. Plaintiff's HMO paid all but a small portion of the bills. Allstate denied coverage under the medical payments coverage of those expenses already paid by the insured's HMO. The Allstate policy provided that it would pay "all reasonable expenses actually incurred by an insured person." The court held that even though the plaintiff was insured under an HMO, she incurred the charges as defined by the Allstate policy and should be able to collect. Moreover, the medical payments section of the policy did not contain a coordination of benefits provision. The court did not conclude that such coordination of benefits provisions are unlawful. Rather, the court stated that "Allstate could have, but did not, specifically provide for reduction of medical payments benefits by a coordination of benefits or other clause limiting medical payments coverage" and therefore, the plaintiff could collect from both sources.

PORTABILITY AND STACKING OF MEDICAL PAY BENEFITS

Generally, by definition and broad scope of policy language, med pay benefits are portable, i.e., they follow the insured.

No Arizona cases have directly addressed the issue of stacking med-pay benefits. However, in ***Schultz v. Farmers Ins. Group of Cos.***, 167 Ariz. 148, 805 P.2d 381 (1991), the Supreme Court held that a non-duplication endorsement is valid if the insured is not deprived of full recovery for medical expenses. In reaching its decision, the court noted that although A.R.S. § 20-259.01(H) was not directly applicable, the stacking preclusion contained in that statute demonstrates Arizona public policy to permit an insurer to preclude double recovery on multiple coverages.

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CHAPTER 12: HEALTH CARE PROVIDER LIENS

In Arizona, an action is not assignable in whole or in part prior to the judgment. *Harleysville Mut. Ins. Co. v. Lea*, 2 Ariz. App. 538, 541, 410 P.2d 495, 498 (1966) (injured party cannot assign his personal injury recovery to insurer to reimburse medical payments made). In addition, an insurer cannot be subrogated to the proceeds of the insured's personal injury action. *Allstate Ins. Co. v. Druke*, 118 Ariz. 301, 303, 576 P.2d 489, 491 (1978); *State Farm Fire & Cas. Co. v. Knapp*, 107 Ariz. 184, 185, 484 P.2d 180, 181 (1971). Where a policy creates "an interest in any recovery against a third party for bodily injury[,] [s]uch an arrangement, if made or contracted for prior to settlement or judgment, is the legal equivalent of an assignment and therefore unenforceable." *Allstate*, 118 Ariz. at 303, 576 P.2d at 492.

Exceptions to the general rule against subrogation and assignment exist. For example, under A.R.S. § 20-259.01, an insurer has a right of subrogation and the right to sue for reimbursement of payments made in the name of the insured against any uninsured motorist liable to the insured for personal injury. A.R.S. § 20-259.01(I). In addition, health care providers in Arizona who render treatment to injured persons resulting from the fault of another and, in some limited circumstances, the health insurers who pay for the medical treatment, may have a right of subrogation (reimbursement) against the injured person's tort recovery. The mechanism by which these rights are secured is referred to as a medical or health care provider lien.

This chapter focuses on the following health care provider liens:

1. Statutory health care providers liens pursuant to A.R.S. § 33-931;
2. Arizona Health Care Cost Containment System (AHCCCS) – Arizona Medicaid liens;
3. ERISA liens; and
4. Medicare's right of reimbursement.

STATUTORY HEALTH CARE PROVIDERS LIENS (A.R.S. § 33-931 ET SEQ.)

Pursuant to A.R.S. § 33-931, health care providers who treat injured persons arising from the fault of another are entitled to a lien against the injured person's tort recovery for the reasonable and customary charges of the treatment rendered. The purpose of allowing health care provider liens is to "lessen the burden on hospitals and other medical providers imposed by non-paying accident cases." *LaBombard v. Samaritan Health Sys.*, 195 Ariz. 543, 548 ¶ 18, 991 P.2d 246, 251 (Ct. App. 1998).

The lien created under this statute attaches solely to proceeds the injured party receives; the health care provider may not pursue an action to enforce its lien directly against the injured party. In addition, statutory health care provider liens apply only to third-party tort recoveries; first party underinsured and uninsured motorist proceeds and liens and/or claims for subrogation by

health insurance companies are specifically exempt. A.R.S. § 33-931 (“except health insurance and underinsured and uninsured motorist coverage as defined in section 20-259.01”).

Perfection Requirement

To be valid and enforceable, a lien pursuant to this statute must be perfected in compliance with A.R.S. § 33-932. To perfect a lien under § 33-932, the lien holder must record, in the county where the treatment was rendered, before or within 30 days of the first date of service, a lien setting forth the following information:

1. The name and address of the patient;
2. The name and address of the health care provider;
3. The name and address of the executive officer or agent of the health care provider, if any;
4. The dates or range of dates of services and treatment received;
5. The amount claimed due;
6. The name of those alleged to be responsible for paying the damages, i.e., the tortfeasor and the tortfeasor’s insurance company; and
7. Whether the treatment has been terminated or will be continued.

A.R.S. § 33-932(A)-(B). In addition to timely recordation, A.R.S. § 33-932 requires the lien holder to send a copy of the lien via first class mail to all named persons within 5 days of recordation. A.R.S. § 33-932(C).

In *Premier Physicians Grp., PLLC, v. Navarro*, 240 Ariz. 193, 197-98, 377 P.3d 988, 992-93 (Ct. App. 2016), the Arizona Supreme Court held that A.R.S. § 33-932(A) clearly requires non-hospital providers to record liens before services are first rendered—or within thirty days thereafter. A health care provider must therefore strictly comply with the statutory recording requirements to perfect a medical lien.

“Treatment Continuing”

Liens that are recorded with “treatment continuing” language are valid for the final amount billed as opposed to the amount listed on the lien. See A.R.S. § 33-932(B). There is no requirement to re-record with the final amount billed.

Special Rules for Hospitals and Ambulance Companies

Hospitals and ambulance companies are not required to name the tortfeasor and his/her insurance company as described above. See A.R.S. § 33-932(A)(6). In addition, hospitals and ambulance companies are not required to record within 30 days of when service is first rendered.

Rather, a hospital or ambulance company need only record 30 days before either the date the settlement or judgment is agreed to or the date the settlement or judgment proceeds are paid, in order to have a valid enforceable lien. A.R.S. § 33-932(D). Finally, hospital liens take priority over all other liens authorized by A.R.S. § 33-931, but not as to other forms of recovery, such as AHCCCS. See A.R.S. § 33-931(D).

Enforcement

A perfected statutory health care provider lien is enforceable against the patient's recovery, the liable tortfeasor, or the tortfeasor's insurance company for two years after judgment/settlement. See A.R.S. § 33-934(A)-(B); see also *Midtown Med. Grp., Inc. v. Farmers Ins. Grp.*, 235 Ariz. 593, 595 ¶ 12, 334 P.3d 1252, 1254 (Ct. App. 2014). Although A.R.S. § 33-934 permits a lien holder to pursue its lien against the patient's recovery, it does not permit a lien holder to pursue the patient beyond the amount of tort recovery, i.e., to reach the patient's personal assets. *Blankenbaker v. Jonovich*, 205 Ariz. 383, 387 ¶ 18, 71 P.3d 910, 914 (2003). Moreover, the lien holder is only entitled to recover the "customary charges" for reasonable and necessary medical treatment. See A.R.S. § 33-931(A); 33-934(B).

Not Enforceable Against Wrongful Death Recoveries

A statutory health care provider lien is not applicable to wrongful death recoveries. *Gartin v. St. Joseph's Hosp. & Med. Ctr.*, 156 Ariz. 32, 36, 749 P.2d 941, 945 (Ct. App. 1988). The lien is enforceable only against a recovery of medical expenses by the decedent's estate. See A.R.S. § 12-613 ("In an action for wrongful death . . . [t]he amount recovered in such action shall not be subject to the debts or liabilities of the deceased, unless the action is brought on behalf of the decedent's estate.").

Health Care Providers Who Accept AHCCCS and/or Medicare Benefits

Health care providers who accept AHCCCS and/or Medicare benefits are prohibited from pursuing a "balance billing lien" for the difference between the billed charges and the AHCCCS and/or Medicare payment. See *Ansley v. Banner Health Network*, 248 Ariz. 143, 152 ¶ 35, 459 P.3d 55, 64 (2020) (holding that federal law preempts Arizona's lien statute that allowed recovery for difference between Medicaid reimbursement and hospital's actual costs because Medicaid participation is limited to "providers who accept, as payment in full, the amounts paid by the agency plus any deductible, coinsurance or copayment required by the plan to be paid by the individual"); see also *Lizer v. Eagle Air Med. Corp.*, 308 F. Supp. 2d 1006, 1009 (D. Ariz. 2004); 42 U.S.C. § 1396a(a)(25)(C); 42 C.F.R. § 447.15. But see *Grunwald v. Scottsdale Healthcare Hosps.*, 252 Ariz. 141, 146 ¶ 20, 499 P.3d 329, 334 (Ct. App. 2021) (a hospital may pursue balance billing liens against the tort recoveries of plaintiffs enrolled in private health care insurance).

Defenses to Enforcement

A defendant in a lien enforcement action cannot argue that it is not liable for the underlying accident giving rise to the lien. See A.R.S. § 33-934(B). The only available defenses to a lien

enforcement action are: (1) that the charges sought are erroneous or exceed the customary charges; and/or (2) that the care or treatment was not reasonable, medically necessary, or causally related to the event giving rise to the underlying claim. *Id.* The lien holder has the burden to prove the charges were “usual and customary” and that the care or treatment was reasonable, necessary, and causally related to the underlying claim. Consequently, when defending an action to enforce a lien, it is important to determine first whether the treatment was reasonable and necessary, and second whether the charges sought are truly customary. If not, it might be possible to negotiate a reduction on those grounds.

RESOLVING STATUTORY HEALTH CARE PROVIDERS LIENS

The Common Fund Doctrine

Even if the treatment were reasonable and the charges customary, health care providers pursuing a lien under A.R.S. § 33-931 are required to reduce the lien by an amount that represents a pro-rata share of the legal expenses incurred in securing the tort recovery. ***LaBombard v. Samaritan Health Sys.***, 195 Ariz. 543, 548-49 ¶ 22, 991 P.2d 246, 251-52 (Ct. App. 1998). The purpose of the “common fund doctrine,” as it is often called, is to “ensure fairness to the successful litigant, who might otherwise receive no benefit because his recovery might be consumed by the expenses . . .” *Id.* For example, a litigant who recovers \$50,000 and faces a health care provider lien in the amount of \$20,000 can argue, under the common fund doctrine, that the lien should be reduced by a proportionate share of the attorneys’ fees and legal expenses incurred in securing the judgment. Assuming for purposes of this example that the attorneys’ fees are 25% of the settlement, and the expenses incurred were \$5,000, the total “cost” associated in securing the judgment is \$17,500, or 35% of the settlement amount. The lien holder is then asked to reduce its lien by the same percentage, which in this case would be a reduction of \$7,000.

Does a “Released” Health Care Provider Lien Resolve the Debt?

In ***Blakenbaker***, 205 Ariz. 383, 388 ¶ 19, 71 P.3d 910, 915 (2003), the court held that even in the absence of a perfected health care provider lien, the provider could pursue the patient directly, under a contract theory, for the amount owed. In ***Pain Management Clinic v. Preese***, 229 Ariz. 364, 275 P.3d 1284 (Ct. App. 2012), the court of appeals took that analysis one step further. There, the clinic released a lien when the patient told them that there was no source of recovery from the tortfeasor. Despite the lien release filed by the clinic stating that the lien had been “released in full having been compromised or paid,” the clinic was permitted to recover from the patient. *Id.* at 365-66 ¶¶ 7-8, 275 P.3d at 1285-86. The court held that “the language in the Release did not constitute a waiver of Pain Management’s right to payment on the debt obligation.” *Id.* at 366 ¶ 8, 275 P.3d at 1286. Therefore, a health care provider may be able to seek full reimbursement despite having released a health care provider lien. However, that action can only be taken against the patient. Nothing in this decision allows a health care provider to sue the tortfeasor and/or her insurer for the debt. A health care provider’s only recourse against

a tortfeasor and/or her insurer for the repayment of medical expenses is through the enforcement of a valid, perfected health care provider lien pursuant to A.R.S. § 33-931.

ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM (AHCCCS) LIENS (A.R.S. § 36-2915 ET SEQ.)

Under federal law, every state that participates in the Medicaid program is required to enact statutes to provide for the reimbursement of expenses paid on behalf of Medicaid beneficiaries. See 42 U.S.C. § 1396a(a)(25)(B), (H). Arizona participates in the federal Medicaid program through AHCCCS, the State agency that provides medical care and treatment to the indigent. Under A.R.S. § 36-2915(A), AHCCCS is entitled to pursue a lien against “any third party or . . . monies payable from accident insurance, liability insurance, workers’ compensation, health insurance, medical payment insurance, underinsured coverage, uninsured coverage or any other first or third party source.”

Perfection Requirement

To perfect a lien pursuant to A.R.S. § 36-2915(B), the AHCCCS lien holder must record, within 60 days from either the date of hospital discharge or the first date of service, in the county in which the injuries were incurred, a lien setting forth the following:

1. The name and address of the injured person;
2. The name and address of the administration;
3. The dates of service and treatment;
4. The amount charged; and
5. The names and addresses of those alleged to be responsible for the injuries giving rise to treatment and their insurance carriers.

In addition, the AHCCCS lien holder must, within 5 days of recordation, mail a copy of the lien to the patient and each person or entity alleged to be responsible for the damages and their insurance carriers. A.R.S. § 36-2915(B).

Alternative Recovery Under A.R.S. § 12-962

An AHCCCS lien holder that fails to properly record its lien as required by § 36-2915(B) may still recover the expenses paid on behalf of the plan beneficiary under § 12-962. However, recovery under A.R.S. § 12-962 is limited to only third party proceeds. See *Arizona Health Care Cost Containment Sys. v. Bentley*, 187 Ariz. 229, 234, 928 P.2d 653, 658 (Ct. App. 1996) (noting that AHCCCS’s lien rights under A.R.S. § 36-2915 do not preempt AHCCCS recovery under A.R.S. § 12-962); *Arizona Dep’t of Admin. v. Cox*, 222 Ariz. 270, 278 ¶ 35 n.6, 213 P.3d 707, 715 n.6 (Ct. App.

2009) (noting that A.R.S. § 12-962 does not permit the state to recover anything other than what is recovered from the third party).

Enforcement

Under A.R.S. § 36-2916(B), the AHCCCS lien holder may enforce its lien against the patient, the tortfeasor, or the tortfeasor's insurance company. Alternatively, should the AHCCCS lien holder choose to pursue its right of subrogation under A.R.S. § 12-962, it may do so by initiating a direct action against the tortfeasor or the AHCCCS beneficiary's tort recovery, or by intervening in an existing third party personal injury action brought by the AHCCCS beneficiary. A.R.S. § 12-962(B).

Priority and Statute of Limitations

AHCCCS liens pursuant to A.R.S. § 36-2915 have priority over liens by the Department of Economic Security ("DES"), the counties, statutory health care provider liens pursuant to A.R.S. § 33-931, and claims against a third party payor. A.R.S. § 36-2915(F). An AHCCCS lien holder has 2 years from the date of judgment or settlement to pursue its lien rights. A.R.S. § 36-2916(B).

Resolving AHCCCS Liens

To determine whether an AHCCCS lien exists, one should begin by determining the third-party administering entity. In rare circumstances will a lien be filed on behalf of AHCCCS itself. In Arizona, common AHCCCS entities include Mercy Care Plan and APIPA, among others.

An AHCCCS lien holder is required to reduce its lien if, after considering the following factors, it determines that the reduction provides a settlement of the claim that is fair and equitable:

1. The nature and extent of the person's injury or illness;
2. The sufficiency of insurance or other sources of indemnity available to the person; and
3. Any other factor relevant to determining a fair and equitable settlement under the circumstances of a particular case.

A.R.S. § 36-596.01(I). Note, however, that 15 days after being put on notice of a settlement, the AHCCCS lien amount becomes final and cannot be amended. A.R.S. § 36-2915(G).

An AHCCCS lien holder is not required to reduce the federal portion of the benefits paid, which can account for up to 30%. *Eaton v. Arizona Health Care Cost Containment Sys.*, 206 Ariz. 430, 435 ¶ 20, 79 P.3d 1044, 1049 (Ct. App. 2003). The only exception to this rule occurs when a plaintiff recovers less than the full value of his/her claim, in which case the AHCCCS lien holder is entitled to recover only a pro-rata share of what it paid on behalf of the injured person, less a deduction for litigation expenses consistent with the "common fund doctrine." *Southwest Fiduciary, Inc. v. Arizona Health Care Cost Containment Sys. Admin.*, 226 Ariz. 404, 411 ¶ 28, 249 P.3d 1104, 1111 (Ct. App. 2011); see also *Arkansas Dep't of Health & Human Servs. v.*

Ahlborn, 547 U.S. 268, 284-85 (2006) (Medicaid’s share of a settlement may not exceed the portion of the settlement that represents medical expenses.). Additionally, an AHCCCS provider’s lien is enforceable only against the Medicaid beneficiary’s tort settlement/judgment. **Wos v. E.M.A. ex rel. Johnson**, 568 U.S. 627, 632 (2013).

ERISA LIENS

Most private (non-governmental) health plans are organized under the Employee Retirement Income Security Act (ERISA), 29 U.S.C. §§ 1001 *et seq.* ERISA itself does not create any lien or subrogation rights for ERISA health plans. Rather, the scope and extent of each specific plan’s lien rights are dictated by the provisions of the Summary Plan Description adopted and incorporated as part of the plan. See **CIGNA Corp. v. Amara**, 563 U.S. 421, 436 (2011) (terms must be part of the plan to be enforceable). Consequently, it is critical to obtain these documents to fully understand the extent of each specific plan’s lien rights.

Obtaining Plan Documents

ERISA grants a plan beneficiary the right to make a written request and receive certain specified documentation from the plan administrator. See 29 U.S.C. § 1024(b)(4). The failure to provide this information within 30 days can result in the imposition of a penalty of up to \$100 per day for each day of noncompliance. See 29 U.S.C. § 1132(c)(1)(B). Note, however, that only the ERISA plan administrator, not the subrogation company or health insurer, is subject to the \$100 per day penalty for late production of requested plan documents. Thus, it is important to always request plan documents from the plan administrator, even if you also request plan documents from the subrogation company or health insurer.

Perfection Requirement

ERISA plan liens have no perfection requirements. The lien automatically arises upon the payment of benefits under the plan for accident related treatment.

Enforcement

Actions to enforce an ERISA lien are governed by 29 U.S.C. § 1132, and can be brought by the Secretary, a participant, beneficiary, or fiduciary. 29 U.S.C. § 1132(A).

Formerly, provisions in ERISA plans providing for lien/subrogation and reimbursement from personal injury settlements were void and unenforceable in the Ninth Circuit. See, e.g., **Westaff (USA) Inc. v. Arce**, 298 F.3d 1164, 1167 (9th Cir. 2002); see also **Great-West Life & Annuity Ins. Co. v. Knudson**, 534 U.S. 204 (2002). **Knudson** and **Westaff** held that because ERISA’s enforcement statutes allow only equitable relief, an ERISA plan could not bring an action to enforce its lien rights against the plan beneficiary. In 2006, however, the U.S. Supreme Court ruled in **Sereboff v. Mid Atlantic Medical Services, Inc.**, 547 U.S. 356, 363 (2006), that an action by an ERISA plan for reimbursement of medical expenses paid on behalf of the plan beneficiary is a form of “equitable relief” under 29 U.S.C. § 502(a)(3). **Sereboff** expressly abrogated the

decision in *Westaff* and distinguished *Knudson* on the grounds that the Knudsons' funds were in trust, whereas the Sereboffs' funds were in their own possession and control. *Sereboff* thus provided a means by which an ERISA plan could enforce its lien rights against personal injury tort recoveries.

After *Sereboff*, an ERISA plan has a valid enforceable lien if the subrogation provision in the plan documents (the Summary Plan Description) includes the following language:

1. The fund "specifically identifie[s] a particular fund, distinct from the [plan beneficiaries'] general assets," i.e., the tort recovery;
2. The funds sought belong in "good conscience" to the plan; and
3. The plan specifically identifies the particular share of the fund to which the plan is entitled.

An ERISA lien is unenforceable if it fails to meet any of the above requirements. *Popowski v. Parrott*, 461 F.3d 1367, 1371 n.4 (11th Cir. 2006). Additionally, as set forth above, it is not enough that the subrogation provision complies with *Sereboff*. The Summary Plan Description must be appropriately incorporated into the health care plan. See *Amara*, 563 U.S. at 436.

Resolving ERISA Liens

Assuming that the ERISA plan contains a valid, enforceable subrogation provision, the terms of the plan will dictate the extent, and limitations on the plan's recovery. *US Airways, Inc. v. McCutchen*, 569 U.S. 88, 101 (2013) (plan's clear terms will be enforced). This includes the equitable defenses, if any, that are available to the plan beneficiary. Where the plan is silent as to equitable defenses, i.e., the common-fund and make-whole doctrines, such defenses should arguably be available. *Id* at 102-05.

MEDICARE'S RIGHT OF REIMBURSEMENT: PART A & B COVERAGE

Medicare provides health insurance and medical benefits for the following:

- People aged 65 or older;
- People under 65 who have been receiving Social Security Disability Income (SSDI) for 24 continuous months; or
- People of any age with End-Stage Renal Disease (ESRD).

Once an individual becomes eligible for Medicare Part A (which covers hospital care) and Part B (which covers physician care), he or she can opt to enroll in a Part C, or Medicare Advantage Plan. Medicare's right to reimbursement with respect to payments made under Part A & B plans are

distinct from the reimbursement rights which apply to payments made under Part C. Thus, this section addresses them separately.

Medicare Secondary Payer Act of 1980

Medicare's lien rights are governed by the Medicare Secondary Payer (MSP) Act of 1980, codified at 42 U.S.C. § 1395y(b)(2)(B)(ii). Prior to the enactment of the MSP Act, Medicare was the "primary payer" of medical bills for its beneficiaries and could not seek reimbursement. The MSP Act now provides that Medicare is the "secondary payer" of medical bills after primary health care insurance, workers' compensation, automobile insurance coverage and other liability plans. To facilitate the coordination of treatment and benefits, however, Medicare often pays the medical expenses of its beneficiaries up front as a "conditional payment." 42 U.S.C. § 1395y(b)(2)(B). Medicare is then entitled to reimbursement of the conditional payment from the beneficiary's primary plan.

Perfection Requirement

No formal perfection requirements exist for Medicare to have a valid enforceable lien. Rather, the right of reimbursement arises upon Medicare's issuance of a conditional payment on behalf of the beneficiary. Note that Medicare's rights to recover from tortfeasors' insurance policies under the MSP Act are essentially rights of subrogation, even though Medicare's rights are referred to as a lien.

Enforcement

Medicare may initiate an action to enforce its liens against all those involved in the personal injury action, including the plaintiff and his or her attorney, the tortfeasor, and the insurance carrier. See 42 U.S.C. § 1395y(b)(2)(B)(iii). Through the Strengthening Medicare and Repaying Taxpayers ("SMART") Act, Medicare has three (3) years from the date it learns of the settlement/recovery to enforce its lien rights. The time limit runs from the date the settlement is reported to CMS as part of the Medicare reporting requirements.

Resolving Medicare Liens

Resolving and negotiating Medicare liens requires an understanding of the Medicare claims process through which Medicare formally asserts its right of reimbursement. Following is a brief description of the procedure in place at the time of this writing. For the most current information on the Medicare claims process, visit www.cms.gov.⁴

⁴ Medicare Claims Processing Manual is available at <https://www.cms.gov/Regulations-and-Guidance/Guidance/Manuals/Internet-Only-Manuals-IOMs-Items/CMS018912.html>. (last visited June 28, 2022).

Medicare pursues its right of reimbursement through the Benefits Coordination & Recovery Center (BCRC). Whenever a Medicare beneficiary initiates a personal injury action, a claim is opened with the BCRC. Upon receipt of the claim, the BCRC issues a Rights and Responsibilities letter, setting forth Medicare's right of reimbursement and the beneficiary's responsibility to report information to Medicare in conformance with the claims process. A Conditional Payment letter is issued 65 days later and sets forth an itemized list of expenses that Medicare claims it paid on behalf of the beneficiary for the subject accident or incident. If any of the charges listed are disputed, i.e., because they are not accident related, the BCRC will review the dispute and may issue a revised Conditional Payment Letter.

Once the case is settled or judgment entered, a Final Settlement Detail is submitted which lists the date and amount of the settlement, and any attorneys' fees and costs incurred. The BCRC then issues a Final Lien Demand letter which formally sets forth the amount Medicare is seeking in reimbursement. Medicare is required to, at a minimum, reduce its lien by a pro-rata share of the attorneys' fees and costs incurred in securing the judgment. 42 C.F.R. § 411.37.

The beneficiary has 60 days from the receipt of the Final Demand letter to pay the amount due before interest and penalties begin accruing, unless an administrative remedy is pending. See *Haro v. Sebelius*, 747 F.3d 1099, 1109 (9th Cir. 2014) (holding that the Secretary could not pursue collection action against a Medicare beneficiary while an administrative remedy was pending).

Tender of Funds

The district court in *Haro* held that while the Secretary is precluded from pursuing a collection action against a beneficiary prior to the exhaustion of administrative remedies, attorneys are not precluded from "disbursing undisputed portions of the settlement proceeds to their beneficiary clients." *Haro*, 789 F. Supp. 2d 1179, 1195 (D. Ariz. 2011). The district court decision could have allowed defendants to consider tendering the entire settlement funds to the plaintiff's attorney, conditioned upon the plaintiff's attorney's agreement to retain the disputed portion in trust pending the Medicare lien resolution. But the district court's ruling was reversed by the 9th Circuit's amended decision issued in January 2014. In that decision, the 9th Circuit held "reasonable" the "Secretary's demand that attorneys who have received settlement proceeds reimburse Medicare before disbursing those proceeds to their clients [which] certainly increases the likelihood that proceeds will be available for reimbursement." 747 F.3d at 1117.

Therefore, in light of *Haro*, defendants might want to consider the conditions of tendering settlement funds in cases involving Medicare beneficiaries. Considerations include:

1. Whether to demand conditional payment information prior to tender;
2. Whether to demand a copy of Medicare's formal demand letter prior to tender;
3. Whether to demand a complete (or partial) hold-back of funds by plaintiff and her counsel pending the resolution of Medicare's right of reimbursement;

4. Whether to demand proof of satisfaction of Medicare's right of reimbursement as part of the settlement AND a liquidated damages provision for any failure to provide proof of satisfaction; and
5. The extent of the indemnification required by Plaintiff and his/her lawyer for any failure to satisfy Medicare's right of reimbursement.

The law regarding Medicare's right of reimbursement is ever-changing. We encourage you to contact us with any specific questions you have regarding Medicare's right of reimbursement and the appropriate steps you should take to protect your client's interests.

MEDICARE ADVANTAGE'S RIGHT OF REIMBURSEMENT: PART C PLANS

Unlike Medicare Part A & B, Medicare Advantage Plans are administered by private insurers and governed by separate statutes. 42 U.S.C. § 1395w-21 *et seq.* These statutes permit, but do not require, a Medicare Advantage Plan to recover against a primary plan, whereas payments made under Part A & B coverage "shall be conditioned" upon reimbursement by a primary plan. *Compare* 42 U.S.C. § 1395y(b)(2)(B)(i) *with* 42 U.S.C. § 1395mm(e)(4). Courts have said this reflects Congress's intent not to give these plans the same reimbursement rights as the Medicare program. *See Care Choices HMO v. Engstrom*, 330 F.3d 786, 789 (6th Cir. 2003); *Nott v. AETNA U.S. Healthcare, Inc.*, 303 F. Supp. 2d 565, 570 (E.D. Pa. 2004). These courts have further held that Medicare Advantage Plan statutes create a right of reimbursement without providing a remedy to enforce that right. *See Nott*, 303 F. Supp. 2d at 571 ("[W]hile granting statutory permission to include recovery provisions in their contracts, Congress did not create a mechanism for the private enforcement of subrogation rights of Medicare substitute[s]."). Even after the Medicare Advantage statutes were amended in 2005 to give Medicare Advantage Plans the same rights as the Medicare program under 42 U.S.C. § 1395 *et seq.*, courts continued to reject Medicare Advantage Plans' attempts to enforce lien rights under federal law.

Parra v. PacifiCare of Arizona, Inc., 715 F.3d 1146, 1154 (9th Cir. 2013), held that the Medicare statutes did not grant a Medicare Advantage Plan a private right of action to enforce its lien rights in federal court and that the Plan had to pursue its claim in state court. It was originally thought that this might not be possible because of the anti-subrogation decision in *Allstate Ins. Co. v. Druke*, 118 Ariz. 301, 304, 576 P.2d 489, 492 (1978).

In *Estate of Ethridge v. Recovery Management Systems, Inc.*, 235 Ariz. 30, 39 ¶ 30, 326 P.3d 297, 306 (Ct. App. 2014), however, the court that the federal statutes authorizing Medicare Advantage Plans preempted any state laws or decisions that precluded a Medicare Advantage Plan private carrier from enforcing its lien/subrogation rights in Arizona state courts. It specifically ruled that *Druke* and its anti-abrogation doctrine were not applicable to Medicare Advantage Plans.

MEDICARE SET ASIDE

Workers' Compensation Cases

The Medicare statutes specifically mandate that settlement funds in workers' compensation cases earmarked for future medical treatment be "set aside." 42 C.F.R. § 411.46(a). Once those funds are exhausted, Medicare assumes liability for any further medical expenses.

Third Party Liability Cases

Some lawyers representing plaintiffs in third-party liability cases argue that, unlike workers' compensation, there is no specific statutory language requiring a Medicare Set Aside ("MSA"). While the statutes are not a model of clarity, we believe there is a requirement for an MSA where the settlement or judgment contemplates the payment of future medical expenses. *See* 42 U.S.C. § 1395y(b)(2)(A)(ii) (as secondary payer, Medicare will not cover items or services for which "payment has been made or can reasonably expected to be made . . . under a[] . . . liability insurance policy or plan (including a self-insured plan.>"). Medicare recently indicated it would not require or consider the MSA in a third-party liability case where a beneficiary's treating physician certifies in writing that the accident-related injuries have resolved and no further treatment is required. *See* CMS Memorandum: "Medicare Secondary Payor – Liability Insurance (Including Self-Insurance) Settlements, Judgments, Awards, or Other Payments and Future Medicals -- INFORMATION," September 30, 2011.⁵ In 2012, CMS proposed a Rule CMS-6047-P Medicare Secondary Payer and "Future Medicals," that would require MSAs in all third party liability cases where "future medical care is claimed, or the settlement, judgment, award or other payment releases (or has the effect of releasing) claims for future medical care." That Rule was, however, withdrawn in October 2014. In the fall of 2018, CMS issued another notice indicating that it planned to issue proposed rules in September, 2019 to address future medicals.⁶ But it does not appear this became law. In light of Medicare's overall mandate that its payments are "secondary" to those that are made, or can be made, by a "primary plan," it is important to consider an MSA in liability settlements where future medical expenses are specifically allocated by a jury on the verdict form, or where future medical expenses are paid as part of a personal injury settlement.

Wrongful Death Proceeds

When a liability insurance payment is made pursuant to a wrongful death action, Medicare may recover from the payment only if the state statute permits recovery of these medical expenses. *See* Medicare Secondary Payer Manual Chapter 7, § 50.5.4.1.1. In Arizona, damages recoverable in a wrongful death action "shall not be subject to debts or liabilities of the deceased, unless the action is brought on behalf of the decedent's estate." A.R.S. § 12-613. Accordingly, in Arizona,

⁵ <https://www.cms.gov/files/document/future-medicals.pdf> (last visited June 28, 2022).

⁶ <https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201810&RIN=0938-AT85> (last visited June 28, 2022).

Medicare may only enforce its right of reimbursement against wrongful death proceeds if the claim is brought on behalf of the estate. Beyond that, Medicare cannot enforce its lien against recoveries paid to beneficiaries of a wrongful death claim. *Id.*; see also **Gartin v. St. Joseph's Hosp. & Med. Ctr.**, 156 Ariz. 32, 34, 749 P.2d 941, 943 (Ct. App. 1988) (holding that only the estate can make a survival claim for the medical expenses incurred by the decedent before his or her death). This holding was reaffirmed in **Ethridge**, *supra*.

MEDICARE REPORTING REQUIREMENTS

As of January 1, 2012, all insurers (including no-fault and self-insured policies) are required to report first and third party personal injury settlements, verdicts or awards to Medicare whenever Medicare paid medical expenses on behalf of its beneficiary that are compensated as part of the recovery. This change is the result of the implementation of the Medicare, Medicaid, and SCHIP Extension Act of 2007 ("MMSEA"), which effectively shifted the burden to the insurer to put Medicare on notice of settlements so that Medicare can pursue its statutory right of reimbursement. 42 U.S.C. § 1395y(b)(7)-(8). A Registered Reporting Entity ("RRE") that fails to comply can be fined \$1,000 per day for failing to report and faces "double damages," i.e., double the amount Medicare paid on behalf of the beneficiary for expenses related to the subject incident.

While it remains unclear whether settlements involving Medicare Advantage Plans must be reported, if in doubt, it is certainly prudent to report any settlement involving a Medicare beneficiary, to avoid the potential imposition of fines and penalties.

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CHAPTER 13: ARIZONA PROPERTY AND CASUALTY INSURANCE GUARANTY FUND

OVERVIEW

In 1977, the Arizona Legislature established the Arizona Property and Casualty Insurance Guaranty Fund (“the Fund”). From its inception, the objective of the Fund was to protect Arizona claimants and policyholders from financial loss due to the insolvency of an insurance company. To achieve this objective, the legislature made the Fund liable to the same extent the insolvent insurance company would have been liable under the policy had it remained solvent. See *Arizona Prop. & Cas. Ins. Guar. Fund v. Herder*, 156 Ariz. 203, 205, 751 P.2d 519, 521 (1988) (citing *Treffenger v. Arizona Ins. Guar. Ass’n*, 22 Ariz. App. 153, 524 P.2d 1326 (1974)). Thus, when an insolvency occurs, the Board activates the Fund, which then “steps into the shoes” of the insolvent insurance company to indemnify and defend its Arizona insureds.

FINANCING THE FUND (A.R.S. § 20-666)

To finance the Fund, the Fund evaluates the losses of the insolvent carrier and makes assessments against all other property and casualty insurers in Arizona. These assessments are then used to pay the claims made against the Fund, as well as the Fund’s expenses. Although the Fund is administered through the Department of Insurance under the auspices of the state, the money used does not include tax dollars. However, the member insurers do receive a tax credit for the assessment.

REQUIREMENTS TO COLLECT FROM THE FUND (A.R.S. § 20-661 & A.R.S. § 20-667)

Because the Fund’s resources are limited, the statute mandates six minimum requirements before a claimant may collect against the Fund:

1. The claimant or insured must be a resident of Arizona at the time of the loss. Where a property loss occurs, this requirement can be met if the property is permanently located in Arizona;
2. The carrier must be authorized to transact business in Arizona either when the policy was issued or when the loss occurred;
3. The carrier must be adjudged insolvent by a court of competent jurisdiction;
4. The claim amount must be in excess of \$100;
5. The loss must be covered by the insolvent carrier’s policy; and

6. The claim must arise within the statutorily prescribed period.

THE FUND’S RIGHTS, OBLIGATIONS, AND DUTIES (A.R.S. § 20-664)

As mentioned above, when the Fund participates in a covered claim, it steps into the same position held by the insolvent carrier. In doing so, it assumes the same rights, duties, and obligations that the insolvent carrier had under the policy. Consequently, the Fund owes the insured of the insolvent carrier three duties: (1) to indemnify where a covered claim is involved; (2) to defend; and (3) to treat settlement proposals with equal consideration. See *Arizona Prop. & Cas. Ins. Guar. Fund v. Helme*, 153 Ariz. 129, 137, 735 P.2d 451, 459 (1987) (stating that the insolvent carrier’s policy language is controlling for coverage). Likewise, the insured has a duty to cooperate with the Fund under the terms of standard insurance policies.

Once the Fund takes over the role formerly held by the insolvent carrier, the Fund becomes authorized to investigate the claims brought against it and to “adjust, compromise, settle and pay covered claims to the extent of the Fund’s obligation.” A.R.S. § 20-664(A)(1). Indeed, the Fund becomes authorized to negotiate and become a party to such contracts as are necessary to terminate the Fund’s obligation, and becomes empowered to deny all non-covered claims. To this end, the Fund may also initiate litigation to determine its obligations. See *Helme*, 153 Ariz. at 133, 735 P.2d at 455; *Herder*, 156 Ariz. at 208, 751 P.2d at 524.

COVERAGE UNDER THE FUND (A.R.S. § 20-661 & A.R.S. § 20-667)

A “covered claim” is one that would have been covered by the insolvent carrier’s policy had it remained solvent. See *Helme*, 153 Ariz. at 133, 735 P.2d at 455. Accordingly, the Fund must analyze the insolvent carrier’s policy to determine if coverage exists to decide whether the Fund should provide protection for the insured. In addition to having a claim that is covered under the policy, the claimant must also meet the statutory requirements as discussed above. If the claim is one that deserves protection by the Fund, then the Fund will become liable for the loss, but only to the extent the insolvent carrier would have been under the policy. See *Treffenger*, 22 Ariz. App. at 154, 524 P.2d at 1327; e.g., *Benevides v. Arizona Prop. & Cas. Ins. Guar. Fund*, 184 Ariz. 610, 911 P.2d 616 (Ct. App. 1995). Regardless of the policy limits, however, the Fund will not become liable for an amount greater than \$300,000. Arizona law requires the Fund to consider a covered claim that is more than \$100, which means each claim is subject to a \$100 statutory deductible. Finally, the Fund’s obligations extend only to claims arising during the policy period of the insolvent carrier, not to exceed thirty (30) days after the date of insolvency.

MULTIPLE COVERAGE PROBLEMS UNDER THE FUND (A.R.S. § 20-673)

Under the provisions of A.R.S. § 20-673, all applicable coverage available through other policies issued by solvent carriers must be exhausted before the Fund is required to pay a covered claim. See *Herder*, 156 Ariz. at 203, 751 P.2d at 524. In other words, all claimants are required to pursue any “other available insurance” which may also cover their loss. This usually

means uninsured motorist coverage and underinsured motorist coverage, but also includes health insurance, workers' compensation insurance, and other types of insurance that may cover the insured. See *Jangula v. Ariz. Prop. & Cas. Ins. Guar. Fund*, 207 Ariz. 468, 471, 88 P.3d 182, 185 (Ct. App. 2004). The court of appeals, however, held unconstitutional that portion of A.R.S. § 20-673(D) which provided: "Such claimant shall have no claim against the insured of the insolvent carrier or the fund if the full amount of uninsured motorist coverage was not recovered by such claimant." That portion violated Ariz. Const. Article 18, Section 6 ("the right of action to recover damages for injuries shall never be abrogated, and the amount recovered shall not be subject to any statutory limitation."). *McKinney v. Aldrich*, 123 Ariz. 488, 490, 600 P.2d 1120, 1122 (Ct. App. 1979).

Where any other policy of insurance applies to a claim, the policy issued by the insolvent carrier is deemed by statute to be "excess" coverage. In this situation, the Fund will take an offset for the full amount of other coverage available to a claimant before paying a claim, even if the claimant did not exhaust the coverage. See *Clark Equip. Co. v. Ariz. Prop. & Cas. Ins. Guar. Fund*, 189 Ariz. 433, 442-43, 943 P.2d 793, 802-03 (Ct. App. 1997). In addition, although there are no subrogation rights against the Fund or the insured of an insolvent insurer, subrogation is permitted against the ancillary or domiciliary receiver of the insolvent insurer. Furthermore, when the Fund pays its insured for an uninsured or underinsured claim, the Fund may subrogate against the third-party tortfeasors who caused the injuries to the insured.

THE FUND'S IMMUNITY (A.R.S. § 20-675)

A.R.S. § 20-675 immunizes the Fund from tort claims, such as bad faith and misrepresentation. See *Wells Fargo Credit Corp. v. Ariz. Prop. & Cas. Ins. Guar. Fund*, 165 Ariz. 567, 572-73, 799 P.2d 908, 913-14 (Ct. App. 1990); *McKinney*. Specifically, according to A.R.S. § 20-675(A), the Fund shall have no liability, and no cause of action shall arise against any member carrier, the Fund's board, or its agents or employees, "for any action taken in the performance of their powers and duties pursuant to [A.R.S. § 20-661, -680]." However, an issue arises whether this immunity was intended to apply to the individual members of the board, agents, and employees of the Fund.

According to A.R.S. § 20-675(B), the Fund shall indemnify its board, agents, and employees against all expenses incurred in the defense of any action, suit or proceeding based on these persons' actions taken pursuant to their powers and duties. But if such persons are "finally adjudged" to have breached a duty involving gross negligence, bad faith, dishonesty, willful malfeasance or reckless disregard of the responsibilities of his or her office, the Fund will not provide indemnification. Further, an attorney hired by the Fund to represent the insured is not the Fund's "agent" for immunity and indemnification purposes, and can be sued for malpractice. *Barmat v. John & Jane Doe Partners A-D*, 155 Ariz. 519, 520, 747 P.2d 1218, 1219 (1987). Thus, when the immunity and indemnification principles of A.R.S. § 20-675(A) and (B) are read together, it appears that the Fund has absolute immunity from suit while individual board members, agents, and employees of the Fund may not be immunized from suit if they act willfully in violation of their appointed duties.

The court of appeals discussed the wide scope of the Fund's immunity from tort liability in *Bills v. Ariz. Prop. & Cas. Ins. Guar. Fund*, 194 Ariz. 488, 498-99, 984 P.2d 574, 584-85 (1999). The court analyzed whether the Fund's statutory immunity from bad-faith liability violated the Arizona Constitution's anti-abrogation and no-damage limitation provisions. The court held that the Fund's statutory immunity was constitutional because suing the Fund for bad faith was not a fundamental right, and the Fund's immunity rationally furthered the state's legitimate interest in preserving the Fund's financial integrity.

SUBROGATION RIGHTS (A.R.S § 20-673)

While A.R.S. § 20-259.01(I) allows subrogation in the uninsured motorist context, the legislature has abrogated that right of subrogation in situations where a person's "uninsured" status is caused by the insolvency of the insurance carrier. Particularly, under A.R.S. § 20-673(D), insurance carriers "have no right of subrogation against the insured of the insolvent carrier or against the Fund for any amount paid by such insurer under uninsured motorist coverage." Similarly, under A.R.S. § 20-672(A), the Fund acquires no right of action against the insured of the insolvent carrier for any sums it has paid.

STAY OF PROCEEDINGS (A.R.S. § 20-676)

Once an insurance carrier is deemed insolvent, the Fund is entitled to an automatic six-month stay of all legal proceedings against the insolvent insurer and its insureds. At the request of any party with a showing of good cause, the court may shorten or lengthen the stay. For the Fund, the simple logic in this stay is to allow the newly acquired adjusting company and defense counsel time to properly prepare a defense for the insured. Other interested parties can seek leave of court to shorten or extend the stay to re-evaluate their respective positions in light of the Fund technically "stepping into the shoes" of the insolvent insurer, but also being entitled to additional offsets and credits for "other insurance" the insolvent carrier would not have had the benefit of exploiting in the legal proceedings. Additionally, the Fund is entitled to set aside any "judgments under any decision, verdict, or finding based on the default of the insolvent insurer or its failure to defend an insured." As a result, the Fund is entitled to start a proceeding over and provide a proper defense for its newly acquired insured. Nonetheless, the Fund cannot extend the time for filing a notice of appeal by utilizing the stay. Particularly, where the insurance company becomes insolvent after a judgment has been entered against its insured, and no appeal is ultimately filed before the expiration of the 30 days required by Rule 9(a), Arizona Rules of Civil Appellate Procedure, the Fund will be bound by the judgment. *Arizona Prop. & Cas. Ins. Guar. Fund v. Lopez*, 177 Ariz. 1, 2-3, 864 P.2d 558, 559-60 (Ct. App. 1993).

CASE LAW

Maricopa County v. Fed. Ins. Co., 157 Ariz. 308, 310, 757 P.2d 112, 114 (Ct. App. 1988) (excess carriers do not become primary if primary insurer becomes insolvent).

Betancourt v. Ariz. Prop. & Cas. Ins. Guar. Fund, 170 Ariz. 296, 297-98, 823 P.2d 1304, 1305-06 (Ct. App. 1991) (a settlement between claimant and insolvent carrier is binding on the Fund, but only if: (1) Plaintiff's case was dismissed due to settlement; (2) The statute of limitations has run on plaintiff's claims; and (3) the Fund took no action to preserve plaintiff's claim.) Note: Even if the prior settlement is found binding on the Fund, the Fund is still entitled to an offset for other insurance available to the claimant.

Martinez v. State Workman's Comp. Ins. Fund, 163 Ariz. 380, 383-84, 788 P.2d 113, 116-17 (Ct. App. 1990) (Workers' compensation insurance companies are not authorized to assert a lien against the Fund from amounts paid to an injured worker, even though Arizona's workers' compensation statutes would have authorized the lien).

State v. Ariz. Prop. & Cas. Ins. Guar. Fund, 192 Ariz. 390, 391-95, 966 P.2d 557, 558-62 (Ct. App. 1998) (State, whose insurer was declared insolvent, was entitled to sue the Fund for a claim paid by the State. The court rejected the argument that the State, in suing the Fund, was suing itself. State was an insured under the statute and thus was entitled to payment on the claim from the Fund).

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CHAPTER 14: THIRD PARTY RECOVERY IN WORKERS' COMPENSATION CASES

Overview

Under Arizona Workers' Compensation law, an injured worker who makes a claim for workers' compensation benefits may also pursue a claim against the alleged tortfeasor. A.R.S. § 23-1023; **Moretto v. Samaritan Health Sys.**, 190 Ariz. 343, 347, 947 P.2d 917, 921 (Ct. App. 1997). If the injured worker pursues a third-party recovery, however, the workers' compensation carrier is entitled to a lien for the amount of benefits paid on the worker's behalf. A.R.S. § 23-1023(D). The workers' compensation carrier is entitled to the amount "actually collectable," or "the total recovery less the reasonable and necessary expenses, including attorney fees, actually expended in securing the recovery." A.R.S. § 23-1023(D).

In the event of the employee's death, the employee's dependents may pursue the claim. A.R.S. § 23-1023(A). An injured employee who elects to take workers' compensation benefits does not give up his right to sue the third party tortfeasor. **Aitken v. Indus. Comm'n**, 183 Ariz. 387, 389–90, 904 P.2d 456, 458–59 (1995).

A workers' compensation insurance carrier or self-insured employer may, under the limited circumstances explained in this section, pursue a claim against the third-party tortfeasor who injured the employee. See A.R.S. § 23-1023(B). Additionally, as is also discussed later in this section, the workers' compensation carrier or self-insured employer has certain statutory lien rights against an injured employee's recovery from a third party tortfeasor. See A.R.S. § 23-1023(D).

ASSIGNMENT OF CLAIMS TO WORKERS' COMPENSATION PROVIDER

Unless an injured worker (or his eligible dependent) files a tort action against the third-party tortfeasor within one year of the industrial injury or death, any claims the injured party may have against the third-party tortfeasor are assigned to the workers' compensation provider pursuant to Arizona statute. See A.R.S. § 23-1023(B). The workers' compensation provider may sue the third-party tortfeasor, settle the claim, or do nothing. **K.W. Dart Truck Co. v. Noble**, 116 Ariz. 9, 11, 567 P.2d 325, 327 (1977).

The effect of assignment is that the workers' compensation provider is a statutory plaintiff and a necessary party. At that point, the injured employee cannot sue the third-party tortfeasor because the action belongs to the assignee – the self-insured employer or workers' compensation insurance carrier. **Hills v. Salt River Project Ass'n**, 144 Ariz. 421, 426, 698 P.2d 216, 221 (Ct. App. 1984). This outcome, however, is dependent on the law of the state where the employee receives compensation. For example, in **Jackson v. Eagle KMC LLC**, an employee who worked for a

Nebraska trucking company received worker's compensation in Nebraska. He sued a truck driving training company that had trained the employee, driver, and owner of the truck in which the employee was injured during a training session in Arizona. 245 Ariz. 544, 545 ¶¶ 2–3, 431 P.3d 1197, 1198 (2019). The Arizona Supreme Court held that Nebraska law applied to the employee's personal injury claims because “[w]hen compensation has been paid[,] the law of the state of compensation should govern in third-party actions including the nature and extent of lien subrogation, and assignment rights.” *Id.* at 546 ¶ 9, 431 P.3d at 1199. Further, because Nebraska did not have an automatic assignment statute, the employee still had standing to bring his claims. *Id.* at 547 ¶ 13, 431 P.3d at 1200.

Once the injured employee's claim is assigned to the workers' compensation provider, the provider has no duty to the injured employee regarding the claim. ***Hertel v. Home Ins. Co.***, 124 Ariz. 338, 340, 604 P.2d 269, 271 (Ct. App. 1979). The “whole” claim is assigned to the workers' compensation provider by operation of law and the employee has no legal interest in the claim after assignment or after the workers' compensation provider receives payment from the third party. *Id.*

The injured employee also cannot sue a fictitious defendant to attempt to delay the one-year statute of limitations. ***Meyer v. Kelsey-Hayes, Corp.***, 126 Ariz. 165, 166, 613 P.2d 628, 629 (Ct. App. 1980). The workers' compensation carrier or self-insured employer's statutory right of assignment, which comes into existence one year after the employee's injury, is unconditional; and an injured employee cannot delay the workers' compensation provider's right of action against the third party tortfeasor through procedural maneuvering. *See id.*

Pursuant to A.R.S. § 23-1023(B), a workers' compensation carrier or self-insured employer may reassign a third-party tort claim to the injured employee. The interest reassigned is the entire interest as it existed before assignment to the workers' compensation provider by operation of law. Thus, once the employee's claim is assigned to the workers' compensation provider by operation of law, the provider is free to pursue the third party tortfeasor or not, or to reassign the claim to the employee or not. ***State v. Superior Court (Garcia)***, 155 Ariz. 166, 169, 745 P.2d 614, 617 (Ct. App. 1987). For reassignment to be effective, the reassignment must be done expressly. ***Lavello v. Wilson***, 150 Ariz. 235, 240, 722 P.2d 962, 967 (Ct. App. 1985). Reassignment after the two-year Arizona statute of limitations for personal injuries is ineffective. ***Grim v. Anheuser-Busch, Inc.***, 154 Ariz. 66, 70–71, 740 P.2d 487, 491–92 (Ct. App. 1987).

WORKERS' COMPENSATION LIENS AND THEIR LIMITS

A workers' compensation carrier or self-insured employer does not have a lien against an injured worker's uninsured motorist recovery for a work-related injury. That is because the recovery is not from the third-party tortfeasor, as is required by the statute that creates the lien. ***State Farm Mut. Auto. Ins. Co. v. Karasek***, 22 Ariz. App. 87, 89, 523 P.2d 1324, 1326 (1974). A.R.S. § 23-1023(D) specifically provides for a lien only against those “other person[s]” whose negligence caused the injury. A workers' compensation lien is not enforceable against UM or UIM funds, even

when the Guaranty Fund has picked up coverage. **Martinez v. State Workman's Comp. Ins. Fund**, 163 Ariz. 380, 382–84, 788 P.2d 113, 115–17 (Ct. App. 1990).

An employer or workers' compensation carrier has a statutory lien against a third party recovery only to the extent of compensation, medical, surgical, and hospital benefits paid by the carrier to the injured worker. **EBI Cos./Orion Group v. Indus. Comm'n of Arizona**, 178 Ariz. 624, 626, 875 P.2d 857, 859 (Ct. App. 1994). However, this does not preclude parties to a settlement from specifying in the settlement agreement that a workers' compensation provider has a lien for a certain amount and that sums paid by the provider are in lieu of wage and medical compensation and benefits, or that benefits are being paid for a specific condition. *Id.*

Because the "recovery" to which the workers' compensation lien applies already takes into account the reasonable and necessary expenses incurred in securing such recovery, the workers' compensation carrier is not required by law to reduce its lien against the "recovery" under the "common fund doctrine." **Boy v. Fremont Indem. Co.**, 154 Ariz. 334, 337, 742 P.2d 835, 838 (Ct. App. 1987). However, in some cases, it is to the workers' compensation carrier or self-insured employer's advantage to compromise its statutory lien; if the lien is compromised, the carrier or employer guarantees itself at least some recovery and avoids the risk of the injured worker receiving no damages at all at trial. *See id.*

A.R.S. § 23-1023 does not preclude the workers' compensation provider from having a lien on third-party tortfeasor proceeds if the injured employee's employer was also negligent. **Stroud v. Dorr-Oliver, Inc.**, 112 Ariz. 403, 409, 542 P.2d 1102, 1108 (1975).

FUTURE CREDIT

In addition to a lien, a workers' compensation carrier or self-insured employer is entitled to a future credit on the net recovery of a third-party tort claim. **Hartford v. Indus. Comm'n**, 178 Ariz. 106, 110, 870 P.2d 1202, 1206 (Ct. App. 1994). The future credit applies to workers' compensation benefits as well as medical, disability, and death benefits. *Id.*

A.R.S. § 23-1023(D) requires the workers' compensation carrier's or self-insured employer's written approval if the settlement between the injured employee and the third-party tortfeasor is "less than the compensation and medical, surgical and hospital benefits" provided by the workers' compensation provider. *See also Grijalva v. Ariz. State Compensation Fund*, 185 Ariz. 74, 76, 912 P.2d 1303, 1305 (1996). Even where a worker has requested but not received benefits because his or her claim for compensation was denied, he or she cannot settle without prior approval from the workers' compensation provider. **Macaluso v. Indus. Comm'n**, 181 Ariz. 447, 448, 891 P.2d 914, 915 (Ct. App. 1994). A settlement without notice could result in forfeiture of workers' compensation benefits unless the claimant is able to establish that his settlement with the third party tortfeasor was reasonable. **Bohn v. Indus. Comm'n**, 196 Ariz. 424, 427, ¶ 17, 999 P.2d 180, 183 (2000). Further, under **Hartford** the workers' compensation carrier is entitled to a future credit equal to the amount of the net settlement. 178 Ariz. at 110, 870 P.2d at 1206.

Consequently, the injured worker must exhaust the future credit before they can seek to re-open the workers' compensation claim for benefits.

RECOVERABLE MEDICAL EXPENSES

In *Anderson v. Muniz*, 21 Ariz. App. 25, 515 P.2d 52 (Ct. App. 1973), the court of appeals addressed the amount of medical expenses a plaintiff can recover at trial against a third-party tortfeasor when a workers' compensation carrier or self-insured employer provides workers' compensation benefits. The plaintiff was injured while working and the workers' compensation provider paid his medical expenses at rates contractually agreed upon between it and the employee's medical providers—rates lower than those billed others. Plaintiff sued a negligent third party. At trial, the court ruled that the plaintiff's doctors could testify that they “ordinarily” would have charged more for their services than what they accepted from the workers' compensation provider. The court of appeals, however, held that the plaintiff could only recover the doctors' actual charges. *Id.* at 29, 515 P.2d at 56.

The court later distinguished *Anderson* in *Lopez v. Safeway Stores, Inc.*, 212 Ariz. 198, 129 P.3d 487 (Ct. App. 2006). Lopez slipped and fell while entering a Safeway store and sustained various injuries. She sued Safeway. Before trial, Safeway moved to prohibit Lopez from presenting evidence of the amounts Lopez's health care providers charged for their care, which far exceeded the amounts the providers actually accepted due to a contract with Lopez's insurance company. Citing *Anderson*, Safeway argued Lopez should only be able to claim the amount the health care providers actually accepted in full satisfaction of the services rendered. The court held that under the collateral source rule, the injured plaintiff could claim the full amount of the health care providers' billed charges, regardless of whether her insurance company contracted to pay them at lower rates. It distinguished *Anderson* as follows:

There, the State Compensation Fund paid the plaintiff's healthcare providers the 'actual amount charged' by each of them. *Id.* at 28, 515 P.2d at 55. Thus, as Lopez points out, 'the [Anderson] decision stands for the proposition that a party cannot recover for medical expenses in excess of the amounts actually charged (i.e., billed) by healthcare providers,' because 'the amount billed in that case was identical to the amount paid by the compensation carrier.'

Here, in contrast, the billing charges of Lopez's healthcare providers totaled almost \$59,700, even though the providers accepted only \$16,837 in full satisfaction of those charges based on reduced rates to which the providers had contractually agreed with Lopez's medical insurance carriers.

Id. at 202 ¶¶ 11–12, 129 P.3d at 491.

The court in *Aitken v. Industrial Commission* held that under A.R.S. § 23-1023(D) the workers' compensation carrier may assert a lien against a third-party recovery, “only to the extent that

the compensation benefits paid exceed the [non-party] employers' proportionate share of the total damages fixed by verdict in the [third-party] action." 183 Ariz. at 392, 904 P.2d at 461. Following *Aitken*, the court stated in ***Twin City Fire Insurance Company v. Leija***, 244 Ariz. 493, 494 ¶ 1, 422 P.3d 1033, 1034 (2018), that an injured employee who settles all of their third-party claims is not entitled to a post-settlement trial to determine the percentage of employer fault, solely to reduce or extinguish the insurance carrier's lien.

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CHAPTER 15: PREMISES LIABILITY

LIABILITY OF THE POSSESSOR OF LAND

Premises liability is an action in tort and, with a few exceptions, is generally based upon allegations of negligence. That is, the landowner or person in possession of the premises failed to keep the premises reasonably safe for others on or using the premises.

The duty a landowner and possessor of land owes depends upon the status of the plaintiff. Arizona is one of the few states that has retained the traditional distinctions between invitees, licensees and trespassers. See *Bellezzo v. State*, 174 Ariz. 548, 851 P.2d 847 (Ct. App. 1992); *Shaw v. Petersen*, 169 Ariz. 559, 821 P.2d 220 (Ct. App. 1991); and *Woodty v. Weston's Lamplighter Motels*, 171 Ariz. 265, 830 P.2d 477 (Ct. App. 1992). Consequently, defending any premises liability action in Arizona requires a determination of whether the claimant is an invitee, licensee or trespasser.

INVITEES

An invitee is a person invited to enter or remain upon the premises for a purpose either connected with the landowner's or occupier's business, or as a member of the public for a purpose for which the land is held open to the public. See RESTATEMENT (SECOND) OF TORTS § 332 (followed in *Nicoletti v. Westcor, Inc.*, 131 Ariz. 140, 639 P.2d 330 (1982)). In the context of a business establishment, an invitee is a person who enters or remains upon the premises for some benefit to the business proprietor, *i.e.*, a customer who will potentially make a purchase of a product or is upon the premises for some other reason that benefits the business proprietor. For example, the tenant of an apartment complex is considered an invitee. See *Fehribach v. Smith*, 200 Ariz. 69, 73, 22 P.3d 508, 512 (Ct. App. 2001).

A person may be an invitee when originally entering the premises, but subsequently lose the invitee status by entering portions of the premises not held open to the public, or by remaining on the premises for personal purposes that no longer benefit the landowner or occupier. See *Nicoletti*, 131 Ariz. at 143, 639 P.2d at 333. For this reason, it is always important during investigation and discovery to determine why the claimant was on the premises and what he or she was doing at relevant times.

In *Ritchie v. Costello*, 238 Ariz. 51, 356 P.3d 337 (Ct. App. 2015), the court assumed that a paraglider who collided with a hot air balloon was a business invitee of the nearby Cottonwood airport, an uncontrolled airport. As such, the airport owed the paraglider a duty to maintain the airport premises in a reasonably safe manner and to provide reasonably safe conditions for aircraft using the airport, including runways. But once the invitee safely leaves the premises, the relationship ends and so does the duty. Here, the collision occurred after the paraglider had been in the air for half an hour. Therefore, the paraglider ceased to be an invitee after successfully

getting into the air and moving away from the airport, and the airport did not owe him a duty. Because the airport was uncontrolled, it did not owe him a duty while he was in the air.

The Arizona Supreme Court held that sublessees of a multi-tenant commercial building did not owe a duty to a worker who fell through the skylight on the roof of the building due to the contracted roofing company's allegedly negligent repairs. The sublease did not give the sublessees the right to control the roof, the sublessees did not exercise actual control over the roof, and there was no evidence the sublessees assumed a duty to protect the worker from the risk of falling through the skylight. Further, the court held that the sublessee who contracted for the repairs did not thereby "possess" the roof. **Dabush v. Seacret Direct LLC**, 250 Ariz. 264, 478 P.3d 695 (2021).

The occupier of premises owes a duty to invitees to discover, correct and/or warn of hazards the occupier should reasonably foresee will endanger the invitee. **Robertson v. Sixpence Inns of America Inc.**, 163 Ariz. 539, 544, 789 P.2d 1040, 1045 (1990). This duty might require the occupier to reasonably inspect for potentially harmful hazards. But the proprietor of a business is not an insurer of an invitee's safety, and is not required to keep the premises absolutely safe. **Preuss v. Sambo's**, 130 Ariz. 288, 289, 635 P.2d 1210, 1211 (1981). Rather, the possessor of the premises only has the duty to use reasonable care to keep the premises in a reasonably safe condition. A possessor's duty to invitees also extends to providing a reasonably safe means of entering and leaving the property. See **Stephens v. Bashas', Inc.**, 186 Ariz. 427, 430, 924 P.2d 117, 120 (Ct. App. 1996). A business owner may be liable for injury occurring *off the premises* if the business owner's activities on the premises contributed to the injury off the premises.

In Arizona it is not enough for an invitee to show that a dangerous condition existed on the premises. The invitee must also show that the possessor and its employees either created the condition, actually knew of the condition, or had "constructive" notice of the condition. For an invitee to establish liability against the possessor, the invitee must prove, by a preponderance of the evidence, the following:

1. The existence of an unreasonably dangerous condition on the premises which caused injury to the invitee;
2. That the business proprietor or its employees created the dangerous condition; or
3. That the possessor or its employees actually knew of the dangerous condition in time to provide a remedy or warning; or
4. The dangerous condition existed for a sufficient length of time that the possessor or its employees, in the exercise of reasonable care, should have known of it; and
5. The business proprietor failed to use reasonable care to prevent harm under the circumstances.

Premises Liability Instruction No. 1, RAJI (6th). Note, an invitee does not have to show the possessor had actual or constructive notice if the possessor actually created or revised the dangerous condition. *Isbell v. Maricopa County*, 198 Ariz. 280, 283, 9 P.3d 311, 314 (2000).

Sometimes, a particular condition's inherent nature can evidence the landowner/possessor's constructive notice that it caused the plaintiff's accident. This is particularly true when the condition is a deteriorated sidewalk or stairwell. In *Haynes v. Syntek Finance Corp.*, 184 Ariz. 332, 339, 909 P.2d 399, 406 (Ct. App. 1995), the plaintiff was injured when she fell on a chipped and decaying sidewalk within an apartment complex. Though the apartment owner claimed it did not have actual or constructive notice of the sidewalk's condition, the court held that the inherent nature of the condition, plus photographs of similar conditions in other areas of the property, and prior complaints of similar conditions, was sufficient to establish the landowner's "constructive notice." Indeed, the very nature of the deterioration suggested that the condition did not arise suddenly, but instead developed slowly over a period of time.

Conversely, in *Alcombrack v. Ciccarelli*, 238 Ariz. 538, 363 P.3d 698 (2015), a tenant shot a locksmith who was changing the locks on the house. Unbeknownst to the tenant, the landlord's house had been sold through foreclosure. The tenant thought the locksmith was trying to break in. The locksmith, a business invitee, sued the landlord for negligence. The landlord won summary judgment because the landlord was not in possession of the property, thus, there was no landlord-invitee relationship. The court also declined the locksmith's invitation to adopt the RESTATEMENT (THIRD) OF TORTS § 7. That section, which provides that "[a]n actor ordinarily has a duty to exercise reasonable care when the actor's conduct creates a risk of physical harm," would greatly expand Arizona law. *Id.* at 542, 363 P.3d at 702.

Once a landowner/possessor has knowledge of a dangerous condition, it cannot escape liability merely by showing that it did "something" to remedy the situation. The attempts to remedy or warn must be reasonable. If the attempts to remedy or warn of the situation are not reasonable or are inadequate, the possessor may still be held liable. Consequently, the relevant inquiry is whether the possessor pursued adequate and reasonable measures to correct the condition or to warn invitees of the condition.

MODE OF OPERATION RULE

In some cases, it is almost impossible for the invitee to prove that a landowner or possessor of premises had actual notice of the dangerous condition; or that the dangerous condition existed for such a length of time that the landowner or possessor should have had notice of the condition. In such cases, the invitee might attempt to rely upon the "mode of operation" rule to establish liability.

The mode of operation rule applies only in certain limited circumstances, and is not a rule of strict liability. The mode of operation rule simply relieves the invitee from having to prove that the possessor had actual or constructive notice of the dangerous condition. The mode of operation rule applies where the possessor has adopted a method of operation from which it could

reasonably be anticipated that dangerous conditions would regularly arise. See *Chiara v. Fry's Food Stores*, 152 Ariz. 398, 733 P.2d 283 (1987); Premises Liability Instruction No. 2, RAJI (5th). The court defines "regularly" as "customary, usual or normal," and focuses its analysis on whether a business is able to reasonably anticipate that a condition hazardous to customers will regularly occur. See *Contreras v. Walgreens Drug Store*, 214 Ariz. 137, 149 P.3d 761 (Ct. App. 2006). The mode of operation rule is commonly applied in situations where the business proprietor is a self-service market, a self-service department store, a convenience store, or a service station. See *McKillip v. Smitty's SuperValu, Inc.*, 190 Ariz. 61, 945 P.2d 372 (Ct. App. 1997); *Chiara v. Fry's Food Stores*, 152 Ariz. 398, 733 P.2d 283 (1987); *Tom v. S.S. Kresge Co.*, 130 Ariz. 30, 633 P.2d 439 (Ct. App. 1981); and *Shuck v. Texaco Refining & Mktg., Inc.*, 178 Ariz. 295, 872 P.2d 1247 (Ct. App. 1994).

Claimants seeking to use the rule must establish two elements for there to be liability. First, the claimant must prove that the business adopted a method of operation from which it could reasonably anticipate that dangerous conditions would regularly arise. Second, the claimant must prove that the business failed to exercise reasonable care to prevent harm under those circumstances. Accordingly, when defending a mode of operation case, the defendant would show that it follows reasonable inspections and cleaning procedures in an attempt to reduce or discover dangerous conditions, even though it did not discover the particular dangerous condition that caused the claimant's injury.

FAILURE TO WARN

A property owner has a duty to invitees to warn of dangerous conditions. See RESTATEMENT (SECOND) OF TORTS § 343. The warning needs to be sufficient to allow invitees to make an informed decision to protect themselves, or to move to other premises. This duty may also extend to employees of independent contractors. In *Robertson v. Sixpence Inns of America, Inc.*, 163 Ariz. 539, 789 P.2d 1040 (1990), the court considered whether a hotel was liable for the death of a security guard who was killed in a robbery attempt of the premises. The security guard was an employee of an independent contractor retained by the hotel. The court held that the hotel had a duty to warn its independent contractor of a known danger. Additionally, since the hotel manager knew an armed robber was fleeing the premises at the same time the security guard was patrolling the grounds, it was up to the jury to decide as to whether the hotel had breached its duty of care. Again, the key factor is foreseeability. If the property possessor has information that leads him to believe a danger exists, a warning should be given to those within the zone of danger.

LICENSEES

A licensee is a person who is privileged to enter or remain upon land by virtue of possessor's consent, whether given by invitation or permission, and usually for their own benefit. See *Barry v. S. Pac. Co.*, 64 Ariz. 116, 166 P.2d 825 (1946); See also RESTATEMENT (SECOND) OF TORTS § 330. An example of a licensee is a person who is loitering on the property or who is using the parking lot or entrance to the premises as a rendezvous point for friends and acquaintances. Likewise,

someone who is walking across the property as a shortcut to get from one point to another is a licensee. A social guest in one's home is also a licensee. **Parish v. Truman**, 124 Ariz. 228, 229, 603 P.2d 120, 121 (Ct. App. 1979).

The possessor of premises owes a licensee the duty to adequately warn of hidden or concealed dangers of which the possessor has actual knowledge, and also to refrain from willfully injuring the licensee. **Shannon v. Butler Homes**, 102 Ariz. 312, 316, 428 P.2d 990, 994 (1967); **Shaw v. Petersen**, *supra*; Premise Liability Instruction No. 3 RAJI (5th). With respect to a licensee, the possessor of property does not have an obligation to inspect and discover concealed dangers, but only to warn of concealed dangers of which the possessor has actual knowledge.

The issue in the licensee context is often whether the possessor of the premises gave adequate warning of the hidden danger. Whether adequate warning was given is generally a question of fact. In determining whether a warning is adequate, an important factor is whether the claimant is an adult or a child. A condition that might not be deemed hidden or concealed from an adult licensee could be deemed to be a hidden or concealed hazard to a younger child. Likewise, whether the warning of a hidden condition is adequate might also depend upon the age and capacity of the child to appreciate the extent of the risk of harm involved. See Premises Liability Instruction No. 4, RAJI (5th); **McLeod v. Newcomer**, 163 Ariz. 6, 9, 785 P.2d 575, 578 (Ct. App. 1989).

Recreational Users

Hikers, hunters, boaters and others who enter another's property for recreational uses without payment of fee are deemed to be licensees, provided that they are on the property with the possessor's consent. The possessor's duty to these individuals, however, has been modified by statute. A.R.S. § 33-1551. A possessor of land will not be liable for injury to these specific licensees except upon a showing of willful, malicious or grossly negligent conduct on the part of the possessor of land. The conduct of the landowner must be more than simply negligent before any liability will attach. A.R.S. § 33-1551 applies to premises such as agricultural, range, open space, park, flood control, mining, forest, or railroad lands, among others. Additionally, the statute appears to apply to users of green belt areas and community parks located in residential neighborhoods. Because the recreational use statute limits common law liability, courts must construe it strictly to avoid any overbroad statutory interpretation that would give unintended immunity and take away a right of action. **Andresano v. County of Pima**, 213 Ariz. 65, 138 P.3d 1192 (Ct. App. 2006).

Recreational premises

In **Smith v. Arizona Bd. of Regents**, 195 Ariz. 214, 986 P.2d 247 (Ct. App. 1999), the court limited the recreational use immunity to open spaces used for recreation. Here, the injury occurred on a trampoline in an open area of Arizona State University's campus. The court held that the statute did not protect the school from liability because the accident was caused by a piece of equipment, not by a condition of the land. The purpose of the statute is to encourage landowners

to open their outdoor, open land for recreation. In *Armenta v. City of Casa Grande*, 205 Ariz. 367, 71 P.3d 359 (Ct. App. 2003), however, a child rode his bike under a goal post and was injured when the post fell on top of him. Plaintiff argued the recreational use statute did not apply because a goal post is a type of apparatus that is excluded from the statutory definition of “premises.” The court disagreed, distinguishing the *Smith* trampoline case. It reasoned that the “critical issue is whether improvements to recreational premises such as a softball field, which there included human-made structures such as bases and fences, ‘change the character of the premises and [thus] put the property outside the protection’ of the statute.” The goal post did not “change the character of the premises” as the trampoline in the *Smith* case did. The court went on to hold that the express language of the statute defines “premises” to include “fixtures” and “structures” on the land.

Recreational user

To be protected by A.R.S. § 33-1551, not only must the landowner/possessor have “recreational” land, but also the plaintiff must fall within the definition of a “recreational user.” If the plaintiff does not fit the statutory definition of a “recreational user,” the statute does not limit a landowner/possessor’s liability. In determining whether the entrant is a recreational user, the court will give primary consideration to the nature and purpose of the entrant’s activities, not the plaintiff’s subjective intent. *Relyea v. United States*, 220 F.Supp.2d 1048 (D. Ariz. 2002) (minor who was injured in car accident when returning to campsite to retrieve belongings was still a recreational user because camping was the activity that originally brought her to the forest land). Compare *Herman v. City of Tucson*, 197 Ariz. 430, 4 P.3d 973 (1999) (plaintiff who went to park to work at concession was not a recreational user).

The statute defines a “recreational user” as “a person to whom permission has been granted or implied without the payment of an admission fee or any other consideration to travel across or enter [the] premises.” *Id.* In *Andresano v. County of Pima*, 213 Ariz. 65, 138 P.3d 1192 (Ct. App. 2006), a participant in a fundraising event at a county park fell in a drainage culvert and broke her ankle. She was deemed a recreational user because she did not pay an admission fee. The court did not impute the charity’s user fee to the participant individually, so as to remove her from her recreational user status.

An entrant can still be considered a “recreational user” if the fee paid for entry is nominal, paid only to offset the costs of using the premises, and is paid to a public or non-profit entity. *MacKinney v. City of Tucson*, 231 Ariz. 584, 299 P.3d 1282 (Ct. App. 2013). What is a “nominal” fee? In *Prince v. City of Apache Junction*, 185 Ariz. 43, 912 P.2d 47 (Ct. App. 1996), the court held that the plaintiff member of a city softball league team was not a recreational user because each softball team was required to pay the city a \$250 entry fee to play in the league, and \$250 is not nominal. Hence, A.R.S. § 33-1551 did not control the standard of liability. In direct response to the *Prince* case, the legislature amended A.R.S. § 33-1551 to add the “nominal fee” provision (property owners do not lose protection of the statute by charging a nominal fee), thus indicating legislative belief that a \$250 fee is “nominal.” Thus, in *Allen v. Town of Prescott Valley*, 244 Ariz. 288, 418 P.3d 1061 (Ct. App. 2018), the court held that a \$270 fee charged to each softball team

was nominal and the town was entitled to the protection of the statute. The court remanded *Allen*, however, for a trial on whether the town acted with gross negligence.

Statute's constitutionality

The Arizona Supreme Court has held that the recreational use statute does not violate the anti-abrogation provision of Arizona's Constitution when applied to a negligence action against a municipality engaged in a governmental function. *Dickey v. City of Flagstaff*, 205 Ariz. 1, 66 P.3d 44 (2003) (city held out park to the public for recreational use, and maintenance of the park was a governmental function). Because the city's stewardship of the park was governmental in nature, the city would have been immune at common law for acts of negligence arising from its maintenance of the park, and thus, the constitution's anti-abrogation provision did not apply.

In *Normandin v. Encanto Adventures, LLC*, 245 Ariz. 67, 425 P.3d 243 (Ct. App. 2018), a mother sued an amusement park and the City after she fell and broke her ankle during her daughter's birthday party. The trial court granted summary judgment for the park and city. The court of appeals affirmed, upholding the constitutionality of the recreational use statute against plaintiff's claims that it violated Arizona's anti-abrogation clause (by depriving her of a right to sue a private party for simple negligence) and equal protection (by treating non-recreational users more favorably than recreational users). The court also held that the statute was rationally related to a legitimate governmental interest and not an unconstitutional special law. Though the Arizona Supreme Court granted review, it did not decide whether the anti-abrogation clause bars the Legislature from granting a private business tort immunity from negligence on the ground that the private business has a contract with a public entity and is arguably an "agent" of the public entity. Instead, the Court held that the amusement park operator was not a "manager" within the definition of the statute and remanded the case back to the trial court without addressing the constitutional issue. *Normandin v. Encanto Adventures, LLC*, 246 Ariz. 458, 441 P.3d 439 (2019).

TRESPASSER

A trespasser is a person who is on the premises without the consent or privilege of the landowner or possessor. *Barry v. S. Pac. Co.*, 64 Ariz. 116, 166 P.2d 285 (1946); *see also* RESTATEMENT (SECOND) OF TORTS § 329. The standard of care a landowner or possessor owes to an adult trespasser is to refrain from intentionally injuring the adult trespasser. *Spur Feeding Co. v. Fernandez*, 106 Ariz. 143, 472 P.2d 12 (1970); Premises Liability Instruction No. 5, RAJI (6th); A.R.S. § 12-557. A different standard of care applies to a child trespasser under the attractive nuisance doctrine discussed below.

As previously stated, a claimant's status can change as he or she goes about the premises. For example, a claimant might originally enter upon the premises as an invitee or licensee, but then become a trespasser if his or her presence exceeds the possessor's consent (either in terms of time, space or location). An invitee will not become a trespasser, however, unless it is obvious that he is about to enter an off-limits area. *See McMurtry v. Weatherford Hotel, Inc.*, 231 Ariz.

244, 293 P.3d 520 (Ct. App. 2013). In *McMurtry*, the decedent fell to her death from her hotel room window because the balcony railing extended only halfway across the window opening. The court rejected the hotel's argument that the decedent became a trespasser upon going through the window because the hotel openly invited patrons to smoke on the balcony. The court further held that since the hotel knew patrons frequently sat on the edges of their windows to smoke, and did nothing to stop them from doing so, the hotel impliedly invited patrons to go through their windows to smoke. Thus, landowners/possessors should clearly mark areas that are off limits and enforce those boundaries.

Attractive Nuisance Doctrine

The attractive nuisance doctrine is a theory of liability that applies to child trespassers. An attractive nuisance is an artificial condition on the property posing a serious risk of harm that children, because of their youth and inexperience, might not recognize as posing a serious risk of harm. The landowner or possessor of the property could be liable to children injured by the "attractive nuisance" on the property if the landowner or possessor knows or has reason to know that children are likely to trespass on the property. *Spur Feeding Co. v. Fernandez*, 106 Ariz. 143, 472 P.2d 12 (1970); RESTATEMENT (SECOND) OF TORTS § 339; Premises Liability Instruction No. 6, RAJI (6th). Application of the attractive nuisance doctrine is not limited to trespassing children but can also include child licensees and child invitees. *State v. Juengel*, 15 Ariz. App. 495, 489 P.2d 869 (1971) (*disagreed with on other grounds by New Pueblo Constructors, Inc. v. State*, 144 Ariz. 95, 696 P.2d 185 (1985)). The dangerous condition need not actually attract the child; liability may be imposed even though the child was not aware of the dangerous condition before entering the property or before it injured him. *MacNeil v. Perkins*, 84 Ariz. 74, 324 P.2d 211 (1958); *Brown v. Arizona Pub. Serv. Co.*, 164 Ariz. 4, 790 P.2d 290 (Ct. App. 1990).

For liability under the attractive nuisance doctrine, all of the following must be proven:

1. The child trespasser was injured by a condition on the property;
2. The landowner/possessor knew or should have known that children were likely to trespass near the dangerous condition;
3. The landowner/possessor knew or should have known that the condition posed an unreasonable risk of harm to children;
4. Because of the child's age, the child did not understand the risk of harm involved;
5. The usefulness of the condition and the burden of eliminating the risk of harm are slight compared to the risk of harm to children; and
6. The landowner/possessor failed to use reasonable care to protect the child from danger.

Premises Liability Instruction No. 6, RAJI (6th).

DOCTRINES APPLICABLE TO EVERY CLASS OF ENTRANT

Non-Party at Fault

In *McKillip v. Smitty's SuperValu, Inc.*, 190 Ariz. 61, 62, 945 P.2d 372, 373 (Ct. App. 1997), a patron slipped on waxed tissue paper that had been dropped on the floor of the supermarket. The court held that under Arizona's comparative fault scheme, Smitty's could name the "unknown paper dropper" as a non-party at fault, and the jury could apportion fault to that non-party.

Res Ipsa Loquitur

If a plaintiff is not in a position to show that the defendant's negligence caused her injury, she might be able to use the doctrine of *res ipsa loquitur*. *Res ipsa loquitur* allows a jury to find negligence and causation simply from the fact of the accident and the defendant's relation to the accident. *Cox v. May Dep't Store Co.*, 183 Ariz. 361, 363, 903 P.2d 1119, 1121 (Ct. App. 1995) (plaintiff was ascending the escalator at store when her jacket became lodged between the escalator's moving handrail and stationary guide, causing her to be thrown down and dragged to the top of the escalator). For the doctrine of *res ipsa loquitur* to apply: (1) the accident must be of a kind that ordinarily does not occur in the absence of negligence; (2) the accident must be caused by an instrumentality within the exclusive control of the defendant; and (3) the plaintiff must not be in a position to show the particular circumstances or defects that caused the instrumentality to produce injury. *Id.* The *Cox* court held that a fourth element – that the accident must not have been due to any voluntary action on the part of the plaintiff – was no longer applicable due to the advent of comparative fault.

Open and Obvious Defense

The open and obvious nature of a condition is not a complete defense to a premises liability action. See *Markowitz v. Ariz. Parks Bd.*, 146 Ariz. 352, 706 P.2d 364 (1985) (*superseded by statute on other grounds as recognized in Wringer v. U.S.*, 790 F. Supp. 210 (D. Ariz. 1992)). The open and obvious nature of a condition is simply one factor to consider in determining whether the landowner or possessor of the premises breached his standard of care. If a condition is "open and obvious," then it probably will not qualify as a hidden or concealed peril, and therefore, the landowner's failure to warn of the condition probably will not result in a finding of liability. Additionally, a condition that is not readily visible might not be deemed a dangerous condition because one would reasonably expect a reasonable person keeping a lookout would see and avoid the condition. Therefore, open and obvious conditions do not present an unreasonable risk of harm.

Generally, the open and obvious nature of a condition is a factual argument to be made to the jury in arguing either that the landowner satisfied its duty toward the claimant, or alternatively, for arguing that the claimant was comparatively negligent for failing to see that which was open and obvious.

EASEMENT HOLDERS

While an easement holder has a general duty to act reasonably, the nature of its duty depends on the degree of control over the property that the easement holder has (or does not have). The scope of the duty cannot extend beyond the scope of the holder's use, even when the easement holder has knowledge of the allegedly dangerous conditions created by another. **Clark v. New Magma Irrigation & Drainage Dist.**, 208 Ariz. 246, 92 P.3d 876 (Ct. App. 2004).

LIABILITY FOR THE ACTS OF AN INDEPENDENT CONTRACTOR

In general, a principal is not vicariously liable for the acts of an independent contractor who injures someone, unless there is a special relationship between the principal and the claimant, or the principal and the independent contractor. **Parish v. Truman**, 124 Ariz. 228, 603 P.2d 120 (Ct. App. 1979); RESTATEMENT (SECOND) OF TORTS § 315.

There are, however, some notable exceptions to the general rule, particularly in the context of premises liability. A landowner/business proprietor might be vicariously liable for the torts of an independent contractor under (1) the non-delegable duty rule; (2) the doctrine of retained control; and (3) inherently dangerous activities. For additional theories holding a principal liable for the acts of an independent contractor, see RESTATEMENT (SECOND) OF TORTS §§ 415, 425.

The Non-delegable Duty Rule

A possessor of land's duty to an invitee to keep the premises reasonably safe, to warn of dangerous conditions and, if practicable, make safe the dangerous conditions on the premises is "non-delegable." **Fort Lowell-NSS Ltd. P'ship v. Kelly**, 166 Ariz. 96, 101, 800 P.2d 962, 967 (1990) (a non-delegable duty is one "for which the employer must retain responsibility, despite proper delegation to another.") Such duty arises in those "special situations in which the law prescribes a duty requiring a higher degree of care," such as the affirmative duty of a landowner "to protect those described as his invitees by making and keeping the premises safe." **Simon v. Safeway, Inc.**, 217 Ariz. 330, 338, 173 P.3d 1031, 1039 (Ct. App. 2007). This means that a land possessor who hires a contractor to perform work on the premises may be vicariously liable to an invitee if an independent contractor creates a dangerous condition that injures the invitee. In **Wiggs v. City of Phoenix**, 198 Ariz. 367 10 P.3d 625 (2000), for example, the City of Phoenix owed a non-delegable duty to keep its streets reasonably safe for travelers, and therefore the City could be vicariously liable for the negligence of its subcontractor, APS. In these circumstances, it makes no sense to name the independent contractor as a non-party at fault because doing so does not relieve the employer of any liability. Under the non-delegable duty rule, a business proprietor is vicariously liable for the torts of an independent security agency's guards. **Simon v. Safeway, Inc.**, *supra* at 339, 173 P.3d at 1040 ("Safeway did not initially have a specific, nondelegable duty to provide security services. Instead, it voluntarily assumed that duty within the context of the heightened duty it already owed to its business invitees. Having assumed the task of providing security services on its premises, Safeway thus created for itself a personal, non-delegable duty to protect its invitees from the intentionally tortious conduct of those with whom it had

contracted to maintain a presence and provide security on its premises.”). The fact that the land possessor might be vicariously liable for the independent contractor’s negligence does not take away the claimant’s right to also sue the independent contractor for its own negligence if it breaches the applicable standard of care. **Nelson v. Grayhawk Props., L.L.C.**, 209 Ariz. 437, 440, 104 P.3d 168, 171 (Ct. App. 2004).

Notably, the non-delegable duty rule does not hold land possessors vicariously liable for the torts of the contractor’s employees. *See, e.g., Vanoss v. BHP Copper Inc.*, 244 Ariz. 90, 94, 418 P.3d 457, 461 (Ct. App. 2018). This is because employees are covered by Arizona’s workers’ compensation scheme—the premiums of which a landowner either directly or indirectly pays by hiring an independent-contractor employer. *Id.*

Doctrine of Retained Control

The doctrine of retained control is often invoked where a plaintiff seeks to hold a general contractor responsible for the acts of a subcontractor. The general contractor may be liable for the acts of an independent subcontractor if the general contractor retains “control” over the independent contractor. This is a theory of direct, not vicarious, liability. An employer who entrusts work to an independent contractor, but who retains control over any part of the work is subject to liability for the physical harm to others for whom the employer owes a duty to exercise reasonable care.

Control must relate to the actual manner in which the work is performed, not merely the retention of some control over the premises. That is, the employer must have the right to control the manner and the method or the details of the work. **Koepke v. Carter Hawley Hale Stores**, 140 Ariz. 420, 425-26, 682 P.2d 425, 430-31 (Ct. App. 1984); **German v. Mt. States Tel. Co.**, 11 Ariz. App. 91, 94-95, 462 P.2d 108, 111-12 (1969); **Lee v. M & H Enterprises, Inc.**, 237 Ariz. 172, 347 P.3d 1153, 1160 (Ct. App. 2015). It is not enough that the employer has a general right to order the work stopped or resumed, to inspect the progress of the work, to make suggestions or recommendations, or to prescribe deviations. These general rights are usually reserved to employers, but it does not mean that the contractor is controlled as to its *method* of work or as to *operative* detail.

Inherently Dangerous Activities

A landowner/possessor of land will retain liability for injuries caused by inherently dangerous activities performed on the premises, even if those activities are performed by an independent contractor, if the contractor failed to take reasonable precautions against such danger. *See* RESTATEMENT (SECOND) OF TORTS § 427.

Inherently dangerous work is work that involves a risk that cannot be eliminated even with the exercise of reasonable care. **Bible v. First Nat’l. Bank of Rawlins**, 21 Ariz. App. 54, 57, 515 P.2d 351, 354 (1973). The key element of an inherently dangerous activity is that the risk cannot be eliminated by the exercise of reasonable care, even if the risk could be diminished. Blasting is an

example of an inherently dangerous activity. The only way the risk can be eliminated is by eliminating the activity.

VICARIOUS LIABILITY FOR PUNITIVE DAMAGES

Arizona has not yet directly addressed the issue of whether a business proprietor can be held vicariously liable for punitive damages based upon the conduct of an independent contractor. However, the non-delegable duty rule and the retained control doctrine might provide the avenue for vicarious punitive damages.

Arizona courts have already held that an employer can be vicariously liable for the punitive damages awarded due to acts of an employee. *Wiper v. Downtown Dev. Corp. of Tucson*, 152 Ariz. 309, 732 P.2d 200 (1987). However, an employer can be vicariously liable for those punitive damages only if the punitive damages were actually awarded against the employee. *Wiper*, at 311-12, 132 P.2d at 202-03. When no punitive damages have been awarded against an employee, no punitive damages can be imposed on the employer unless they are based on some independent tortious conduct of the employer.

In light of the fact that Arizona strongly adheres to the principle that a business owner has a non-delegable duty to keep its premises reasonably safe, it might not be much of a step for the courts to hold that the business proprietor is vicariously liable for punitive damages under the non-delegable duty rule or the retained control doctrine.

LIABILITY FOR CRIMINAL ACTS COMMITTED BY THIRD PARTIES

A landowner/possessor of property owes no duty to protect a person against the criminal acts of a third party absent proof of a special relationship between the landowner/possessor and the person who commits the crime, or between the landowner/possessor and the person who is injured. RESTATEMENT (SECOND) OF TORTS § 315. Special relationships are those such as parent/child, master/servant, possessor of land/invitee, and one who is required by law to take custody, or who voluntarily takes custody, of another under circumstances such as to deprive the other of his normal opportunities for protection. RESTATEMENT (SECOND) OF TORTS § 314A.

A landowner owes a common law duty to use reasonable care to prevent harm from criminal acts on the landowner's property. This includes the duty to take reasonable measures to protect against foreseeable activities creating danger, including criminal attacks in common areas under the landowner's control. *Knauss v. DND Neffson Co.*, 192 Ariz. 192, 196-97, 963 P.2d 271, 275-76 (Ct. App. 1997). Even if no special relationship exists with the landowner (social guests or licensees are not "special relationships"), the landowner still has a duty, with respect to common areas under its control, to maintain its property in a reasonably safe condition. *Martinez v. Woodmar IV Condominiums Homeowners Ass'n Inc.*, 189 Ariz. 206, 208, 941 P.2d 218, 220 (1997).

The criminal conduct of a third person will not relieve a landowner or possessor of property of liability if the landowner's/possessor's negligence created the risk that the crime or tort would

be committed. A landowner or possessor may be liable for negligence if its action or inaction afforded the third person an opportunity to commit a tort or crime, and the landowner or possessor realized or should have realized that the third person might avail him or herself of the opportunity. The key issue is almost always whether the landowner or possessor should have foreseen or anticipated the risk of criminal activity. RESTATEMENT (SECOND) OF TORTS § § 448, 449; ***Cent. Alarm v. Ganem***, 116 Ariz. 74, 567 P.2d 1203 (Ct. App. 1977). In *Ganem*, a burglar alarm company left a key to deactivate the alarm system in a place accessible to unauthorized persons. The key was stolen and homes were burglarized. The alarm company was not relieved of liability for the subsequent burglaries. The court ruled that the subsequent burglaries were an intervening cause, but not a superseding cause because the burglaries were certainly within the risk created by the alarm company's actions in leaving the deactivation key accessible to other people.

TAVERN OWNERS

Until very recently, tavern owners and other licensed sellers of alcohol owed a duty of care and could be held liable under the common law for selling liquor to an intoxicated patron or customer under circumstances where the liquor licensee or his employees knew or should have known that such conduct created an unreasonable risk of harm to others who may be injured either on or off the premises. ***Ontiveros v. Borak***, 136 Ariz. 500, 667 P.2d 200 (1983). Recently, however, the Arizona court of appeals held that Arizona's dram shop statutes expressly preempt common law negligence claims. ***Torres v. Jai Dining Services (Phoenix), Inc.***, 508 P.3d 1148, 1159 (Ct. App. 2022); A.R.S. § 4-312(B). Arizona's dram shop statute, A.R.S. § 4-311(A), provides that a licensee is liable for property damage or personal injuries if the licensee sold liquor to an obviously intoxicated person and that person's consumption of the liquor proximately caused the plaintiff's injury. See also ***Dupray v. JAI Dining Servs. (Phoenix), Inc.***, 245 Ariz. 578, 432 P.3d 937 (Ct. App. 2018) (evidence was sufficient for jury to find bar breached duty of care in overserving patron who then caused accident). The plaintiff in *Torres* has sought review with the Arizona Supreme Court, but as of the date of this publication, that process has not been completed. As such, for now, common law dram shop claims remain preempted and invalid until and unless the Arizona Supreme Court decides otherwise.

FAILURE TO MAINTAIN ADEQUATE SECURITY

The failure to provide adequate lighting, door locks, or other security measures may subject certain landowners to liability for harm caused by a criminal attack on persons to whom the owner owes a duty of care. ***Martinez v. Woodmar IV Condominiums Homeowners Ass'n, Inc.***, 189 Ariz. 206, 210, 941 P.2d 218, 222 (1997). The landlord's duty of care might include measures to protect others from criminal attacks, provided the attacks are reasonably foreseeable and preventable. *Id.* See also ***Grafitti-Valenzuela ex rel. Grafitti v. City of Phoenix***, 216 Ariz. 454, 458, 167 P.3d 711, 715 (Ct. App. 2007).

In cases involving apartment complexes, plaintiffs might allege that the landlord's failure to provide adequate security breached the warranty of habitability. The basis of this claim might be

(1) an express warranty in the lease agreement assuring that the premises will be kept in a safe and habitable condition; (2) an implied warranty requiring the landlord to protect the tenant from injury due to conditions which are unreasonably dangerous, *Presson v. Mountain States Props., Inc.*, 18 Ariz. App. 176, 501 P.2d 17 (Ct. App. 1972), or (3) a statutory duty to protect tenants from criminal acts. The Arizona Residential Landlord and Tenant Act requires the landlord to “do whatever is necessary to put and keep the premises in a fit and habitable condition.” Plaintiff might argue that keeping the premises habitable includes taking whatever steps are reasonably necessary to protect the tenant from the likelihood of criminal attack.

Innkeeper Statute

Arizona has an innkeepers’ statute which limits the liability of innkeepers for property loss. The statute does not apply to guests’ personal or bodily injury. A.R.S. § 33-302(A). In *Terry v. Linscott Hotel Corp.*, 126 Ariz. 548, 617 P.2d 56 (Ct. App. 1980), hotel guests sued the Scottsdale Hilton for the theft of their jewelry from their hotel room. Plaintiffs alleged the hotel owed them a duty to disclose the rash of recent break-ins and to provide adequate security. The hotel won summary judgment because it had complied with the “posting provisions” of A.R.S. § 33-302(A). The statute provides limited liability for innkeepers who post notice in motel rooms regarding the availability of a fireproof safe for the keeping of their valuables.

LANDLORD’S LIABILITY TO TENANT AND GUESTS OF TENANTS

Evaluating the liability of a landlord requires considering each of the following.

1. Is the claimant a tenant, guest of the tenant, or a trespasser?
2. Did the injury occur in a common area or specifically in the tenant’s leased premises?
3. Was the injury caused by a defect that already existed at the time of the lease or was it a condition that was created subsequent to the lease?
4. Who created the condition that caused injury?

Generally, a landlord satisfies its duty to keep its premises safe by: (1) inspecting the premises when he has reason to suspect defects existing at the time the tenants take possession; and (2) either repairing them or warning the tenant of their existence. In the broadest sense, a landlord has a duty to take those precautions for the safety of the tenant as a reasonably prudent person would take under similar circumstances. *See, e.g., Ibarra v. Gastelum*, 249 Ariz. 493, 497, 471 P.3d 1028, 1032 (Ct. App. 2020) (approving jury instruction stating, “[i]f you find that [landlord] had notice of the unreasonably dangerous condition and failed to use reasonable care to prevent harm under the circumstances, then [landlord] was negligent.”). In *Ibarra*, the court also held that the tenant could not sue the landlord for negligence per se under the Uniform Residential Landlord and Tenant Act for an alleged breach of a statutory duty to keep the apartment in a fit and habitable condition. The purpose of the Act is to define and simplify the law “governing the rental of dwelling units and the rights and obligations of landlord and tenant” and to encourage

both landlords and tenants “to maintain and improve the quality of housing.” A.R.S. § 33-1302. Remedies available under the Act focus on relief other than personal injuries, such as possession, lease termination and payment for repairs. The Act does not mention personal injury claims or remedies. Further, said the court, the statute only defines a general standard of care; it does not prohibit a specific act. Thus, the Act’s violation is not negligence per se. 249 Ariz. at 496, 471 P.3d at 1031.

If a nuisance exists on the premises at the time of renting, the landlord might not be discharged from liability for injury occurring as a result of that nuisance. The landlord cannot simply claim that he had no actual knowledge of the condition if by exercising reasonable diligence, a reasonable inspection of the premises would have discovered the nuisance. The landlord’s liability is suspended as soon as he surrenders possession and control of the premises in good condition to the tenant. However, the landlord will remain liable to persons injured in or on “common areas” of the property over which the landlord retains control, or are for the tenants’ and guests’ common use.

Although the landlord’s duty of reasonable care requires the landlord to remedy or warn of defects existing at the time of leasing the premises, the landlord’s liability for failure to remedy or warn might continue only until such time as the tenant has a reasonable opportunity to discover the condition himself and take precautions. If the tenant or a guest of the tenant is injured by a defect of which the tenant already had notice, the landlord may be shielded from liability for any injuries resulting to the tenant or the tenant’s guests. Such was the case in **Piccola v. Woodall**, 186 Ariz. 307, 921 P.2d 710 (Ct. App. 1996), where a tenant’s guest was injured when she fell through a sliding door made of plate glass rather than safety tempered glass. The tenant was well aware of this condition. Accordingly, the court held that the landlord’s duty to warn of reasonably discoverable dangerous conditions had passed to the tenant because the tenant had, in fact, discovered the condition. Therefore, the duty to warn the guest of the dangerous condition rested with the tenant, not the landlord. *Id.*

If the tenant has control of premises in good condition when leased, any injury subsequently caused by a condition on the premises or use of the premises is *prima facie* evidence of the tenant’s liability, not the landlord’s. The landlord is not responsible for injuries occurring as a result of a tenant’s tort with respect to the use of the property. For example, a landlord is not responsible for a tenant’s act in creating or maintaining a nuisance upon the leasehold after a landlord transfers possession to the tenant. However, if a landlord knows or should know that his tenant has created a nuisance on his leased premises and nevertheless continues to rent to the same tenant beyond the time period needed to terminate the lease, the landlord might be held liable if a third party suffers damage as a result of the nuisance. **Klimkowski v. De la Torre**, 175 Ariz. 340, 857 P.2d 392 (Ct. App. 1993).

In **Siddons v. Bus. Props. Dev. Co.**, 191 Ariz. 158, 953 P.2d 902 (Ct. App. 1998), the tenant propped a heavy door next to the building on the sidewalk in front of his business. It fell on the plaintiff, injuring him. While the landlord has no duty to protect against a condition created exclusively by the tenant after the tenant takes possession, the court stated that the landlord could still be

subject to liability, under the RESTATEMENT (SECOND) OF TORTS § 360, if the landlord still had control over the area (sidewalk) where the accident occurred and retained the duty to inspect and make the sidewalk area safe.

The RESTATEMENT (SECOND) OF TORTS § 837(1) creates an exception to the general principle that a landlord is not liable for injuries caused by the acts of the tenant after the tenant takes control of the property. This Restatement section has been adopted in Arizona. *Klimkowski, supra*. It states:

- (1) A lessor of land is subject to liability for a nuisance caused by an activity carried on upon the land while the lease continues and the lessor continues as owner, if the lessor would be liable if he had carried on the activity himself, and (a) at the time of the lease the lessor consents to the activity or knows or has reason to know that it will be carried on, and (b) [the lessor] then knows or should know that it will necessarily involve or is already causing the nuisance.

If you have questions regarding the information in this chapter, please contact the author.

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CHAPTER 16: MEDICAL LIABILITY

MEDICAL MALPRACTICE CLAIMS

Medical malpractice, also commonly referred to as medical negligence, is a cause of action that occurs when a licensed health care provider violates the applicable standard of care in providing treatment to a patient, causing the patient to suffer injury. A.R.S. § 12-561. To establish a prima facie claim for medical malpractice a plaintiff must prove the following: (1) the defendant owed the plaintiff a duty of care; (2) the defendant breached his or her duty to the plaintiff; (3) the breach was the proximate cause of the plaintiff's injury; and (4) damages. A.R.S. § 12-563.

The first element of a medical malpractice action is duty. Arizona courts traditionally held that a formal doctor-patient relationship must be established before a duty of care is owed. *Hafner v. Beck*, 185 Ariz. 389, 391, 916 P.2d 1105, 1107 (Ct. App. 1995). But Arizona courts have expanded the breadth of the duty owed beyond the formal doctor-patient relationship requirement. For example, in *Stanley v. McCarver*, 208 Ariz. 219, 226 ¶ 22, 92 P.3d 849, 856 (2004), the court held that a consulting radiologist owed a duty of reasonable care to the patient despite the absence of a direct doctor-patient relationship. See also *Ritchie v. Krasner*, 221 Ariz. 288, 296 ¶ 18, 211 P.3d 1272, 1280 (Ct. App. 2009) (independent medical examiner owed claimant a duty of reasonable care despite the lack of a formal doctor-patient relationship); *Diggs v. Arizona Cardiologists, Ltd.*, 198 Ariz. 198, 202 ¶ 22, 8 P.3d 386, 390 (Ct. App. 2000) (express contractual relationship was not necessary to find that a cardiologist whom the patient's emergency room physician informally consulted owed the patient a duty of care because the cardiologist voluntarily undertook to provide his expertise to the emergency room physician, knew it was necessary for the patient's protection, and knew the emergency physician would rely on it); *Lasley v. Shrake's Country Club Pharmacy, Inc.*, 179 Ariz. 583, 587, 879-80 P.2d 1129, 1132-33 (Ct. App. 1994) (pharmacist owed a duty to comply with the applicable standards of care when dispensing potentially addictive drugs to a customer); cf. *Golob v. Arizona Med. Bd.*, 217 Ariz. 505, 509 ¶ 12, 176 P.3d 703, 707 (Ct. App. 2008) (evidence supported board's findings that physician deviated from standard of care by prescribing medicine over the internet for individuals without establishing a physician-patient relationship or performing physical examinations).

The second element in a medical malpractice action is a breach of duty. The duty owed in a medical malpractice action is the duty to act in accordance with the applicable standard of care. The standard of care is generally defined as the degree of care, skill, and learning that would be expected under similar circumstances of a reasonably prudent health care provider practicing in the same specialty in Arizona. See *Jaynes v. McConnell*, 238 Ariz. 211, 217 ¶ 19, 358 P.3d 632, 638 (Ct. App. 2015) (evidence of expert's personal practices was relevant for the jury to determine the applicable standard of care and to evaluate expert's credibility); see also *Bell v. Maricopa Med. Ctr.*, 157 Ariz. 192, 196, 755 P.2d 1180, 1184 (Ct. App. 1988) (jury can consider protocols as evidence of the standard of care). A healthcare provider breaches his or her duty to act in accordance with the standard of care if he or she fails to exercise the degree of care, skill and learning expected of a reasonable, prudent health care provider in the profession or class to

which he or she belongs within the state acting in the same or similar circumstances. A.R.S. § 12-563.

Normally, the plaintiff in medical malpractice cases must establish the standard of care with expert testimony. *See, e.g., Riedisser v. Nelson*, 111 Ariz. 542, 544, 534 P.2d 1052, 1054 (1975). The only time expert medical testimony is not required to establish the standard of care is where the negligence is so grossly apparent that laymen would have no difficulty recognizing it. *Id.* Such cases are rare.

The third and fourth elements in a medical malpractice action are proximate cause and damages. A plaintiff must establish that the health care provider's negligence was the proximate cause of his/her injuries. Specifically, the plaintiff must demonstrate "a natural and continuous sequence of events stemming from the defendant's act or omission, unbroken by any efficient intervening cause, that produces an injury, in whole or in part, and without which the injury would not have occurred." *Barrett v. Harris*, 207 Ariz. 374, 378 ¶ 11, 86 P.3d 954, 958 (Ct. App. 2004). Proximate cause must be proven through expert medical testimony unless the connection is readily apparent to the trier of fact. *Seisinger v. Siebel*, 220 Ariz. 85, 94 ¶ 33, 203 P.3d 483, 492 (2009); *see also* A.R.S. § 12-2601 et seq.; *Sampson v. Surgery Ctr. of Peoria, LLC*, 251 Ariz. 308, 311 ¶ 15, 491 P.3d 1115, 1118 (2021) ("a plaintiff must show that causation is probable, not merely speculative").

Preliminary Expert Affidavit Requirement

Arizona law requires the plaintiff in a medical malpractice action to support his or her claim with a preliminary affidavit from a properly qualified expert. A.R.S. § 12-2603. The statute requires the plaintiff to serve this affidavit at the time initial disclosure statements are exchanged. Initial disclosures are due thirty days after the defendant files a responsive pleading to the plaintiff's complaint. Rule 26.1, Ariz. R. Civ. P. The preliminary expert affidavit must contain at least the following: (1) the expert's qualifications to opine on the defendant's standard of care or liability; (2) the factual basis for each claim against the defendant; (3) the defendant's acts, errors or omissions that the expert believes violate the standard of care; and (4) how those acts, errors or omissions caused or contributed to the plaintiff's claimed damages. Failure to serve the required preliminary expert affidavit shall result in the dismissal of the claim without prejudice. A.R.S. § 12-2603(F). However, the court has wide discretion to allow a plaintiff additional time to cure an insufficient expert affidavit.

Normally, defendants raise the lack of a qualifying preliminary expert affidavit in a motion to dismiss; thus, the statutory requirement of dismissal without prejudice (to give plaintiff a chance to provide a valid preliminary affidavit) makes sense. In *Preston v. Amadei*, 238 Ariz. 124, 357 P.3d 159 (Ct. App. 2015), however, the defendant did not challenge the plaintiff's preliminary affidavit. He waited and filed a summary judgment motion arguing the plaintiff had no qualified expert to testify that defendant fell below the standard of care. The court of appeals held that the trial court should have allowed the plaintiff additional time to substitute another standard of care expert. *Id.* at 131 ¶ 19, 357 P.3d at 166; *see also Sanchez v. Old Pueblo Anesthesia, P.C.*, 218

Ariz. 317, 324 n.10, 183 P.3d 1285, 1292 n.10 (Ct. App. 2008) (“We merely hold that, under the particular circumstances here, where the Sanchez’s’ inability to remedy the violation of § 12–2604 within the deadline arose from Old Pueblo’s approximate six-month delay in raising a challenge on that basis, such a drastic sanction [of dismissal with prejudice] is not supported by the record before us.”).

The Arizona Supreme Court has since disapproved of *Preston* and *Sanchez*, holding that the A.R.S. §12-2603(F) “opportunity to cure” does not automatically entitle a plaintiff the chance to substitute a new expert at the summary judgment stage; that remedy is limited to challenges to the preliminary affidavit. ***Rasor v. Northwest Hosp.***, 243 Ariz. 160, 165 ¶ 24, 403 P.3d 572, 577 (2017) (allowing an automatic substitution of expert provision to carry beyond the preliminary and discovery phases defeats the overall purpose of A.R.S. §12-2603). Furthermore, the Hospital was not required to challenge the plaintiff’s proposed expert’s preliminary affidavit as a prerequisite to challenging it on summary judgment. *Id.* But see ***St. George v. Plimpton***, 241 Ariz. 163, 168 ¶ 30, 384 P.3d 1243, 1248 (Ct. App. 2016) (holding that the proper recourse for a plaintiff whose expert’s qualifications are challenged for the first time at the summary judgment stage is to seek relief for additional discovery under Rule 56(d)).

Expert Witness Qualifications

Expert witnesses in medical malpractice actions are required to possess certain minimum qualifications to provide standard of care testimony. Pursuant to A.R.S. § 12-2604(A), a witness may not give expert testimony on the standard of care unless the person is licensed as a health professional in Arizona or another state and the person meets the following criteria:

1. If the party against whom or on whose behalf the testimony is offered is or claims to be a specialist, the expert must have specialized, at the time of the occurrence that is the basis for the action, in the same specialty or claimed specialty as the party against whom such testimony is offered. If the party against whom the testimony is offered is or claims to be a specialist who is board certified, the expert witness shall be a specialist who is board certified in that specialty or claimed specialty; and
2. During the year immediately preceding the occurrence giving rise to the lawsuit, the expert must have devoted a majority of his or her professional time to either or both of the following: (a) the active clinical practice of the same health profession as the defendant and, if the defendant is or claims to be a specialist, in the same specialty or claimed specialty; (b) the instruction of students in an accredited health professional school or accredited residency or clinical research program in the same health profession as the defendant and, if the defendant is or claims to be a specialist, in an accredited health professional school or accredited residency or clinical research program in the same specialty or claimed specialty.

Similar requirements apply to general practitioners. If the defendant in a medical malpractice action is a health care institution that employs a licensed health professional accused of

malpractice, the statute applies as if the health professional was the defendant against whom the testimony is offered. A.R.S. § 12-2604(B).

“Specialty,” for purposes of the statute, refers to a limited area of medicine in which a physician is or may become board certified. This includes subspecialties and is not limited to the 24 member boards on the American Board of Medical Specialties (ABMS). **Baker v. University Physicians Healthcare**, 231 Ariz. 379, 386 ¶ 22, 296 P.3d 42, 49 (2013). Likewise, “specialist” is someone who devotes a majority of his or her professional time to a particular specialty. *Id.*

“Claimed specialty” refers to situations in which a physician purports to specialize in an area that is eligible for board certification, regardless of whether the physician in fact limits his or her practice to that area. *Baker, supra.*

Under this statute, an expert witness testifying against a board-certified specialist in a medical malpractice action must be board-certified in the same specialty as the defendant physician, even if physician does not claim to have been a board-certified specialist at time he treated the patient. **Awsienko v. Cohen**, 227 Ariz. 256, 257 P.3d 175 (Ct. App. 2011) (expert witness who was not a board-certified specialist in either cardiovascular disease or interventional cardiology was not qualified to render standard of care opinion against physician who was board-certified in both areas, in medical malpractice action against the physician, despite argument that expert’s criticisms were unrelated to any cardiac treatment; statute contained no such exception). *But see Baker*, 231 Ariz. at 384 ¶ 12, 196 P.3d at 47 (“The standard of care, however, necessarily depends on the particular care or treatment at issue. . . . Thus, only if the care or treatment involved a medical specialty will expertise in that specialty be relevant to the standard of care in a particular case.”). Thus, in **Sanchez v. Old Pueblo, supra**, the court held that an orthopedic surgeon could not testify in a medical malpractice action arising from knee surgery against an anesthesiologist defendant, even if the orthopedic surgeon might have the necessary qualifications and experience to knowledgeably address the standard of care for anesthesiologists in the context of the specific operation at issue. In **Baker, supra**, a father sued a physician specializing in pediatric hematology-oncology for the death of his 17-year-old daughter after being treated for blood clots. The trial court was within its discretion in concluding that the defendant physician was practicing within her specialty of pediatric hematology-oncology at time of the treatment, and that the father’s proposed expert, who was board certified in internal medicine and in hematology and oncology, did not meet the statutory requirement of being certified in same specialty as the defendant physician, even though the proposed expert might also have competently provided treatment. *See also Raso*, *supra* (upholding the determination that a wound care nurse was not qualified to testify as standard of care expert against an ICU nurse because she had not spent the majority of the preceding year working as an ICU nurse).

As of the publication date of this Guide, the Arizona Supreme Court is considering two important issues in a medical negligence case. The first is whether a plaintiff can avoid having to obtain qualified medical experts by labeling her claim as one against the “institution,” even though the claim is that unnamed “practitioners,” lumped as a group, fell below the standard of care by

failing to appropriately treat the patient. The court of appeals ruled plaintiff was bringing an institutional claim against the entity and need not comply with A.R.S. § 12-2604 at all. The Supreme Court granted review and will hopefully clarify that claims against an entity need to allege more than simply allegedly negligent care decisions. Instead, institutional claims are ones such as the entity's policies were inadequate, the entity failed to maintain safe facilities and equipment, or failed to select competent physicians, or failed to supervise its employees. The second issue in *Windhurst* is whether a registered nurse is qualified to testify to the cause of death in a wrongful death case. ***Windhurst v. Ariz. Dept of Corrections***, 252 Ariz. 240 (Ct. App. 2021), review granted April 5, 2022.

A.R.S. § 12-2604 applies to Adult Protective Services Act (APSA) claims that are based on allegations of medical negligence. ***Cornerstone Hosp. of Se. Ariz., L.L.C. v. Marner ex rel. Cnty. of Pima***, 231 Ariz. 67, 72 ¶ 10, 290 P.3d 460, 465 (Ct. App. 2012) (holding that a registered nurse (RN) was qualified to testify about the standard of care required of a licensed practical nurse (LPN) or certified nurse assistant (CNA)). However, A.R.S. § 12-2604 does not apply to the admission of expert testimony during physician disciplinary proceedings because a disciplinary proceeding is not "an action alleging medical malpractice" to which the statute applies. ***Kahn v. Arizona Med. Bd.***, 232 Ariz. 17, 21 ¶ 23, 300 P.3d 552, 556 (Ct. App. 2013).

This statute has been held constitutional against an equal protection and due process challenge, because it neither imposes a burden upon a plaintiff at filing nor unduly limits who a plaintiff can employ as an expert; rather, it specifies the type of evidence a plaintiff must offer to prove one of the elements of a medical malpractice claim. ***Governale v. Lieberman***, 226 Ariz. 443, 447 ¶ 11, 250 P.3d 220, 224 (Ct. App. 2011).

Though A.R.S. § 12-2604 conflicts with Rule 702, Ariz. R. Evid. (which allows experts to testify if they are simply qualified by knowledge, experience, education, or training), the statute does not violate the separation of powers because it is not a procedural rule of evidence. Instead, it creates a substantive requirement for bringing a medical malpractice claim. ***Seisinger v. Siebel***, 220 Ariz. 85, 95 ¶ 38, 203 P.3d 483, 493 (2009).

Burden of Proof

The burden of proof in a medical malpractice claim is typically a "preponderance of the evidence" standard. Thus, the plaintiff must demonstrate that the health care provider more likely than not violated the applicable standard of medical care and caused the patient's injury. However, there is a heightened burden of proof in a few limited circumstances. For example, students such as residents and interns enrolled in educational or training programs are not liable in a medical malpractice action for injury that occurs as a result of the care they provide unless the plaintiff proves gross negligence by clear and convincing evidence. A.R.S. § 12-564. Additionally, emergency room doctors, on-call medical specialists, hospitals or hospital employees are liable for their emergency treatment only if the plaintiff presents clear and convincing evidence that the medical care provider committed malpractice. A.R.S. § 12-572; *see also* ***Stafford v. Burns***, 241 Ariz. 474, 479 ¶ 15, 389 P.3d 76, 81 (Ct. App. 2017) (heightened burden of proof applies to all

patients who go to hospital's emergency department "for what may be an emergency condition") (emphasis in original).

Loss of Chance

In some cases, a jury is permitted to determine that a defendant probably caused the plaintiff's injury if the plaintiff demonstrates that the plaintiff suffered a "loss of chance" at a better outcome. *Thompson v. Sun City Cmty. Hosp., Inc.*, 141 Ariz. 597, 608, 688 P.2d 605, 616 (1984). In *Thompson*, a patient was transferred to another hospital at a time when he needed emergency care. The patient survived but suffered residual impairment of his leg. The plaintiff's expert testified that there would have been a "substantially better chance" of full recovery if surgery had been performed immediately. *Id.* at 607, 688 P.2d at 615.

This looser standard of causation is limited to cases in which the defendant undertook to protect the plaintiff from harm but whose negligence increased the risk of harm or deprived the plaintiff of a significant chance of survival or better recovery. See RESTATEMENT (SECOND) OF TORTS § 323 ("One who undertakes . . . to render services to another which he should recognize as necessary for the protection of the other's person or things, is subject to liability to the other for physical harm resulting from his failure to exercise reasonable care to perform his undertaking, if . . . his failure to exercise such care increases the risk of such harm."); see also *Clemens v. DMB Sports Clubs Ltd. P'ship*, 2015 WL 8166584, at *3 (Ariz. Ct. App. Dec. 8, 2015) (rejecting a loss of chance claim where the plaintiff did not prove the defendant "negligently interrupted a chain of events" that would have given the plaintiff a chance for a better outcome).

Res Ipsa Loquitur

In very limited circumstances, a plaintiff can bring a claim against a medical provider without direct proof of negligence under the doctrine of *res ipsa loquitur*, which is Latin for "the thing speaks for itself." In order to prove a *res ipsa* claim, a plaintiff must prove three elements:

1. The injury does not ordinarily occur in the absence of negligence;
2. The instrumentality of harm was in the defendant's exclusive control; and
3. The plaintiff is not in a position to show how the instrumentality of harm caused the injury.

In *Tucson Gen. Hosp. v. Russell*, 7 Ariz. App. 193, 437 P.2d 677 (1968), a plaintiff was injured when an x-ray machine fell on her while she was lying on the x-ray table due to an improperly positioned pivot shaft. The court of appeals held there was sufficient evidence for a jury to infer the hospital's negligence through a theory of *res ipsa loquitur* on the basis that (1) mechanical failure of a pivot shaft does not ordinarily occur in the absence of negligence where the undisputed evidence was that "somebody didn't put it in properly;" (2) the x-ray machine was in the hospital's possession and control for nine years prior to the injury notwithstanding the use of contractors to service the machine; and the plaintiff had no means by which to determine how

or when the pivot shaft was improperly positioned. *Id.* at 196, 437 P.2d at 680 (“The res ipsa doctrine is a particular application of the use of circumstantial evidence.”).

The application of the doctrine is not appropriate where there are multiple potential causes of an injury. In a case involving a plaintiff who developed neck pain immediately following abdominal surgery and was found to have a herniated cervical disk, the defendants offered expert testimony that the plaintiff’s condition could have been triggered by some mechanism other than surgical positioning such as “coughing, sneezing, or merely awakening in the morning.” ***Faris v. Doctors Hosp., Inc.***, 18 Ariz. App. 264, 266, 501 P.2d 440, 442 (1972). Likewise, in ***Korak v. Para***, 2019 WL 3429164, at *2 (Ariz. Ct. App. July 30, 2019), the court of appeals rejected a res ipsa theory when the plaintiff’s expert testified that her splenic artery injury following a laparoscopic cholecystectomy could have been caused either by a surgical instrument or by the plaintiff’s post-operative pancreatitis. *See also* ***McWain v. Tucson Gen. Hosp.***, 137 Ariz. 356, 369, 670 P.2d 1180, 1183 (Ct. App. 1983) (“The mere fact that an occurrence is rare does not lead to the application of the doctrine.”).

Res ipsa loquitur is also not applicable in the context of multiple, independent theories of liability against separate defendants. In a case involving a total knee replacement that failed, the plaintiff put forth two competing theories under the doctrine of res ipsa: (1) the surgeon failed to properly lock in or size the implant at the time of surgery; or (2) the locking mechanism on the device was defective, thereby implicating the manufacturer. ***Cook v. Hawkins***, 2019 WL 2442263, at *1 (Ariz. Ct. App. June 11, 2019). The court of appeals affirmed summary judgment in favor of both defendants because the plaintiff failed to show exclusive control of the instrumentality of harm by either defendant and further failed to show that the plaintiff’s injury was probably the result of either defendant’s negligence. *Id.* at *3 (The plaintiff’s “offer of two independently sufficient potential causes for the implant’s failure (based on different negligence at different times by different parties) means that [the plaintiff] failed to present evidence sufficient to support an inference that either individual defendant’s negligence was probably responsible for [the plaintiff’s] injuries.”).

Limitations on Liability

While an individual, corporation or institution can be sued for medical malpractice, there are some limits placed on cases that can be brought against healthcare providers. For example, A.R.S. § 12-562 states that a medical malpractice action shall not be brought against a licensed healthcare provider for assault and battery. However, a battery cause of action can be brought when the claim alleges a lack of consent. ***Duncan v. Scottsdale Med. Imaging, Ltd.***, 205 Ariz. 306, 310 ¶ 13, 70 P.3d 435, 439 (2003) (“[C]laims involving lack of consent, i.e., the doctor’s failure to operate within the limits of the patient’s consent, may be brought as battery actions[, while] true “informed consent” claims, i.e., those involving the doctor’s obligation to provide information, must be brought as negligence actions.”). In cases involving “conditional consent,” use of the typical RAJI battery instruction will not suffice as the issue is whether the defendant willfully performed “an unconsented to” procedure outside the scope of patient consent, not whether the defendant intended to cause harm or offensive contact. ***Carter v. Pain Ctr. of Ariz.***, 239 Ariz.

164, 167 ¶ 9, 367 P.3d 63, 71 (Ct. App. 2016). The requested “conditional consent” instruction should have been read to the jury. *Id*

Additionally, a corporation can be held vicariously liable for the actions of its employees and can be sued directly for failing to supervise or for negligently supervising its employees. *See, e.g., North Star Charter Sch., Inc. v. Valley Protective Servs., Inc.*, 2016 WL 7209681 at 5 ¶¶ 20-21 (Ariz. Ct. App. 2016) (“expert testimony is either required or appropriate to establish the standard of care for a claim of negligent hiring, training, and supervision of [skilled] personnel”). A medical malpractice action based upon breach of contract for professional services is not available unless such contract is in writing. A.R.S. § 12-562(C).

Comparative Fault

Under Arizona’s comparative fault scheme, each defendant is liable only for his or her own percentage of fault. *See* A.R.S. §12-2506 (abolishing joint and several liability except for (1) those acting in concert; (2) vicarious liability or persons acting as agent of the party; and (3) Federal Employer’s Liability Act). The Arizona Supreme Court held that a defendant may name as a nonparty at fault the physician who subsequently provided negligent care to an injured plaintiff and thereby enhanced the harm to the plaintiff. Allowing this is consistent with Arizona’s Uniform Contribution Among Tortfeasors Act (UCATA). *Cramer v. Starr*, 240 Ariz. 4, 10 ¶ 21, 375 P.3d 69, 75 (2016) (holding the “original tortfeasor rule” provision of RESTATEMENT (SECOND) OF TORTS is not the law in Arizona because UCATA allows for apportionment of fault among successive tortfeasors, not only joint tortfeasors).

Statute of Limitations

In Arizona, a medical malpractice action must be commenced within two years after the cause of action accrues. A.R.S. § 12-542. A malpractice cause of action accrues under the discovery rule once a patient is put on reasonable notice to investigate whether his or her injury may be attributable to negligence. *Walk v. Ring*, 202 Ariz. 310, 316 ¶ 24, 44 P.3d 990, 996 (2002). The statute of limitations on claims by a minor or incapacitated adult will be tolled until two years after the age of majority (18 years) or after competency is re-established. Courts have placed limits on the tolling doctrine, however. Conclusory allegations that a plaintiff was temporarily “too sick” or unable to manage his or her daily affairs will not qualify as objective evidence of mental disability sufficient to toll the statute of limitations for an adult. *Kopacz v. Banner Health*, 245 Ariz. 97, 101 ¶ 16, 425 P.3d 586, 590 (Ct. App. 2018).

Exception to Collateral Source Rule

The collateral source rule generally prevents defendants in tort cases from introducing evidence that another source has provided payments or benefits to the injured party. *Taylor v. Southern Pac. Transp. Co.*, 130 Ariz. 516, 519, 637 P.2d 726, 729 (1981); RESTATEMENT (SECOND) OF TORTS § 920A(2) (1979). This means that payments made to the injured party from another source, such as an insurer, are not credited against the defendant’s potential liability even if those payments cover all or part of the harm for which the defendant is liable. The reasoning behind the collateral

source rule is that a tortfeasor should not receive a windfall and escape liability simply because the party he injured had the foresight to purchase insurance. The rule punishes a party who commits a tort by making sure the party is unable to escape liability merely because a plaintiff was able to recover from another source. *Lopez v. Safeway Stores, Inc.*, 212 Ariz. 198, 202-03 ¶ 14, 129 P.3d 487, 491-92 (Ct. App. 2006).

Medical malpractice actions are a statutory exception to the collateral source rule. Pursuant to A.R.S. § 12-565, a defendant in a medical malpractice action may introduce evidence of payments or benefits a plaintiff received from a source independent of the defendant. If a defendant chooses to show a plaintiff has received payments or benefits from another source, the plaintiff may then introduce evidence of payments he made to secure those payments or benefits (such as insurance premiums). The plaintiff may also show that any recovery from the defendant is subject to a lien, that the plaintiff is legally obligated to reimburse the provider of the payments, or that the provider of the payments or benefits has a right of subrogation to plaintiff's tort recovery in the medical malpractice action. The purpose of this exception is to help medical professionals obtain insurance coverage at reasonable rates by eliminating medical malpractice plaintiffs' double or triple recovery. By reducing the amount insurers are required to pay out in lawsuits, the exception allows insurers to provide lower malpractice premiums. *Eastin v. Broomfield*, 116 Ariz. 576, 585, 570 P.2d 744, 753 (1977). The Arizona Supreme Court has held that the medical malpractice exception to the collateral source rule is constitutional. *Id.*

ADULT PROTECTIVE SERVICES ACT (APSA) CLAIMS

In addition to claims for medical malpractice, nursing facilities, medical directors of nursing facilities, and even acute care hospitals can be subject to liability under Arizona's Adult Protective Services Act (APSA). See A.R.S. § 46-451 et seq. In order to prevail on an APSA cause of action, a plaintiff must prove that the patient was: (1) a "vulnerable adult;" (2) who was the subject of "neglect, abuse or exploitation." A "vulnerable adult" is defined as:

[A]n individual who is 18 years of age or older and who is unable to protect himself from abuse, neglect or exploitation by others because of a physical or mental impairment. Vulnerable adult includes an incapacitated person.

A.R.S. §§ 46-451(A)(11); 14-5101(3) (defining an incapacitated person as lacking sufficient understanding or capacity to make or communicate responsible decisions due to mental illness, mental deficiency, mental disorder, physical illness or disability, chronic use of drugs, or chronic intoxication).

If the plaintiff can prove that the patient was a vulnerable adult, the plaintiff must next prove that the patient was neglected, abused or exploited.

"Neglect" is defined as:

[T]he deprivation of food, water, medication, medical services, shelter, cooling, heating or other services necessary to maintain a vulnerable adult's minimum physical or mental health.

A.R.S. § 46-451(A)(8).

“Abuse” is defined as any of the following:

- Intentional infliction of physical harm;
- Injury caused by negligent acts or omissions;
- Unreasonable confinement; or
- Sexual abuse or sexual assault.

A.R.S. § 46-451(A)(1).

“Exploitation” is defined as the illegal or improper use of an incapacitated or vulnerable adult's resources for another's profit or advantage. A.R.S. § 46-451(A)(5).

The Arizona Supreme Court has held that despite the use of the plural words “acts” or “omissions” in the APSA, a plaintiff does not necessarily have to demonstrate a pattern of multiple negligent acts or omissions in order to support a claim of abuse. *Estate of McGill ex rel. McGill v. Albrecht*, 203 Ariz. 525, 530 ¶ 16, 57 P.3d 384, 389 (2002) (“We therefore conclude that we can neither automatically limit the negligent act or omission wording of A.R.S. § 46–451(A)(1) to a series of negligent acts nor say that a single act of negligence involving an incapacitated person will never give rise to an APSA action. We hold instead that to be actionable abuse under APSA, the negligent act or acts (1) must arise from the relationship of caregiver and recipient, (2) must be closely connected to that relationship, (3) must be linked to the service the caregiver undertook because of the recipient's incapacity, and (4) must be related to the problem or problems that caused the incapacity.”). Due to confusion and discrepancies in applying the four-part *McGill* test, the Arizona Supreme Court has since adopted a more straightforward test, requiring that APSA claimants now prove that (1) a vulnerable adult (2) has suffered an injury (3) caused by abuse (4) from a caregiver. *Delgado v. Manor Care of Tucson*, 242 Ariz. 309, 313 ¶ 19, 395 P.3d 698, 702 (2017). It remains to be seen if this test will be applied more consistently.

If the plaintiff can meet his burden of proving that a vulnerable adult was subject to neglect, abuse or exploitation, the plaintiff can then claim damages for the pre-death pain and suffering of the patient if the patient is deceased. *In re Guardianship/Conservatorship of Denton*, 190 Ariz. 152, 156–57, 945 P.2d 1283, 1287–88 (1997) (estate may recover damages for pain and suffering pursuant to § 46–455 after the death of an elder abuse victim).

Where APSA conflicts with another statute that takes away specific remedies provided by APSA, APSA usually controls to promote the legislature's intent in passing APSA to protect elder abuse victims' remedies against caregivers. See A.R.S. § 46-455(O) (“A civil action authorized by this

section is remedial and not punitive and does not limit and is not limited by any other civil remedy or criminal action or any other provision of law.”); see also *In re Estate of Winn*, 214 Ariz. 149, 152 ¶ 15, 150 P.3d 236, 239 (2007) (limitations placed on personal representatives by the probate code do not restrict APSA claims); *Bailey-Null v. ValueOptions*, 221 Ariz. 63, 69 ¶ 13, 209 P.3d 1059, 1065 (App. 2009) (exhaustion of remedies doctrine did not apply to APSA claim).

However, this precept applies only where statutes conflict. Statutes are followed if they do not conflict with APSA. As such, APSA does not “provide[] for damages for the inherent value of a human life.” *In re Estate of Winn*, 225 Ariz. 275, 276 ¶ 5, 237 P.3d 628, 629 (Ct. App. 2010) (alteration in original). Nor does APSA bar the application of comparative fault. *Wallace v. Heilman*, 2009 WL 325447, at *3 (Ariz. Ct. App. Feb. 10, 2009).

Because of tort reform efforts, other plaintiff-friendly sections of the APSA, including a 7-year statute of limitations and recovery of attorneys’ fees, have been removed from the statute.

Importantly, an APSA cause of action is separate and distinct from a wrongful death cause of action. If the patient is deceased, an APSA cause of action is essentially a personal injury claim made on the decedent’s behalf by the decedent’s estate which alleges damages related to the decedent’s pre-death neglect, abuse or exploitation. An APSA cause of action and a wrongful death cause of action can be contemporaneously brought in any lawsuit involving a decedent who was a vulnerable adult prior to his death.

This concept becomes clear in the APSA cases discussing the enforceability of arbitration agreements or clauses in nursing home admitting documents. APSA does not prevent the enforcement of a voluntary arbitration agreement entered into by an elderly person or an elderly person’s authorized representative. *Mathews ex rel. Mathews v. Life Care Ctrs. of Am., Inc.*, 217 Ariz. 606, 610 ¶ 19, 177 P.3d 867, 871 (Ct. App. 2008). But such clauses or agreements cannot bind the elderly person’s statutory beneficiaries without their consent. See *Estate of Decamacho ex rel. Guthrie v. La Solana Care & Rehab, Inc.*, 234 Ariz. 18, 25 ¶ 27, 316 P.3d 607, 614 (Ct. App. 2014) (claim asserted under APSA was derivative of resident’s rights and fell within scope of arbitration clause, whereas wrongful-death claim was independently held by the decedent’s statutory beneficiaries and therefore not subject to arbitration clause); *Dueñas v. Life Care Ctrs. of Am., Inc.*, 236 Ariz. 130, 138-39 ¶ 25, 336 P.3d 763, 771-72 (Ct. App. 2014) (express language in nursing home agreement purporting to bind statutory heirs to arbitrate their wrongful death claims is not valid or enforceable).

Acute care hospitals may be liable under APSA because acute care hospitals provide care to vulnerable adults and are not expressly exempted by the statutory language of APSA. *In re Estate of Wyatt*, 235 Ariz. 138, 140 ¶ 10, 329 P.3d 1040, 1042 (2014). However, APSA’s enforcement scheme suggests the legislature did not intend to include the State as a potential defendant and, while law permits an APSA action to be filed against a person or an enterprise, the State is neither a person nor an enterprise. *Estate of Braden ex rel. Gabaldon v. State*, 228 Ariz. 323, 326 ¶ 12, 266 P.3d 349, 352 (2011).

Punitive damages are awardable in APSA cases. In ***Newman v. Select Specialty Hosp.-Ariz., Inc.***, 239 Ariz. 558, 562-63 ¶¶ 14-16, 374 P.3d 433, 437-38 (Ct. App. 2016), the court of appeals held that evidence that the hospital’s nurses and employees had been ordered to reposition the patient, clean his wound, and administer medication, and understood the importance of these precautions and the risk of improper care of pressure sores, but failed to follow these orders, was sufficient to send the punitive damage claim to the jury under a “conscious disregard” standard. *But see In re Estate of Fazio*, 2009 WL 1830719, at *5 (Ariz. Ct. App. June 25, 2009) (Evidence of defendant’s alleged understaffing, fraudulent charting, and specific instances of its failure to properly treat decedent did not support a claim that it acted with an “evil mind.” Defendant’s conduct, although negligent and a violation of APSA, is not equivalent to a conscious disregard of a substantial risk of significant harm to decedent or other residents).

If you have questions regarding the information in this chapter, please contact the author.

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CHAPTER 17: PROFESSIONAL LIABILITY

ELEMENTS OF MALPRACTICE

The elements of legal malpractice are: (1) an attorney-client relationship; (2) negligence; (3) proximate cause; and (4) damages. See *Glaze v. Larsen*, 207 Ariz. 26, 83 P.3d 26 (2004).

ATTORNEY-CLIENT RELATIONSHIP

First-Party Claims: Liability to Clients

The relationship of attorney and client can be express or implied from circumstances constituting a request for an agreement to render legal assistance or advice by the attorney. *Franko v. Mitchell*, 158 Ariz. 391, 762 P.2d 1345 (Ct. App. 1988). An attorney-client relationship may exist even when the attorney renders services gratuitously. *Id.* The burden of establishing that an attorney-client relationship exists rests on the claimant. See *Solomon v. Aberman*, 196 Conn. 359, 493 A.2d 193 (1985).

Because attorneys owe duties to their clients, clients are entitled to bring direct causes of action for breaches of that duty. Whether an attorney-client relationship exists is usually an issue of fact. *Franko*.

An attorney hired by an insurance company to defend an insured is not the insurance company's "agent," and the insurance company is probably not vicariously liable for the attorney's negligence. See *Barmat v. John & Jane Doe Partners A-D*, 155 Ariz. 519, 747 P.2d 1214 (Ct. App. 1987). But an insurance company can bring a malpractice suit against a lawyer it hired to defend its insured where the law firm provides legal services to both insurer and insured, even absent express agreement between insurer and law firm. *Paradigm Ins. Co. v. Langerman Law Offices, P.A.*, 200 Ariz. 146, 24 P.3d 593 (2001).

Third-Party Claims: Liability to Non-Clients

Over 20% of all claims against attorneys are brought by non-clients. But the general rule is that attorneys do not owe a duty of care to non-clients. As a result, most lawsuits brought by non-clients are not brought under the theory of negligence, but rather as intentional torts such as fraud, malicious prosecution, abuse of process, intentional infliction of emotional distress, invasion of privacy and defamation. There are, however, limited circumstances under which a non-client may sue a lawyer for negligence. Any duty owed by an attorney to a third party is derivative of the duty owed by the attorney to the client. However, an allegation of attorney malpractice toward a client is not necessary to a third person's claim against the attorney. *Paradigm Ins. Co. v. Langerman Law Offices, P.A.*, 200 Ariz. 146, 24 P.3d 593 (2001) (expressly disapproving Franko's language limiting a third party claim against an attorney absent an allegation of malpractice to the client).

In *Fickett v. Superior Court*, 27 Ariz. App. 793, 558 P.2d 988 (1976), the court addressed whether the attorney for a guardian owed a duty to the ward, and said yes; when an attorney undertakes to represent the guardian of an incompetent, he assumes a relationship not only with the guardian but also with the ward. In so holding, the court said the question of whether an attorney “is liable to” a non-client for negligent conduct involves the balancing of various factors, including: (1) the extent to which the transaction was intended to affect the non-client; (2) the foreseeability of harm to the non-client; (3) the degree of certainty that the non-client suffered an injury; (4) the closeness of connection between the defendant’s conduct and the injuries suffered by the non-client; (5) the moral blame attached to the attorney’s conduct; and (6) the policy of preventing future harm.

Assuming the term “is liable to” referred to whether the attorney owed a duty to the ward (as opposed to breached his duty), the *Fickett* factors in determining duty are probably no longer viable in light of *Gipson v. Kasey*, 214 Ariz. 141, 144, 150 P.3d 228, 231 (2007). *Gipson* held that foreseeability is not a factor the court should consider when making determinations of duty; and that whether a defendant acted reasonably under the circumstances or proximately caused injury to a particular plaintiff are factual inquiries reserved for the jury when assessing breach and proximate cause. Whether a duty exists is a legal question for the court. Duties of care may arise from special relationships based on contract, family relations, or conduct undertaken by the defendant. *Gipson v. Kasey*, 214 Ariz. at 145, 150 P.3d at 232. Given the current “special relationships” test, *Fickett* would probably come out the same way today, but not because of the case-specific factors on which it relied. See, e.g., *Cal-Am Properties Inc. v. Edais Eng'g Inc.*, 253 Ariz. 78, 509 P.3d 386, 389 (2022).

Today we revisit our holding in *Donnelly Construction Company v. Oberg/Hunt/Gilleland*, 139 Ariz. 184, 187, 677 P.2d 1292, 1295 (1984), which held that a design professional's duty to use ordinary skill, care, and diligence in rendering professional services extends both to persons in privity with the professional and to persons foreseeably affected by a breach of that duty. We hold that under Arizona's post-*Gipson* framework, which repudiated foreseeability as a basis for duty, design professionals lacking privity of contract with project owners do not owe a duty to those owners to reimburse them for purely economic damages.

An attorney might be liable to a non-client if the non-client was a third-party beneficiary of an attorney-client relationship. For a non-client to qualify as a third-party beneficiary, (1) there must be a clear intention to benefit the third party, (2) the intention to benefit must be both intentional and direct, and (3) it must clearly appear that the attorney and client intended to recognize the third-party as the primary party in interest (e.g., the beneficiary of a will). See *Franko v. Mitchell*, *supra*.

NEGLIGENCE/BREACH OF DUTY

Standard of Care

An attorney is required to perform his or her professional services with that degree of care, skill, diligence and knowledge commonly exercised by members of the profession. An attorney is required to use such skill, prudence and diligence as lawyers of ordinary skill and capacity commonly possess and exercise in the performance of tasks which they undertake. **Commercial Union Ins. Co. v. Lewis & Roca**, 183 Ariz. 250, 902 P.2d 1354 (Ct. App. 1995). The standard of care applicable to attorneys usually needs to be established by expert testimony. **Baird v. Pace**, 156 Ariz. 418, 752 P.2d 507 (Ct. App. 1987). But where an attorney's negligence is so grossly apparent that a lay person would have no difficulty recognizing it, or whether an attorney admits that he or she was negligent, expert testimony is not required. See **Asphalt Engineers v. Galusha**, 160 Ariz. 134, 770 P.2d 1180 (Ct. App. 1989). An attorney undertaking a task in a specialized area of the law must exercise the level of skill and knowledge possessed by those attorneys who practice in that specialty. **Day v. Rosenthal**, 170 Cal.App.3d 1125, 217 Cal.Rptr. 89 (1985).

Breach of Duty

The law does not presume that an attorney is guilty of malpractice merely because his or her client is dissatisfied with the results; rather the law presumes that an attorney has discharged his or her duty. **Molever v. Roush**, 152 Ariz. 367, 732 P.2d 1105 (Ct. App. 1986). Whether an attorney has fallen below the standard of care is generally an issue of fact for the jury. **Baird v. Pace**, 156 Ariz. 418, 752 P.2d 507 (Ct. App. 1987).

As noted above, expert testimony is not necessary to establish a breach of duty where the negligence is so grossly apparent that even a lay person would have no difficulty recognizing it. **Asphalt Eng'rs, Inc. v. Galusha**, 160 Ariz. 134, 770 P.2d 1180 (Ct. App. 1989). Mere errors in judgment or mistakes on unsettled points of law are insufficient to establish a breach of the standard of care. **Martin v. Burns**, 102 Ariz. 341, 429 P.2d 660 (1967). A violation of the rules of professional conduct does not, in and of itself, constitute malpractice. The rules are, however, evidence of the standard of care, and the requirements of the rules, along with expert testimony regarding whether the defendant attorney complied with those rules, is generally admissible. **Elliott v. Videan**, 164 Ariz. 113, 791 P.2d 639 (Ct. App. 1989).

Where an attorney represents clients with conflicting interests, and the dual representation works to the detriment of one client, the conflict of interest may constitute legal malpractice. **Hyatt Regency Phoenix Hotel Co. v. Winston & Strawn**, 184 Ariz. 120, 907 P.2d 506 (1995).

Proximate Cause: "Case Within a Case"

Finding an expert to opine that an attorney breached his or her duty is usually the easy part of a legal malpractice claim. The difficult part is establishing that the alleged negligence adversely affected the client. For a plaintiff to prevail on a malpractice case, he or she must prove a

proximate relationship between the alleged breach of duty and the plaintiff's damage. A legal malpractice action involves a "case within a case," i.e., a plaintiff must prove that but for the attorney's negligence, the result would have been different. See **Hyatt Regency Phoenix Hotel v. Winston & Strawn**, 184 Ariz. 120, 907 P.2d 506 (Ct. App. 1995). The trier of fact in the legal malpractice action views the underlying case from the standpoint of what a reasonable judge or jury would have decided but for the attorney's negligence. **Phillips v. Clancy**, 152 Ariz. 415, 733 P.2d 300 (Ct. App. 1986). See also **Siu v. Cavanagh Law Firm, PA**, 2018 WL 4763886 (Ariz. Ct. App. October 2, 2018).

Damages

An attorney is liable in damages to his or her client for injuries sustained as a proximate consequence of the attorney's negligence or malpractice. **Arizona Mgmt. Corp. v. Kallof**, 142 Ariz. 64, 688 P.2d 710 (Ct. App. 1984). Plaintiff may recover direct damages (actual monetary loss, attorney's fees and expenses), consequential damages (related economic losses, pain and suffering, injured reputation, etc.) and punitive damages. Negligence alone is insufficient to support a legal malpractice claim. The plaintiff must prove actual injury or damage. **Amfac Distribution Corp. v. Miller**, 138 Ariz. 152, 673 P.2d 792 (1983). An attorney is not liable for any damages that are remote or speculative. **Monthofer Invs. Ltd. P'ship v. Allen**, 189 Ariz. 422, 943 P.2d 782 (Ct. App. 1997). The proper measure of damages is the difference between what the plaintiff's pecuniary position is and what it would have been had the attorney not erred. **Kohn v. Schiappa**, 281 N.J.Super. 235, 656 A.2d 1322 (1995). The proper measure of damages for an attorney's negligence causing dismissal of an underlying claim is the compensatory and punitive damages awarded by the jury in trial of case within a case. **Elliott v. Videan**, 164 Ariz. 113, 791 P.2d 639 (Ct. App. 1989). Generally, although annoyance is a foreseeable result of an attorney's error, the emotional distress associated with the annoyance is not compensable in a legal malpractice action. **Pleasant v. Celli**, 18 Cal.App.4th 841, 22 Cal.Rptr.2d 663 (1993), *disapproved on other grounds*, **Adams v. Paul**, 46 Cal.Rptr.2d 594 (1995). A defense attorney can be held liable for an increase in the cost of liability insurance where the lawyer's malpractice results in a judgment against the client. **Transcraft, Inc. v. Galvin, Stalmack, Kirschner & Clark**, 39 F.3d 812 (7th Cir. 1994).

Attorney's fees are generally not recoverable in legal malpractice actions. See **Barmat v. John & Jane Doe Partners A-D**, 155 Ariz. 519, 520, 747 P.2d 1218, 1219 (1987).

Where the injury sustained by the client is an adverse judgment, the judgment sets the measure of direct damages. If the injury is claimed to be an excessive judgment, the proper measure of damages is the amount of the judgment, not the amount the client paid pursuant to the judgment. **Monthofer Investments, supra**. The damages are the difference between the judgment and what the judgment would have been had the attorney properly defended the case. **Gruse v. Belline**, 138 Ill.App.3d 689, 486 N.E.2d 398 (1985).

Punitive damages may be recoverable against an attorney where the attorney makes false representations with the intent to deceive the client, or where an attorney makes such

statements with reckless or conscious disregard of the truth. **Fiedler v. Adams**, 466 N.W.2d 39 (Minn. Ct. App. 1991). A punitive damage award of \$3 million in a malpractice action against a law firm arising from an undisclosed conflict of interest did not violate due process; the award was proportionate to the firm's financial position (approximately 3.1% of firm's gross revenues for the year) and less than three times the amount of compensatory damages. **Hyatt Regency Phoenix Hotel Co. v. Winston & Strawn**, 184 Ariz. 120, 907 P.2d 506 (1995).

As a general rule, a plaintiff in a legal malpractice case cannot recover damages for emotional distress if there is a monetary loss. **Reed v. Mitchell Timbanard, P.C.**, 183 Ariz. 313, 903 P.2d 621 (App. 1995). Cases from other jurisdictions, however, hold that where the only injury suffered by the plaintiff is emotional distress (i.e., where the lawyer's malpractice results in the loss of liberty or a family relationship, etc.) recovery for distress is permissible. See e.g., **Wagenmann v. Adams**, 829 F.2d 196 (1st Cir. 1987).

VICARIOUS LIABILITY

Attorneys are usually liable for the acts and omissions of their partners, and, under the rules of respondeat superior, for the torts of their employees and agents.

A partner in a law firm must make reasonable efforts to ensure that the firm is utilizing measures that ensure all lawyers in the firm conform to the rules of professional conduct. A lawyer having direct supervisory authority over another lawyer must make reasonable efforts to ensure that the other lawyer conforms to the rules of professional conduct. Rule 5.1, Arizona Rules of Professional Conduct. A partner in a legal partnership is jointly and severally liable for the tortious acts of other partners, employees or agents of the partnership if the acts in question were done in the ordinary course of the partnership's business. A.R.S. §§ 29-1021, 29-1026. Where a partner in a law partnership is aware of an impermissible conflict of interest but fails to resolve the conflict, both the individual lawyer and the partnership may be liable for punitive damages. **Hyatt Regency Phoenix Hotel Co. v. Winston & Strawn**, 184 Ariz. 120, 907 P.2d 506 (1995).

A shareholder of a professional corporation, or a member of a professional limited liability company, is personally and fully liable and accountable for any negligent or wrongful act or misconduct committed by the shareholder or member, or by any person under the shareholder's direct supervision and control, while rendering professional services on behalf of the professional corporation or the professional limited liability company. A.R.S. § 10-2234. See **Standage v. Jaburg & Wilk, P.C.**, 177 Ariz. 221, 866 P.2d 889 (Ct. App. 1993).

When lawyers engage in business transactions for their own benefit and without being assisted by the law firm, vicarious liability generally does not exist. **Sheinkopf v. Stone**, 927 F.2d 1259 (1st Cir. 1991).

A legal malpractice claim probably survives the death of a defendant attorney and can be brought against the attorney's estate. Rule 25(a), Arizona Rules of Civil Procedure.

ACTIONS

Claims

The most common causes of action against attorneys are negligence and breach of contract. Other potential causes of action include breach of fiduciary duty, racketeering, misrepresentation, fraud, conversion, malicious prosecution, abuse of process and indemnity.

Generally, a malpractice claim does not “arise out of contract” for purposes of the statute permitting an award of attorney’s fees in contract actions. A.R.S. § 12-341.01; **Barmat v. John & Jane Doe Partners A-D**, 155 Ariz. 519, 520, 747 P.2d 1218, 1219 (1987). However, a malpractice claim may arise out of contract for purposes of an award of attorney’s fees if the client hired the attorney to provide specifically identified services, and the attorney simply failed to perform (as opposed to performed below the standard of care) the requested services. **Towns v. Frey**, 149 Ariz. 599, 721 P.2d 147 (Ct. App. 1986); **Asphalt Eng’rs Inc., v. Galusha**, 160 Ariz. 134, 770 P.2d 1180 (Ct. App. 1989).

Defenses

The following defenses may apply depending upon the theory asserted and the facts of the case: (1) statute of limitations; (2) comparative negligence; (3) prematurity; (4) waiver; (5) failure to mitigate; and (6) superseding cause.

Statute of Limitations

Actions for legal malpractice are tort claims subject to a two-year statute of limitations, and the action must therefore be brought within two years after the action accrues. **Long v. Buckley**, 129 Ariz. 141, 629 P.2d 557 (Ct. App. 1981). For purposes of the statute of limitations, a cause of action for legal malpractice “accrues” when the client both (1) has sustained appreciable, non-speculative harm or damage as a result of such malpractice, and (2) knows, or in the exercise of reasonable diligence should now, that the harm or damage was a direct result of the attorney’s negligence. **Commercial Union Ins. Co. v. Lewis & Roca**, 183 Ariz. 250, 902 P.2d 1354 (Ct. App. 1995). In the litigation context, accrual does not occur until the plaintiff’s damages are certain and not contingent upon the outcome of an appeal. **Amfac Distribution Corp. v. Miller**, 138 Ariz. 152, 673 P.2d 792 (1983). “Litigation” for these purposes means adversary proceedings that have opposing parties and are contested – not an ex parte hearing or proceeding. **Cannon v. Hirsch Law Office, P.C.**, 222 Ariz. 171, 177, 213 P.3d 320, 326 (Ct. App. 2009) (bankruptcy proceeding in which creditor fails to file a complaint objecting to debtor’s discharge does not have the adversarial characteristics of “litigation;” but once a creditor has filed a complaint objecting to the debtor’s discharge, the proceedings take on an adversarial nature and thus constitutes “litigation” for the purposes of determining when a legal malpractice cause of action accrues); **Hayenga v. Gilbert**, 236 Ariz. 539, 342 P.3d 1279, 1282 (Ct. App. 2015) (the failure to name or join a defendant in an action arises “during the course of litigation,” and so does the failure to anticipate a named defendant’s defense).

A cause of action for legal malpractice in a criminal case accrues, and the statute of limitations began to run, when criminal proceedings terminate favorably to the client. **Glaze v. Larsen**, 207 Ariz. 26, 83 P.3d 26 (2004).

A third-party bad faith failure-to-settle claim accrues at the time the underlying action becomes final and non-appealable. **Taylor v. State Farm Mut. Auto. Ins. Co.** 185 Ariz. 174, 179, 913 P.2d 1092, 1097 (1996).

In the transactional context, the harm from an attorney's drafting of a deed occurred at the moment the client executed the deed, which diminished her interest in the property to less than the undivided 75 percent she had intended, even if damages may not have been fully ascertainable at that time. **Keonjian v. Olcott**, 216 Ariz. 563, 169 P.3d 927 (Ct. App. 2007). See also **Best Choice Fund, LLC v. Low & Childers**, P.C., 228 Ariz. 502, 269 P.3d 678 (Ct. App. 2012) (malpractice claim by mutual risk insurance company against law firm that provided legal services in connection with its formation accrued, and two-year statute of limitations began to run, when Department of Insurance (DOI) suspended insurer's certificate of authority).

Malpractice actions can be subject to the three-year statute of limitations applicable to claims based on oral contracts (or six-year limitations if in writing), rather than two year tort limitations period, where the client hired the attorney to perform a specifically identified service, and the attorney failed to perform (as opposed to perform below the standard of care) the requested service. **Towns v. Frey**, 149 Ariz. 599, 721 P.2d 147 (Ct. App. 1986)

Prematurity

Actual injury or damages must be sustained before a cause of action accrues. **Amfac Distribution Corp. v. Miller**, 138 Ariz. 152, 673 P.2d 792 (1983). In the litigation context, attorney negligence is not actionable until the underlying case in which the malpractice arose is finally resolved. **Commercial Union Ins. Co. v. Lewis & Roca**, 183 Ariz. 250, 902 P.2d 1354 (Ct. App. 1995).

Comparative Negligence

A client may be assessed a percentage of responsibility in a legal malpractice action if the client failed to follow the attorney's advice or instructions or otherwise interfered with the representation. **Theobald v. Byers**, 193 Cal.App.2d 147, 150, 13 Cal.Rptr. 864, 866 (1961); **Hansen v. Wightman**, 14 Wash. App. 78, 538 P.2d 1238 (1975).

Waiver

Waiver can be a defense if a client consents to a lawyer's conflict of interest. **Yaklin v. Glusing, Sharpe & Krueger**, 875 S.W.2d 380 (Tex. Ct. App. 1994). Additionally, a client who voluntarily elects not to appeal the underlying case, and thereby forecloses the resolution of whether there was judicial error or attorney malpractice, may be deemed to have waived his malpractice claim. **Segall v. Segall**, 632 So.2d 76 (Fla. Ct. App. 1993).

In *Grubaugh v. Blomo ex rel. Cty. of Maricopa*, 238 Ariz. 264, 359 P.3d 1008 (Ct. App. 2015), a client sued a lawyer for alleged malpractice occurring during the course of a mediation. A.R.S. § 12-2238 provides that mediation proceedings are confidential, except for specifically-defined exceptions. Lawyer argued that the client waived this confidentiality by suing her, just as a client waives the attorney-client privilege by filing suit. See, e.g., *State Farm Mut. Auto. Ins. Co. v. Lee*, 199 Ariz. 52, 56, 13 P.3d 1169, 1173 (2000). The court disagreed, finding mediation different from the attorney-client privilege context. The court did hold, though, that the client's claims based on the mediation process should be stricken. To hold otherwise, said the court, "would allow a plaintiff to proceed with a claim, largely upon the strength of confidential communications, while denying the defendant the ability to fully discover and present evidence crucial to the defense of that claim." *Id.* at 270, 359 P.3d at 1014.

Failure to Mitigate

If a client has a reasonable opportunity to mitigate, or perhaps even eliminate, the consequences of an attorney's malpractice, the client might be denied recovery for those consequences that could have been mitigated or avoided. *Wimsatt v. Haydon Oil Co.*, 414 S.W.2d 908 (Ky. 1967).

Superseding Cause

An attorney, even though negligent, is not liable for damages where the damages are caused by a superseding cause. A cause is considered to be a "superseding cause" if (1) it occurred after the original negligence, (2) it was caused by the original negligence, (3) it actively caused a result which would not otherwise have been caused by the original negligence, and (4) it was not reasonably foreseeable by the originally negligent attorney. *Warnick v. Moss & Barnett*, 490 N.W.2d 108 (Minn. 1992).

If you have questions regarding the information in this chapter, please contact the author or any JSH attorney.

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CHAPTER 18: EMPLOYMENT LAW

ARIZONA EMPLOYMENT PROTECTION ACT (AEPA) (A.R.S. § 23-1501)

Employment in Arizona is presumed to be at-will. This means that an employer may discharge an employee for any reason or for no reason at all, with or without notice. An employer, however, may not discharge an employee for a reason that violates Arizona's public policy or Arizona's employment laws. The public policy of the state is codified in the Arizona Employment Protection Act, A.R.S. § 23-1501.

HISTORY OF THE AEPA

Prior to the enactment of the AEPA, a number of court decisions recognized exceptions to the at-will rule – when termination contravened public policy or where there were implied promises of job security. In *Wagenseller v. Scottsdale Mem'l Hosp.*, 147 Ariz. 370, 710 P.2d 1025 (1985), *superseded in part* by A.R.S. § 23-1501, the Arizona Supreme Court held that an employer may be liable for civil damages if the employer discharges an employee for a reason that contravenes public policy. In so holding, the court reasoned that it had independent authority to determine what actions of the employer violated the public policy of the state.

In 1996, in response to the *Wagenseller* line of cases, the Legislature enacted the AEPA. The AEPA sharply circumscribed common law claims for wrongful termination by, among other things:

- Abolishing implied oral employment contracts altering at-will employment, and making only express written contracts actionable as an exception to the at-will doctrine;
- Limiting the instances in which a wrongful discharge claim could be brought; and
- Preventing employees from bringing common law claims for wrongful termination when the statute alleged to be violated provided a remedy for its violation.

WHEN MAY AN EMPLOYER BE LIABLE UNDER THE AEPA?

To state a claim for wrongful termination under the AEPA, an employee must demonstrate one of three theories of liability:

1. Termination in breach of a qualifying employment contract;
2. Termination in violation of a specific statute; or
3. Retaliatory termination.

TERMINATION IN BREACH OF A QUALIFYING WRITTEN CONTRACT

When Does a Written Contract Qualify?

To be actionable under the AEPA, a written contract must:

1. State that the employment relationship has a specified duration, or otherwise expressly restrict the right of either party to terminate the employment relationship; and
2. Be signed by both parties, or the party to be charged, or clearly set forth an express intent for it to be an employment contract.

A.R.S. § 23-1501(2). Partial performance of employment shall not be deemed sufficient to eliminate the requirements of § 23-1501(2). In addition, the AEPA's contract provisions do not affect the rights of public employees under the Arizona Constitution and state and local laws or the rights of employees and employers as defined by a collective bargaining agreement.

How the Courts Determine Whether a Document Qualifies

In determining whether an employment contract or other document satisfies the requirements of A.R.S. § 23-1501(2), the courts apply common law principles of contract interpretation and give effect to the parties' intent. ***Johnson v. Hispanic Broadcasters of Tucson, Inc.***, 196 Ariz. 597, 599, 2 P.3d 687, 689 (Ct. App. 2000). In *Johnson*, the court of appeals stated that if the employment agreement is reasonably susceptible to the interpretation that it guaranteed the employee employment for a specific length of time, thus restricting the employer from terminating him, extrinsic evidence is admissible to interpret the agreement's terms, but not to supply a required element. *Id.*

Although the AEPA requires contracts to be in writing to be actionable, contract terms limiting the right of the employer or employee to terminate the employment relationship can be either express or implied. ***Roberson v. Wal-Mart Stores***, 202 Ariz. 286, 292, 44 P.3d 164, 170 (Ct. App. 2002). Implied-in-fact terms may be found in an employer's policy statements regarding job security or employee disciplinary procedures, such as those contained in personnel manuals or memoranda. *Id.* Not all employer policy statements, however, create contractual promises. An implied-in-fact contract term is formed when a reasonable person could conclude that both parties intended that the employer's or the employee's right to terminate the employment relationship at-will had been limited. ***Demasse v. ITT Corp.***, 194 Ariz. 500, 505, 984 P.2d 1138, 1143 (1999).

How to Avoid a Court Finding an Implied-in-Fact Contract Term

Including disclaimers in personnel manuals that clearly and conspicuously tell employees that the manual is not part of the employment contract, and that their jobs are terminable at-will, helps insulate an employer from liability. *See, e.g., Hart v. Seven Resorts, Inc.*, 190 Ariz. 272, 278, 947 P.2d 846, 852 (Ct. App. 1997) (holding that the employer prevented the personnel manual from converting an at-will relationship into one for a definite term by including a disclaimer in "plain and common language"); ***Duncan v. St. Joseph's Hosp. & Med. Ctr.***, 183 Ariz. 349, 354, 903 P.2d 1107, 1112 (Ct. App. 1995).

Damages for Breach of Contract Under the AEPA

A.R.S. § 23-1501(A)(3)(a) limits the damages a terminated employee can recover under the AEPA for breach of contract. An employee who prevails on a breach of contract claim under the AEPA is entitled to recover the value of all sums that would have been due from the time of the breach through the end of the agreement, less any sums that reasonably could have been earned from substitute employment before the end of the agreement. Tort damages, on the other hand, including lost earnings, diminution in future earning capacity, lost insurance coverage, mental anguish/emotional distress, reputational harm, punitive damages, etc., are not recoverable for termination in breach of an employment contract, though, as noted below, tort damages may be available for retaliatory discharge or other employment-related claims.

Mitigation of Damages

A terminated employee is required to make reasonable efforts to reduce damages by trying to find substantially similar employment. However, a terminated employee need not accept employment that is not substantially similar to his or her prior employment, nor does the terminated employee have a responsibility to accept employment that imposes an undue burden or hardship.

Statute of Limitations

Under A.R.S. § 12-541(3), claims for damages for breach of an employment contract must be brought within one year after the cause of action accrues.

TERMINATION IN VIOLATION OF AN ARIZONA STATUTE

In the absence of an employment contract, an employee may nevertheless have a viable wrongful termination claim if the employer terminates the employment relationship in violation of a specific statute, or the public policy prescribed in or arising out of a statute.

A.R.S. § 23-1501(3)(b) sets forth a non-exhaustive list of Arizona statutes that restrict an employer's ability to terminate an employee:

- Arizona Civil Rights Act (ACRA) – A.R.S. § 41-1401 *et seq.*
- Occupational Safety and Health Act (OSHA) – A.R.S. § 23-401 *et seq.*
- Statutes governing hours of employment – A.R.S. § 23-201 *et seq.*
- Agricultural Employment Relations Act – A.R.S. § 23-1381 *et seq.*
- Statutes governing disclosure of information by public employees – A.R.S. § 38-531 *et seq.*

Damages for Termination in Violation of Statute

A.R.S. § 23-1501(A)(3)(b) authorizes tort claims only in the limited instances where an employer's conduct was in violation of a statute that otherwise provides no statutory remedy to the

terminated employee. If the statute provides a remedy to the employee for a violation of the statute, the remedies provided to an employee therein are the employee's exclusive remedies.

What if the Statute's Remedies are Unavailable to a Particular Employee/Claimant?

In addition to limiting tort claims to instances where a statute provides no remedy for its violation, A.R.S. § 23-1501(A)(3)(b) provides that "[a]ll definitions and restrictions contained in the statute also apply to any civil action based on a violation of the public policy arising out of the statute." Thus, in *Taylor v. Graham County Chamber of Commerce*, 201 Ariz. 184, 189, 33 P.3d 518, 523 (Ct. App. 2001), the court of appeals held that the terminated employee could not bring an AEPA claim for wrongful termination based on a violation of ACRA because ACRA provides an express remedy for its violation, despite the fact that ACRA's remedy was unavailable to the particular employee/claimant due to the employer's size.

No Claim for Wrongful Failure-to-Hire or Failure-to-Promote

Arizona courts have rejected tort actions for wrongful failure-to-hire, see *Burris v. City of Phoenix*, 179 Ariz. 35, 875 P.2d 1340 (Ct. App. 1993), and wrongful failure-to-promote, see *Mintz v. Bell Atl. Sys. Leasing Intern., Inc.*, 183 Ariz. 550, 553, 905 P.2d 559, 562 (Ct. App. 1995). Thus, the only tort action available in Arizona is for wrongful discharge.

Procedural Requirements

An employee is required to exhaust all administrative procedures provided by the statute before bringing a tort claim under § 23-1501(A)(3)(b).

Statute of Limitations

Under A.R.S. § 12-541(4), a claim for damages for wrongful termination must be brought within one year after the cause of action accrues.

RETALIATORY TERMINATION

Finally, a wrongful termination claim might arise if an employer discharges or otherwise penalizes an employee in retaliation for the employee's exercise of certain legal rights or reporting certain legal violations.

A.R.S. § 23-1501(A)(3)(c)(i)-(x) prohibits employers from terminating the employment relationship of an employee in retaliation for any of the following:

- The employee's refusal to commit an act or omission that would violate a statute or the Arizona Constitution;
- The disclosure by the employee in a reasonable manner that the employee has information or a reasonable belief that the employer, or an employee of the employer,

has violated, is violating or will violate the Constitution of Arizona or the statutes of this state to either the employer or a representative of the employer who the employee reasonably believes is in a managerial or supervisory position and has the authority to investigate the information provided by the employee and to take action to prevent further violations of the Constitution of Arizona or statutes of this state or an employee of a public body or political subdivision of this state or any agency of a public body or political subdivision;

- The exercise of rights under the workers' compensation statutes, A.R.S. § 23-901 *et seq.*;
- Service on a jury as protected by § 21-236;
- The exercise of voting rights as protected by § 16-1012;
- The exercise of free choice with respect to non-membership in a labor organization as protected by § 23-1302;
- Service in the national guard or armed forces as protected by §§ 26-167 and 26-168;
- The exercise of the right to be free from extortion as a condition of employment as protected by § 23-202;
- The exercise of the right to be free from coercion to purchase goods or supplies from any particular person as a condition of employment as protected by § 23-203; or
- The exercise of a victim's right to leave work as provided in §§ 8-420 and 13-4439.

Damages for Retaliatory Discharge

If the referenced statute provides a remedy to an employee for its violation, the remedies provided therein are the employee's exclusive remedies. If the statute does not provide a remedy to an employee for its violation, then A.R.S. § 23-1501(A)(3)(c) allows an employee to recover tort damages.

Typical Method of Proof

Prima Facie Showing

To recover for retaliatory discharge, the plaintiff-employee must first establish a prima facie case by showing that: 1) he engaged in a protected activity; 2) he suffered an adverse employment decision; and 3) there was a causal link between the protected activity and the adverse employment decision. *Villiarimo v. Aloha Island Air, Inc.*, 281 F.3d 1054, 1064 (9th Cir. 2002). With respect to causation, a plaintiff-employee must show by a preponderance of the evidence that engaging in the protected activity was one of the reasons for his firing, and that but for such activity he would not have been fired. *Id.* In some cases, causation can be inferred from timing alone where an adverse employment action follows on the heels of protected activity. *Id.* But timing alone will not show causation in all cases; rather, "in order to support an inference of retaliatory motive, the termination must have occurred fairly soon after the employee's protected expression." *Id.*

McDonnell Douglas Burden-Shifting

Once the plaintiff has established a prima facie case, the burden of production – but not persuasion – then shifts to the employer to articulate some legitimate, nondiscriminatory reason for the challenged action. *McDonnell Douglas Corp. v. Green*, 411 U.S. 792, 802 (1973). If the employer does so, the plaintiff must show that the articulated reason is pretextual “either directly by persuading the court that a discriminatory reason more likely motivated the employer or indirectly by showing that the employer’s proffered explanation is unworthy of credence.” *Villiarimo*, 281 F.3d at 1062. Although a plaintiff may rely on circumstantial evidence to show pretext, such evidence must be both specific and substantial. Note that while intermediate evidentiary burdens shift back and forth under this framework, the ultimate burden of persuading the trier of fact that the defendant retaliated against the plaintiff remains at all times with the plaintiff.

Statute of Limitations

The statute of limitations applicable to retaliatory discharge claims is one year. See A.R.S. § 12-541(4).

THE ARIZONA CIVIL RIGHTS ACT (A.R.S. § 41-1461 ET SEQ.)

The Arizona Civil Rights Act (ACRA) makes it an unlawful employment practice for covered employers, employment agencies and labor organizations, to discriminate against any individual based on race, color, religion, sex, age (40 years old or older), national origin, or disability.

Who is Subject to ACRA?

Employers

Under A.R.S. § 41-1461(7), an “employer” for purposes of ACRA liability means:

Employers with fifteen or more employees during twenty or more weeks of the current or preceding year, or a person who has one or more employees in the current or preceding calendar year and any agent of that person, to the extent that person is alleged to have (i) committed any act of sexual harassment or (ii) discriminated against anyone for opposing sexual harassment or making a charge, testifying, assisting or participating in any manner in an investigation, proceeding or hearing arising from sexual harassment.

Employment Agencies

Under A.R.S. § 41-1461(8), an “employment agency” means any person regularly undertaking with or without compensation to procure employees for an employer or to procure for employees opportunities to work for an employer.

Labor Organizations

Under A.R.S. § 41-1461(9), a “labor organization” means a labor organization and any agent of a labor organization, and includes:

- Any organization of any kind in which fifteen or more employees participate and that exists for the purpose, in whole or in part, of dealing with employers concerning grievances, labor disputes, wages, rates of pay, hours or other conditions of employment and
- Any conference, general committee, joint or system board or joint council that is subordinate to a national or international labor organization.

ACRA Exemptions

ACRA does not apply to:

- Employers with less than fifteen employees during twenty or more weeks of the current or preceding year;
- The United States or any department or agency thereof;
- Corporations wholly owned by the United States;
- Indian tribes;
- Bona fide private membership clubs, other than labor organizations, that are exempt from taxation under section 501(c) of the 1954 Internal Revenue Code;

Unlawful Employment Practices

A.R.S. § 41-1463 sets forth a list of unlawful employment practices. In addition, the Arizona Attorney General’s Office, the agency charged with ACRA’s enforcement, provides a list of employment discrimination examples, which includes:

- Failing or refusing to hire or promote individuals for discriminatory reasons;
- Providing different pay, benefits or other terms of conditions and employment;
- Segregating jobs or work sites based on protected characteristics;
- Sexual harassment;
- Engaging in or tolerating harassment because of race, color, national origin, religion, age or disability;
- Pregnancy discrimination;
- Failing to provide a reasonable accommodation for disabled persons;
- Treating individuals differently because they have complained about discrimination (retaliation); and
- Treating an individual less favorably because of the results of genetic testing.

See www.azag.gov/civil-rights/discrimination/employment (last visited July 14, 2022).

Exempt Activities

The ACRA does not require any employer to grant preferential treatment to any individual or group because of the race, color, religion, sex or national origin of the individual or group on account of an imbalance which may exist with respect to the total number or percentage of persons of any race, color, religion, sex or national origin employed by any employer, in comparison with the total number or percentage of persons of that race, color, religion, sex or national origin in any community, state, section or other area, or in the available work force in any community, state, section or other area. See A.R.S. § 41-1463(L).

In addition, ACRA provides exemptions for certain types of discrimination. For example, it is not an unlawful employment practice:

- For an employer to hire and employ employees on the basis of the individual's religion, sex or national origin in those certain instances when religion, sex or national origin is a bona fide occupational qualification reasonably necessary to the normal operation of that particular business or enterprise.
- For an educational institution to hire and employ employees of a particular religion if the institution is in whole or in substantial part owned, supported, controlled or managed by a particular religion, or if the institution's curriculum is directed toward the propagation of a particular religion.
- For an employer to observe the terms of a bona fide seniority system or any bona fide employee benefit plan such as a retirement, pension, deferred compensation or insurance plan, which is not a subterfuge to evade the purposes of the age discrimination provisions of the Act, except that no seniority system or employee benefit plan may require or permit the involuntary retirement based on age.
- For an employer to apply different standards of compensation or different terms, conditions or privileges of employment pursuant to a bona fide seniority or merit system or a system which measures earnings by quantity or quality of production or to employees who work in different locations, provided that these differences are not the result of an intention to discriminate because of race, color, religion, sex or national origin.
- For an employer to give and act upon the results of any professionally developed ability test provided that the test, its administration or action upon the results is not designed, intended or used to discriminate because of race, color, religion, sex or national origin.

- For an employer to differentiate upon the basis of sex or disability in determining the amount of the wages or compensation to be paid to employees of the employer if the differentiation is authorized by the provisions of § 6(d) or § 14 of the Fair Labor Standards Act of 1938, 29 U.S.C. § 206(d).

See A.R.S. § 41-1463(H), (J).

Procedural Requirements of ACRA

Under A.R.S. § 41-1481, an aggrieved employee must file a claim with the Arizona Civil Rights Division (ACRD) within 180 days of the last discriminatory act, or with the Equal Employment Opportunity Commission (EEOC) within 300 days of the last discriminatory act, before initiating a lawsuit for the alleged discrimination. In *Peterson v. City of Surprise*, 244 Ariz. 247, 418 P.3d 1020 (Ct. App. 2018), a former police detective sued the City alleging it constructively discharged her in retaliation for reporting repeated instances of sexual harassment. The court of appeals reversed the verdict in her favor, holding that she had failed to exhaust her administrative remedies by filing a charge with the Arizona Civil Rights Division within 180 days of the alleged violation. The court held that she could not avoid the exhaustion requirement by alleging “illegal retaliation” instead of “gender discrimination in violation of the Arizona Civil Rights Act” when they were really the same claim.

Investigation

After a charge of discrimination is filed, the ACRD and/or the EEOC will begin an investigation of the allegations contained within the charge. Because the ACRA requires an employee to file a lawsuit within a year from the time the employee filed the charge, the ACRD investigates for a maximum of nine months. There are no time limits, however, for the EEOC investigation period. An investigation, whether conducted by ACRD or EEOC, may include conducting interviews, obtaining documents, and doing site visits. Generally, after investigation, the ACRD and/or the EEOC will determine either that no unlawful discriminatory act has occurred or that there is reasonable cause to believe that an unlawful discriminatory act has occurred. When the investigation is complete, whether or not the agency concludes that an unlawful discriminatory act has occurred, private parties retain the right to bring their own civil action within the time limits specified by law, i.e., within 90 days after receipt of the right-to-sue letter. Note that neither the ACRD nor the EEOC’s conclusions are binding.

Conciliation and Mediation

If the ACRD determines there is reasonable cause to believe that an unlawful employment practice has occurred, it will attempt to eliminate the alleged unlawful practice by informal methods of conciliation, mediation, and persuasion. If 30 days have passed following a determination of reasonable cause, and no conciliation agreement is reached, the ACRD may bring a civil action in state court against the alleged discriminator, or alternatively, issue a right-to-sue letter.

Damages for ACRA Violations

Since ACRA provides its own remedies for wrongful termination, such remedies become the exclusive remedy for an ACRA violation. Remedies available under ACRA are limited to:

- Reinstatement or hiring of employees with or without back pay;
- Front pay; and
- Reasonable attorney's fees.

See A.R.S. § 41-1481(G), (J).

Can a Prevailing Defendant Recover Attorney's Fees it Incurred?

A court may award attorney's fees to a prevailing defendant only if it finds that the plaintiff's action was frivolous, unreasonable, or without foundation, even though not brought in subjective bad faith. See *Harris v. Maricopa County Superior Court*, 631 F.3d 963 (9th Cir. 2011).

ARIZONA WAGE ACT (A.R.S. § 23-350 ET SEQ.)

The Arizona Wage Act, A.R.S. § 23-350 *et seq.*, prohibits an employer from procuring labor and services by a specific promise of compensation and then evading financial responsibility.

Requirements of the Act

Pursuant to A.R.S. § 23-351, every employer must establish at least two regular pay days each month, unless an employer's principal place of business is located – and payroll system is centralized – outside of Arizona. An employer whose principal place of business and payroll system is located outside Arizona may designate one or more days each month as fixed paydays. In addition, nonexempt employers must, with limited exceptions, pay on each regular payday all wages due employees up to such date.

What Happens When an Employment Relationship is Terminated?

If an employee voluntarily terminates, A.R.S. § 23-353(B) provides that the employee must be paid all wages due to him no later than the next regular payday. If an employee is terminated involuntarily, on the other hand, A.R.S. § 23-353(A) requires that the employee be paid all wages due to him within seven working days or the end of the next regular pay period, whichever is sooner.

Damages for Violation of the Arizona Wage Act

When an employer delays payment of wages due an employee without reasonable justification, A.R.S. § 23-355 authorizes the employee to recover treble the amount of unpaid wages. The Act's penalty provision applies to severance and bonus pay, in addition to regular wages.

Generally, the courts have limited treble damages to instances in which the employer has acted unreasonably or in bad faith. However, in at least two cases, the courts upheld treble damages awards against employers who neglected, through inept bookkeeping, to compensate employees for wages due. See *Patton v. County of Mohave*, 154 Ariz. 168, 172, 741 P.2d 301, 305 (Ct. App. 1987); *Apache E., Inc. v. Wiegand*, 119 Ariz. 308, 313, 580 P.2d 779, 774 (Ct. App. 1978).

Court's Discretion

A.R.S. § 23-352 provides that an employer may withhold a portion of an employee's wages if: (1) the employer is required or empowered to do so by state or federal law; (2) the employer has prior written authorization from the employee; or (3) there is a reasonable good faith dispute as to the amount of wages due.⁷ Consequently, a court has discretion to decline to award treble damages if it determines that the employer's failure to pay wages due arises out of a reasonable good faith dispute. In addition, the court may exercise its discretion to deny treble damages under § 23-355 for brief, good faith, inadvertent oversight immediately corrected upon notice. See *Crum v. Maricopa County*, 190 Ariz. 512, 950 P.2d 171 (Ct. App. 1997) (rejecting the assertion that any discretion to deny treble damages under § 23-355 is confined to delayed payments arising from good faith disputes).

Statute of Limitations

Under A.R.S. §§ 23-355, 12-541(5), a claim for unpaid wages and treble damages must be brought within one year after the cause of action accrues.

ARIZONA MINIMUM WAGE LAW (A.R.S. § 23-362 ET SEQ.)

A Brief History of the Arizona Minimum Wage Law

The Arizona Minimum Wage Law allows a terminated employee to recover statutory unpaid minimum wages (plus twice that amount) and interest within two years after a violation last occurs, or three years if the violation was willful. It also allows a claim for retaliatory discharge to be brought if an employee is terminated for asserting or assisting others to assert a minimum-wage claim or informing others about their minimum-wage rights. See A.R.S. § 23-364(E).

Minimum Wage Requirements

Under A.R.S. § 23-363, private employers are prohibited from paying their employees less than minimum wage, unless the employee regularly receives tips or gratuities, in which case special rules apply. This statute set the state minimum wage for 2020 at \$12 per hour, and outlined a

⁷ The Arizona district court held A.R.S. § 23-352(2) invalid to the extent it makes paycheck deductions revocable at the will of the employee. Such a precept conflicts with § 302 of the Labor Relations Management Act. *United Food & Com. Workers Loc. 99 v. Bennett*, 934 F. Supp. 2d 1167, 1216 (D. Ariz. 2013).

formula linked to the Consumer Price Index for recalculating it every year. The 2022 Arizona minimum wage is 12.80 per hour. See <https://www.azica.gov/sites/default/files/2022%20Minimum%20Wage%20Option%20Notification.pdf> (last visited July 14, 2022).

Special Rules for Tipped Employees

In the case of a tipped employee, the employer may pay the employee up to \$3.00 per hour less than minimum wage, if the employer can establish by its records of charged tips, or by the employee's declaration for federal insurance contributions act purposes, that for each week, when adding tips received to wages paid, the employee received not less than the minimum wage for all hours worked. A.R.S. § 23-363(C). Compliance with this provision is determined by averaging tips received by an employee over the course of the employer's payroll period, or any other period selected by the employer that complies with regulations adopted by the commission.

Exempt Employers

State and federal employers are exempt from the state minimum wage requirements. Also exempt are small businesses, defined as businesses with annual gross revenue of less than \$500,000, which are also exempt from federal minimum wage requirements. A.R.S. § 23-362(C).

Statute of Limitations

A civil action to enforce the Arizona Minimum Wage Law may be commenced no later than two years after a violation last occurs, or three years in the case of a willful violation, and may encompass all violations that occurred as part of a continuing course of employer conduct regardless of their date. A.R.S. § 23-364(H). The statute of limitations shall be tolled during any investigation of an employer by the commission or other law enforcement officer, but such investigation shall not bar a person from bringing a civil action under this article. *Id.*

ARIZONA MEDICAL MARIJUANA ACT (A.R.S. § 36-2801 ET SEQ.)

The Arizona Medical Marijuana Act (AMMA) applies to all Arizona employers, both public and private. Among its provisions, the AMMA grants employees certain protections from discrimination. Specifically, the AMMA provides that:

Unless a failure to do so would cause an employer to lose a monetary or licensing related benefit under federal law or regulations, an employer may not discriminate against a person in hiring, termination or imposing any term or condition of employment or otherwise penalize a person based on either:

1. The person's status as a cardholder.

2. A registered qualifying patient's positive drug test for marijuana components or metabolites, unless the patient used, possessed or was impaired by marijuana on the premises of the place of employment or during the hours of employment.

A.R.S. § 36-2813(B).

Discrimination Against Medical Marijuana Cardholders

As noted above, the AMMA prohibits employers from discriminating against employees who are medical marijuana cardholders. Accordingly, the fact that an employee reveals his or her status as a cardholder should be ignored when considering hiring or job placement. Moreover, because a person's status as a cardholder could be viewed as notice that the employee has a disability under the Americans with Disabilities Act, employers have additional reasons to be cautious when considering employment action against medical marijuana cardholders.

Eligible Cardholders

The current medical conditions that can qualify a patient for medical marijuana use are:

- Cancer
- Glaucoma
- HIV/AIDS
- Hepatitis C
- ALS (Lou Gehrig's Disease)
- Crohn's
- Alzheimer's
- Cachexia
- Chronic Pain
- Severe Nausea
- Seizures and Persistent Spasm

A.R.S. § 36-2801(3). Conditions not listed are not eligible for medical marijuana protection.

To obtain a medical marijuana card, a person must have:

1. A medical condition that qualifies for medical marijuana use; and
2. Written certification from a licensed caregiver in Arizona that states that the patient is likely to receive therapeutic or palliative benefit from the medical use of marijuana to treat the patient's debilitating medical condition.

If both of these requirements are met, the patient can apply with the State for a registry identification card. A.R.S. § 26-2801(18); A.R.S. § 36-2804.02(A)(1).

Protection from Positive Drug Tests for Marijuana

The AMMA also restricts an employer’s ability to take adverse employment action against a registered qualifying patient’s positive drug test for marijuana. The results of a drug test alone cannot support an adverse action against medical marijuana cardholders. If, in addition to a positive drug test, an employer has evidence that the employee used, possessed, or was impaired by marijuana on the worksite or during work hours, the employer may take disciplinary action against a medical marijuana cardholder under the AMMA.

In addition, A.R.S. § 36-2814 specifically states:

A. Nothing in this chapter requires:

* * *

3. An employer to allow the ingestion of marijuana in any workplace or any employee to work while under the influence of marijuana, except that a registered qualifying patient shall not be considered to be under the influence of marijuana solely because of the presence of metabolites or components of marijuana that appear in insufficient concentration to cause impairment.

B. Nothing in this chapter prohibits an employer from disciplining an employee for ingesting marijuana in the workplace or working while under the influence of marijuana.

Limited Protections

The AMMA does not specify any other protections for employees beyond those listed above. For example, the AMMA is silent regarding protecting employees for current or past marijuana use. Employers remain free to make employment decisions based on factors not covered by the AMMA, subject to the other employment laws governing employer actions. In addition, the AMMA’s protections do not technically cover activity that remains illegal under Federal law, including marijuana use. *See* 21 U.S.C. § 812(b). Employees are protected from discrimination only for possessing a card or failing a drug test; the use of marijuana is not subject to employment protection. A.R.S. § 36-2813. Likewise, given that medical marijuana use is not covered by the ADA, *see James v. City of Costa Mesa*, 700 F.3d 394, 397 (9th Cir. 2012) (holding that medical marijuana use constitutes “illegal use of drugs” under ADA), a cardholder cannot claim that medical marijuana use is a reasonable accommodation for a disability.

ARIZONA DRUG TESTING LAW (A.R.S. § 23-493)

Arizona Drug Testing Law provides protection from litigation to employers who take adverse employment action against an employee who fails a drug or alcohol test. A.R.S. § 23-493.06; A.R.S. § 23-493.07. The Act’s protections apply to all employers in Arizona, provided the employer’s drug testing policy meets several conditions discussed below.

The Act's Protections

Adverse Employment Action Based on a Positive Test

On receipt of a positive drug test or alcohol impairment test result that indicates a violation of the employer's written policy, or the refusal of an employee or prospective employee to provide a drug testing sample or alcohol impairment testing sample, an employer may use that test result or test refusal as a basis for disciplinary or rehabilitative actions. *See* A.R.S. § 23-493.05. Adverse employment action may include, but is not limited to, the following:

- A requirement that the employee enroll in an employer approved rehabilitation, treatment or counseling program, as a condition of continued employment;
- Suspension of the employee, with or without pay, for a designated period of time;
- Termination of employment; or
- In the case of drug testing, refusal to hire a prospective employee.

Protection from Litigation

Employers who have established a policy and initiated a testing program in accordance with the Act are immune from liability for the following actions, with one exception: implementing, monitoring or measures to assess, supervise or control the job performance of the employee, reassignment of an employee to a different position or job duties, or suspension or termination of employment. *See* A.R.S. § 23-493.06.

The single exception is when the employer's action was based on a false positive test result and the employer knew or clearly should have known that the result was in error and ignored the true test result because of reckless or malicious disregard for the truth or the willful intent to deceive or be deceived. *See* A.R.S. § 23-493.07.

If the employer complied with the provisions of the Act, there is a rebuttable presumption that the test result was valid. *See Id.* Moreover, there is no employer liability for any action based on a false negative drug test or alcohol impairment test, absent evidence of the employer's reckless or wanton conduct. *See Id.* Nor is the employer liable for monetary damages if its reliance on a false positive test result was reasonable and in good faith. *See Id.*

Requirements Regarding Scheduling of Tests

To obtain the benefits of the Act, the employer must follow these conditions regarding the timing and cost of drug tests:

1. Any drug testing or alcohol impairment testing by an employer normally shall occur during, or immediately before or after, a regular work period. The testing by an employer shall be deemed work time for the purposes of compensation and benefits for current employees.

2. An employer shall pay all actual costs for drug testing and alcohol impairment testing required of employees by the employer. An employer may, at its discretion, pay the costs for drug testing of prospective employees.
3. An employer shall pay reasonable transportation costs to current employees if their required tests are conducted at a location other than the employee's normal work site.

A.R.S. § 23-493.02.

Testing Policy Requirements

The Act mandates that drug or alcohol testing be carried out within the terms of a written policy distributed to every employee subject to testing, or which has been made available to employees in the same manner as the employer informs its employees of other personnel practices, and that meets the minimum requirements set forth in A.R.S. § 23-493.04(A). The employer shall inform prospective employees that they must undergo drug testing.

The written policy must contain at least the following:

1. A statement of the employer's policy respecting drug and alcohol use by employees.
2. A description of those employees or prospective employees who are subject to testing. [Note that § 23-493.04(D) requires that all compensated employees including officers, directors and supervisors, be uniformly included in the testing policy if an employer institutes a policy.]
3. The circumstances under which testing may be required.
4. The substances as to which testing may be required.
5. A description of the testing methods and collection procedures to be used.
6. The consequences of a refusal to participate in the testing.
7. Any adverse personnel action that may be taken based on the testing procedure or results.
8. The right of an employee, on request, to obtain the written test results.
9. The right of an employee, on request, to explain in a confidential setting, a positive test result.
10. A statement of the employer's policy regarding the confidentiality of the test results.

See A.R.S. § 23-493.04(A).

Testing Procedures

Finally, all sample collection and testing must be performed according to the conditions set forth in A.R.S. § 23-493.03.

EARNED PAID SICK LEAVE (A.R.S. § 23-371 ET SEQ.)

In November 2016, Arizona voters passed Proposition 206, the Fair Wages and Healthy Families Act. This proposition not only raised the minimum wage, but also required employers to give their employees paid sick leave. A.R.S. § 23-371 *et seq.*

Requirements of the Act

Pursuant to A.R.S. § 23-372(A), employees of an employer with fifteen or more employees shall accrue a minimum of one hour of earned paid sick time for every 30 hours worked, but employees shall not be entitled to accrue or use more than 40 hours of earned paid sick time per year, unless the employer selects a higher limit. Pursuant to A.R.S. § 23-372(B), employees of an employer with fewer than 15 employees shall accrue a minimum of one hour of earned paid sick time for every 30 hours worked, but employees shall not be entitled to accrue or use more than 24 hours of earned paid sick time per year, unless the employer selects a higher limit.

Employees are permitted to use earned paid sick time for a variety of purposes, including their own mental or physical illness, care of a family member with a mental or physical illness, closure of the employee's place of business due to a public health emergency, or absence necessary due to domestic violence. An employer may require documentation to substantiate the purpose of the earned paid sick time if used over three consecutive work days.

Retaliation Prohibited

A.R.S. § 23-374(A) makes it unlawful "for an employer or any other person to interfere with, restrain, or deny the exercise of, or the attempt to exercise, any right protected under" the Fair Wages and Healthy Families Act. Similarly, A.R.S. § 23-374(B) prohibits an employer from retaliating or discriminating against an employee or former employee because that person has exercised rights protected under the Act (such as filing a complaint with the Industrial Commission or the courts or participating in an investigation). Finally, under A.R.S. § 23-374(C), it is unlawful for an employer's absence control policy "to count earned paid sick time taken under this article as an absence that may lead to or result in discipline, discharge, demotion, suspension, or any other adverse action." Subsection (D) states that the protections of this section shall apply to any person who mistakenly but in good faith alleges violations of this article.

Under A.R.S. § 23-364(B), an employer that takes adverse action against a person within ninety days of a person engaging in activities protected by the Act (including requesting earned paid sick leave) raises a presumption that such action was retaliatory. The presumption may be rebutted by clear and convincing evidence that such action was taken for other permissible reasons.

As damages for retaliation, an employer "shall be required to pay the employee an amount set by the [Industrial Commission] or a court sufficient to compensate the employee and deter future violations, but not less than one hundred fifty dollars for each day that the violation continued or until legal judgment is final." This can include unpaid wages, unpaid earned sick time, civil penalties, or equitable relief. A.R.S. § 23-364(G).

If you have questions regarding the information in this chapter, please contact the authors or any JSH attorney.

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CHAPTER 19: CONSTRUCTION LAW

CONSTRUCTION DEFECT LITIGATION

Theories of Recovery

Strict Liability

Arizona does not recognize strict liability recovery for defective residential construction. California, on the other hand, has extended strict liability to cases involving construction defects in mass-produced housing, i.e., condominiums, townhouses, etc. Many construction defect counsel are migrating from California to Arizona, a fertile ground for construction defect litigation. California counsel will likely urge Arizona to adopt the California approach.

In *Menendez v. Paddock Pool Constr. Co.*, 172 Ariz. 258, 836 P.2d 968 (Ct. App. 1991), the court held that the theory of strict liability for a defective product did not apply to a plaintiff's suit against a contractor who built a swimming pool. The policy behind strict liability in tort is to shift costs to mass production manufacturers that can absorb those costs. Although some construction, such as standardized model construction assembled and manufactured by mass-production process for tract homes might fit this theory, a structural improvement to real property, such as a custom designed and constructed swimming pool, does not.

BREACH OF IMPLIED WARRANTY OF WORKMANSHIP/HABITABILITY

This is the most viable theory for pursuing a residential construction defect (CD) claim. Even in the absence of a specific contractual provision, the law implies a warranty on the part of the contractor to perform the agreed task in a good and workmanlike manner and in a manner benefiting a skilled contractor. See *Kubby v. Crescent Steel*, 105 Ariz. 459, 466 P.2d 753 (1970). The warranty is imposed by law and suit can be brought within eight years from the time the residence is completed. See A.R.S. § 12-552(A) (barring claims discovered more than eight years after substantial completion of an improvement to real property). Suit can be brought within nine years if the injury occurred during the eighth year, or if the defect was not discovered until the eighth year after completion. See A.R.S. § 12-552(B) (allowing an additional year for actions to recover damages if injury occurred or the defect was discovered in the eighth year after completion.)

In Arizona, subsequent purchasers can take advantage of the breach of implied warranty regarding latent defects. See *Richards v. Powercraft Homes, Inc.*, 139 Ariz. 242, 678 P.2d 427 (1984). Proof of a defect due to improper construction, design or preparation is sufficient to establish liability. See *Woodward v. Chirco Constr. Co., Inc.*, 141 Ariz. 514, 687 P.2d 1269 (1984). Contractors can bring a claim for breach of implied warranty against their design professionals, such as architects, under an implied warranty theory even if there is no privity of contract. *North Peak Constr., LLC v. Architecture Plus, Ltd.*, 227 Ariz. 165, 254 P.3d 404 (Ct. App. 2011).

The implied warranty is limited to hidden or latent defects that would not have been discoverable upon “reasonable inspection.” See **Hershey v. Rich Rosen Constr. Co.**, 169 Ariz. 110, 114, 817 P.2d 55, 59 (Ct. App. 1991). Reasonable inspection does not mean an inspection by an expert; the warranty applies to hidden defects that could not have been discovered by an average purchaser. *Id.* The implied warranty is not affected or superseded by any express warranty in a contract. See **Nastri v. Wood Bros. Homes, Inc.**, 142 Ariz. 439, 690 P.2d 158 (Ct. App. 1984). Further, an express waiver and disclaimer of the implied warranty by the original homeowner does not bind an innocent subsequent purchaser. *Id.* at 442, 690 P.2d at 161. Arizona has left open the question of whether a knowing waiver of the implied warranty is against public policy. *Id.* at 443, 690 P.2d at 162.

The test for determining whether or not there has been a breach of the implied warranty of workmanship and habitability is one of reasonableness. **Richards v. Powercraft Homes Inc.**, 139 Ariz. 242, 245, 678 P.2d 427, 430 (1984). The court must take into consideration the age of the home, its maintenance, and the use to which it has been put, among other factors, to make the factual determination at trial if a breach occurred. *Id.* This test is limited to defects that are latent. *Id.* Furthermore, the court will assess whether the work performed is comparable to work performed by a worker of average skill and intelligence. **Nastri** at 444, 690 P.2d 163.

A subsequent homeowner raising a breach of implied warranty claim can now recover attorney’s fees under A.R.S. § 12-341.01(A). **Sirrah Enterprises, LLC v. Wunderlich**, 242 Ariz. 542, 547, 399 P.3d 89, 94 (2017). In *Sirrah*, the Arizona Supreme Court determined that implied warranties are a contract term imputed into construction contracts that run to subsequent purchasers. *Id.* Thus, a breach of an implied warranty claim necessarily arises out of a contract and is subject to attorney’s fees pursuant to A.R.S. § 12-341.01(A). *Id.* The bottom line is that all homeowners, whether original or subsequent, may seek recovery of their attorneys’ fees and costs either directly under their contract or pursuant to statute.

Commercial structures and residential structures will be treated differently when determining who can utilize this theory of recovery. As discussed above, residential owners may bring an implied warranty claim whether they are original or subsequent purchasers. For commercial structures, only the original purchasers may bring a claim for implied warranty. **Hayden Bus. Ctr. Condo Ass’n v. Pegasus Dev.**, 209 Ariz. 511, 513, 105 P.3d 157, 159 (Ct. App. 2005). The reasoning is that commercial developers and purchasers are more sophisticated consumers who will perform their due diligence before the purchase.

The Arizona Supreme Court has expanded the potential defendants in an implied warranty of workmanship and habitability case. In **Lofts at Fillmore Condo Ass’n v. Reliance Commercial Constr.**, 218 Ariz. 574, 190 P.3d 733 (2008), the Supreme Court held that a contractor provides an implied warranty even though it was not the seller of the residence. It also allowed the buyer to bring a breach of warranty claim against the contractor, even though the buyer lacked privity of contract with the contractor. *Id.* at 578, 190 P.3d 737. In **Teufel v. American Family Mut. Ins. Co.**, 244 Ariz. 383, 419 P.3d 546 (2018), the Supreme Court held that a homeowner’s insurer had to defend its builder-vendor insured against a claim for negligent excavation of a mountainside

home that he builder built but never lived in. The defective construction claim alleged a stand-alone negligence claim that was independent of the real estate contract, and a policy exclusion for personal liability “under any contract or agreement” did not absolve the insurer of its duty to defend stand-alone tort or negligence claims. However, the Arizona Court of Appeals has so far declined to expand the implied warranty to subcontractors performing new home construction. See **Yanni v. Tucker Plumbing**, 223 Ariz. 364, 312 P.3d 1130 (Ct. App. 2013). *Yanni* holds that absent privity of contract, a homeowner may not bring a claim against a builder’s subcontractors for breach of the implied warranty of workmanship and habitability. *Id.* at 367-8, 312 P.3d 1133-4. The Court noted that the public policy concerns discussed in prior privity exception cases were not present. As a result, a homeowner’s claim for breach of the implied warranty of workmanship and habitability is limited to those with whom the homeowner directly contracts, general contractors, developers, and vendors.

At the time of publication of this Guide, the Arizona Supreme Court is considering whether Arizona’s public policy allows a homebuilder and homebuyer to supplant the implied warranty of habitability with an express warranty of their own choosing to address alleged construction defects. The court of appeals said no, it could not enforce a waiver of the implied warranty created by the Supreme Court. **Zambrano v. M&RC II, LLC**, 252 Ariz. 10, 496 P.3d 789 (Ct. App. 2021). The Supreme Court granted review on March 1, 2022, and is expected to issue a decision in due course.

Breach of Express Warranty

In addition to the implied warranty, a contractor may be sued for breaching an express provision in a contract. This theory is used in commercial construction disputes, and is a primary theory in residential disputes between contractors where the implied warranty does not apply.

Negligence

Recovery of construction defect damages under a negligence theory in Arizona is limited. See **Coldberg v. Rellinger**, 160 Ariz. 42, 770 P.2d 346 (Ct. App. 1988). The “Economic Loss Rule,” adopted in Arizona, will not allow a plaintiff to recover for defects to the structure itself under this theory, unless the structural damage is accompanied by personal injuries or damages to personal property that are caused by the defective structure. **Flagstaff Affordable Housing, LP v. Design Alliance, Inc.**, 223 Ariz. 320, 326-7, 223 P.3d 664, 670-71 (2010). The Economic Loss Rule is limited, however, to contracting parties. *Id.* at 323, 223 P.3d 667. See discussion on the Economic Loss Doctrine below. Relatedly, Arizona does not impose a tort duty on a design professional in favor of a person who suffers purely economic damages and is not in privity of contract with the design professional. **Cal-Am Properties, Inc. v. Edais Engineering, Inc.**, 253 Ariz. 78, 509 P.3d 386 (2022). In essence, a tort claim for professional negligence cannot be levied against a design professional for pure economic loss.

Breach of Fiduciary Duty

This theory is often alleged against the developer of a mass-housing project. The developer has the initial fiduciary obligation to the homeowners' association members. Once enough units are sold, the developer hands over the homeowners' association to the homeowners themselves. The developer is required to keep sufficient funds in the homeowners association to fund initial operating expenditures and reserve requirements. If the developer turns over the homeowners association without sufficient funds, the successor homeowners association will likely argue that the developer breached its fiduciary duty to adequately budget and fund for these expenditures which may have resulted in a deterioration of the community.

Fraud

Although often alleged, this theory is rarely proven, as a plaintiff must prove an intent to deceive. See *Echols v. Beauty Built Homes, Inc.*, 132 Ariz. 498, 647 P.2d 629 (1982) (showing of fraud requires (1) a representation; (2) its falsity; (3) its materiality; (4) the speaker's knowledge of its falsity or ignorance of its truth; (5) the speaker's intent that it be acted upon by the recipient in the manner reasonably contemplated; (6) the hearer's ignorance of its falsity; (7) the hearer's reliance on its truth; (8) the right to rely on it; (9) his consequent and proximate injury), In a construction defect context, the facts rarely support such a claim.

LIMITATIONS ON RECOVERY

Statute of Repose

A homeowner has up to eight years after a project has been substantially completed to file a construction defect claim. However, if the defect is discovered during the eighth year after completion, the claim may be made within the ninth year after the project has been substantially completed. See A.R.S. § 12-552. The filing of a class action lawsuit by the homeowners does not toll the statute of repose for unnamed putative class members. See *Albano v. Shea Homes, L.P.*, 227 Ariz. 121, 254 P.3d 360 (2011).

A.R.S. § 12-552 has always posed problems for developers and general contractors sued in the ninth year (perhaps even on the last day of the ninth year). In *Evans Withycombe v. W. Innovations, Inc.*, 212 Ariz. 462, 133 P.3d 1168 (Ct. App. 2006), the court of appeals held that the statute applies to contract-based claims but not common law indemnity claims and negligence claims, because the statute states that no action or arbitration "based in contract" may be instituted after the nine year limitation. The common law indemnity and negligence claims that are not subject to the statute of repose are often limited in their effectiveness as mechanisms for recovery. A negligence claim can only be brought in the construction context for personal injury or damages to an owner's property. It cannot be brought to recover damage to the structure itself. Similarly, a common law indemnity claim can only be successfully used if the person seeking indemnity (usually the general contractor) is free from any comparative fault. See

Evans at 241, 159 P.3d 551 (“One seeking a common law right to indemnity must be proven free from negligence in order to make any claim to indemnity”).

Contractual Limitation of Liability

Public policy does not prohibit contractual limitation of liability provisions in construction contracts or architect-engineer contracts; but the enforceability of such provisions is left to the jury. *1800 Ocotillo v. The WLB Group*, 219 Ariz. 200, 196 P.3d 222 (2008).

Economic Loss Doctrine

Economic loss refers to pecuniary or commercial damage, including any decreased value or repair costs for a product or property that is the subject of a contract between the plaintiff and defendant, as well as consequential damages such as lost profits. The economic loss doctrine states that recovery of purely economic loss falls within the area of contract law – not tort. *Flagstaff Affordable Hous. Ltd. P'ship v. Design All., Inc.*, 223 Ariz. 320, 323, 223 P.3d 664, 667 (2010). Applied to construction defect cases, this doctrine limits the use of tort claims such as negligence when the defect causes only damage to the building itself or other economic loss. *Id.* at 325, 223 P.3d 669. Such negligence claims are viable only if they involve injury to person or property. *Id.* (“[W]e use [economic loss doctrine] to refer to a common law rule limiting a contracting party to contractual remedies for the recovery of economic losses unaccompanied by physical injury to persons or other property..”). The court rejected the argument that the economic loss doctrine should apply only in cases in which a plaintiff also has contractual remedies against the same tortfeasor. Even where dismissal of a plaintiff’s negligence claim would leave him with no other cause of action against a particular defendant, the economic loss doctrine bars a plaintiff from proceeding in tort for purely economic damages.

In *Flagstaff*, the Supreme Court declined to extend tort recovery against an architect (under a theory of professional negligence) for purely economic loss in a construction defect case. The court clarified, however, that a plaintiff may recover in tort for purely economic loss if the contract so allows. The court reasoned that the economic loss doctrine applies in construction defect cases because construction contracts typically are negotiated on a project-specific basis and the parties should be encouraged to prospectively allocate risk and identify remedies within their agreements.

In *Sullivan v. Pulte Home Corp.*, 237 Ariz. 547, 354 P.3d 424 (Ct. App. 2015), the Arizona court of appeals held that a subsequent homeowner could not maintain a negligence cause of action against a homebuilder for economic losses arising from latent construction defects. Prior to this ruling, the question was open as to whether a negligence claim could be asserted by a subsequent purchaser many years beyond the eight year statute of repose under the auspice of the “discovery rule.” If that had been permissible, the subsequent purchaser would then have two years from the date of discovery of the latent defect to assert the negligence claim.

The ruling in *Sullivan* makes clear that absent a physical injury to persons or other personal property, neither original nor subsequent homeowners can bring a claim for negligence against the homebuilder in Arizona. Original homeowners are limited by the economic loss doctrine to

their contractual remedies, and subsequent homeowners are not able to bring a negligence claim at all, since the *Sullivan* court ruled that public policy did not support a legally recognizable duty flowing from homebuilders to subsequent purchasers. A homebuilder can only be liable for latent defects for up to eight years from substantial completion of the home. It bears noting that the *Sullivan* court expressly did not analyze whether a legally recognizable tort duty could arise by either common law or relationship of the parties. Future cases may test these areas, but for now, the law in Arizona is as described above.

Failure to Mitigate Damages

The plaintiff in a construction defect case must exercise reasonable care to mitigate damages. *Fairway Builders, Inc. v. Malouf Towers Rental Co.*, 124 Ariz. 242, 255, 603 P.2d 513, 526 (Ct. App. 1979). The party alleged to be in breach bears the burden of proving that the mitigation was reasonably possible, but was not reasonably attempted. *Id.* at 256, 603 P.2d 527.

SCOPE OF RECOVERABLE DAMAGES

Direct Damages

Repair costs are the most significant item of damages in a construction defect case. In Arizona, the law of damages for injuries to real property normally focuses on the loss in market value. However, if property can be replaced or repaired, and the cost of repairs is reasonable, the proper measure of damage is the repair/replacement, not to exceed the loss in market value.

Scope of repair and the associated costs are the chief issues in construction litigation. The issues typically involve a “battle of the experts.” Thus, hiring a competent, credible and convincing expert is crucial.

Recently, the California Court of Appeal held that there is no recoverable damage for code violations that pose no risk to health or safety and do not impair the structure.. Arizona, lacking many appellate rulings on construction defect issues, tends to follow California decisions.

Stigma

Plaintiffs will often claim that despite the fact repairs have been made, the obligation to disclose the repairs to future purchasers will result in a loss in market value. Courts allow claims for post-repair stigma only if supported by solid evidence—not mere conclusory claims of percentage losses. *Farmers Ins. Co. of Arizona v. R.B.L. Inv. Co.*, 138 Ariz. 562, 564, 675 P.2d 1381, 1383 (Ct. App. 1983) (citing *Gary v. Allstate Ins. Co.*, 250 So. 2d 168, 169 (La. Ct. App. 1971)). Thus, plaintiffs will likely be required to show other similarly-situated homes suffering a lower resale.

Loss of Use

Loss of use is recoverable. If a homeowner must be relocated, for example, the cost of replacement housing is equivalent to the lost use of the primary residence.

Punitive Damages

Punitive damages are often alleged, rarely proven. In Arizona, an award of punitive damages must be supported by evidence demonstrating an “evil mind.” Rarely will this be the case in a construction defect claim. From an insurance coverage perspective, punitive damages are covered by a standard commercial general liability policy absent any express exclusion to the contrary. In California, punitive damages are never covered by insurance as such coverage is void against public policy.

Emotional Distress

Emotional distress damages have recently been rejected as a recoverable damage in a construction defect claim.

Attorney’s Fees

Attorney’s fees are recoverable under a breach of contract/express warranty claim, which includes a breach of implied warranty of workmanship and habitability claim. An amendment to the pertinent statute affects who is considered the “prevailing party” entitled to fees. Previously, if plaintiff recovered anything, he was considered the prevailing party. Now, if a defendant makes a written settlement offer and does better at trial, defendant is considered the prevailing party. Note, however, that the defendant’s settlement offer must be higher than the plaintiff’s jury verdict plus attorneys’ fees incurred at the time of the settlement offer. *Hall v. Read Dev., Inc.*, 229 Ariz. 277, 279, 274 P.3d 1211, 1214 (Ct. App. 2012). This is helpful to defendants and should be considered in cases involving breach of contract/express warranty claims.

Expert Fees and Costs

In Arizona, the court “may” award expert fees in a contested dwelling action. See A.R.S. § 12-1364. Additionally, A.R.S. § 12-341.01 allows for recovery of attorneys’ fees to a successful party in any action arising out of a contract. The successful party is the party who wins a judgment, or who files an offer of judgment and does better than the offer at trial. The successful party may then recover expert fees as a sanction against the opposing party who refused to accept the formal offer.

THEORIES AVAILABLE TO DEVELOPERS

Express Indemnity

Express indemnity occurs when a written indemnity provision in a contract or agreement dictates the scope of the indemnity provided. Generally, express indemnity agreements are placed into two classes, general or specific. A general indemnity agreement does not specifically address the effect of the developer's own negligence on the subcontractor's obligation to indemnify the developer. A specific indemnity agreement does address the effect of the developer's negligence on the subcontractor's obligation to indemnify the developer. The distinction is important because under a general indemnity provision, a developer cannot obtain indemnity if they were actively negligent; they may only obtain indemnity if they were passively negligent. ***Grubb & Ellis Mgmt. Servs., Inc. v. 407417 B.C., L.L.C.***, 213 Ariz. 83, 86, 138 P.3d 1210, 1213 (Ct. App. 2006). A subcontractor could argue that a developer and/or general contractor who is negligent in any way is not entitled to indemnity under a general indemnity agreement. See ***Herstam v. Deloitte & Touche, LLP***, 186 Ariz. 110, 919 P.2d 1381 (Ct. App. 1996).

An indemnity agreement that attempts to require a subcontractor to indemnify the general contractor for the general contractor's sole negligence, even if the subcontractor had no negligence of its own, is invalid in Arizona by statute. A.R.S. § 34-226, A.R.S. § 32-1159. In 2019, the Arizona legislature expanded Section 32-1159 by enacting A.R.S. § 32-1159.01. This statute states that indemnity agreements that "purport[] to insure, to indemnify or to hold harmless the promisee from or against liability for loss or damages resulting from the negligence of the promisee" are void as against public policy. *Id.* In other words, pursuant to Section 32-1159.01, any construction contract clause requiring a contractor to defend another is limited to defending claims arising out of or related to that contractor's work.

However, after settling with a homeowner, a general contractor may obtain indemnity from the subcontractor pursuant to valid contractual indemnity language, so long as the claim does not arise out of the general contractor's sole negligence or willful misconduct. ***Amberwood Dev., Inc. v. Swann's Grading, Inc.***, 2017 WL 712269, at *3 (Ct. App. 2017). A general contractor does not need to prove that a subcontractor was negligent in performing its work if the contractual provision does not require them to. *Id.* at *2. Although the ***Amberwood*** case is unreported, it contains a helpful analysis of the harsh consequences a subcontractor can face under a narrow-form specific indemnity agreement.

See discussion of Indemnity issues below.

Comparative Indemnity

Typically, indemnity is an all-or-nothing proposition: either the indemnitee gets reimbursed all monies paid in defending the matter, or it gets nothing. Some have argued that this is a harsh result for indemnitees. Consequently, developers and subcontractors have argued for the adoption of a comparative indemnity scheme that ameliorates the harsh "all or nothing result" by applying comparative negligence concepts. While Arizona courts have yet to address the issue,

many jurisdictions have adopted such a scheme. The Arizona Legislature has made efforts to address the issue as well, but has so far not passed any legislation to enact such change.

Third Party Beneficiary

In some circumstances, a developer is not the general contractor and does not enter into a contract with the subcontractors. Although some agreements between the general contractor and the subcontractors might provide indemnity rights on behalf of the developer, other agreements might not. Where no indemnity provision exists, the developer might argue it was a third party beneficiary of the contract between the general contractor and subcontractor, putting the developer in a position to seek indemnification. However, for a person to recover as a third-party beneficiary in Arizona, the contracting parties must intend to directly benefit that person and must indicate that intention in the contract itself. *Sherman v. First Am. Title Ins. Co.*, 201 Ariz. 564, 567, 38 P.3d 1229, 1232 (Ct. App. 2002). If there is no indication that the contracting parties intended to grant the developer indemnification rights, then a developer's right as a third party beneficiary will likely fail.

Breach of Implied Warranty

See discussion above on Breach of Implied Warranty of Workmanship/Habitability.

LITIGATION PROCESS

Prior to the Initiation of the Lawsuit

In 2002, Arizona enacted the Arizona Purchaser Dwelling Act, which contemplates specific notice and opportunity to repair construction defects in an effort to resolve construction defect complaints without congesting the courts with time consuming and costly litigation. In 2019, significant amendments were made to the PDA. A purchaser must comply with § 12-1361 *et seq.*, before filing a dwelling action. Exceptions are made for construction defects that involve an immediate threat to life or safety of persons occupying or visiting the dwelling. See A.R.S. § 12-1362(A). If a purchaser fails to comply with the statute, the dwelling action must be dismissed. If this occurs after the statute of limitations or statute of repose, then the dwelling action is time barred.

Requirement of Notice

Before filing a dwelling action, the purchaser must give written notice to the seller by certified mail, return receipt requested, specifying in "reasonable detail the basis of the dwelling action." A.R.S. § 12-1363(A). Reasonable detail includes a detailed and itemized list describing each alleged construction defect, the location of each alleged construction defect observed by the purchaser in each dwelling that is the subject of the notice, and the impairment to the dwelling that has occurred as a result of each of the alleged construction defects, or is reasonably likely to occur if the alleged construction defects are not repaired or replaced. A.R.S. § 12-1363(Q).

The “seller” of the dwelling then “shall” forward the purchaser’s notice to the last known address of each construction professional (i.e., subcontractors) whom the seller “reasonably believes” is responsible for the defects alleged in the purchaser’s notice. A.R.S. § 12-1363(A).

Right to Inspect

Once the purchaser has given the required notice, the seller and/or builder, as well as the subcontractors whom the seller “reasonably believes” are implicated by the defect allegations, may inspect the dwelling to determine the nature and cause of the alleged defect and the nature and extent of any repairs that might be necessary to remedy the alleged defect. A.R.S. §§ 12-1362(B), 12-1363. If the seller or builder wishes to inspect the alleged defect, the purchaser must ensure that the dwelling is made available for inspection no later than ten days after the purchaser receives the seller’s request for inspection. The seller may then use any “reasonable measures” to inspect the dwelling, including testing to determine the nature and cause of the alleged defect. However, if any testing does occur and it alters the condition of the property, the seller must restore that property back to its condition before the testing occurred. *See* A.R.S. § 12-1363(B).

Response by Seller/Builder

Within 60 days after receipt of the notice of defect, the seller must send to the purchaser a good faith, written response by certified mail, return receipt requested. The response may include a notice of intent by the seller to repair or replace any alleged defects, including a reasonable description of all repairs, replacements, or compensation that the seller is offering to make and an estimate of the date that the remedy will be provided. *See* A.R.S. § 12-1363(C).

Failure of Seller/Builder to Respond to Notice

If the seller does not respond within 60 days of the notice of defect, the purchaser may file the dwelling action. *See* A.R.S. 12-1363(D).

Seller’s Right to Repair

One of the primary changes in the 2019 amendments to the PDA expands the seller’s right to repair. Prior to 2019, the seller was the only party allowed an opportunity to perform repairs at the dwelling. Section 12-1363(C) expands the right to offer and make repairs to the other construction professionals whom the seller “reasonably believes” are responsible for the alleged defects.

The process for offering and making repairs is set forth in Section 12-1363(E). Specifically, if the seller provides a notice of intent to repair or replace the alleged construction defects, the purchaser must allow the seller a reasonable opportunity to repair or replace the construction defects or cause the construction defects to be repaired or replaced pursuant to the following:

1. The purchaser and seller must coordinate repairs or replacements within 30 days after the seller's notice of intent to repair or replace was sent. If requested by purchaser, repair or replacement of alleged construction defects must be performed by a construction professional selected by the seller and consented to by purchaser.
2. Repairs or replacements must begin as agreed by the purchaser and the seller, or the seller's construction professionals, with reasonable efforts to begin repairs or replacements within 35 days after seller's notice of intent to repair or replace was sent.
3. All repairs or replacements must be completed using reasonable care under circumstances and within a commercially reasonable time frame considering the nature of the repair or replacement.
4. The purchaser must provide reasonable access for the repairs or replacements.
5. The seller is not entitled to a release or waiver solely in exchange for any repair or replacement made except that the purchaser and seller may negotiate a release or waiver in exchange for monetary compensation or other consideration.
6. At the conclusion of any repairs or replacements, the purchaser may commence a dwelling action or, if the contract for the sale of the dwelling or the community documents contain a commercially reasonable alternative dispute resolution procedure that complies with § 12-1366(C), may initiate the dispute resolution process including any claim for inadequate repair or replacement.

Evidentiary Issues

Before 2015, A.R.S. § 12-1361 *et seq.* attempted to promote cooperation between the seller and purchasers by determining certain information as admissible or not admissible in a subsequent action. Now, both parties' conduct during the repair or replacement process prescribed in A.R.S. § 12-1362(B)-(E) may be introduced in any subsequent dwelling action. Any repair or replacement efforts undertaken by the seller are not considered settlement communications or offers of settlement and are admissible as evidence. As a result, a purchaser or a seller who fails to participate in the dwelling action process may face adverse evidentiary consequences at trial.

REVISED LITIGATION AND TRIAL PROCESS

The 2019 amendments to the PDA set forth a new process for litigating and trying dwelling actions. The "construction professionals" now "shall be joined as third-party defendants." A.R.S. § 12-1362(D). Additionally, a dwelling action trial proceeds in a bifurcated process, in which the trier of fact "shall first determine if a construction defect exists and the amount of damages caused by the defect," and "identify each seller or construction professional whose conduct, whether by act or omission, may have caused, in whole or in part, any construction defect." *Id.* Second, the trier of fact shall then "determine the relative degree of fault by any defendant or

third-party defendant,” and “allocate the pro rata share of liability based on relative degree of fault.” *Id.* Notably, the seller has the burden of proving the pro rata share of liability for the third-party subcontractor defendants. *Id.*

Attorney’s Fees, Costs and Expert Witness Fees

The 2019 amendments to the PDA re-inserted a statute allowing for the recovery of attorneys’ fees in a construction defect action involving a dwelling. *See* A.R.S. § 12-1364(A). The court now “may” award “reasonable” attorneys’ fees to the prevailing party as to each contested issue in the action. To determine the appropriate attorneys’ fees award, the court is instructed to consider a number of factors, including whether the seller made repair offers before the purchaser filed the action, the purchaser’s response to the repair offers, and the relation between the fees incurred and the value of relief obtained as to each contested issue. *See* A.R.S. § 12-1364(B).

Insurance Coverage Issues

Insurers often face the question of whether their policies cover claims for construction defects. This question has two components: (1) the duty to defend and (2) the duty to indemnify. The threshold question is whether the insurer has a duty to defend. The duty to defend is broader than the duty to indemnify. Insurers have a duty to defend if there is any “potential” that any claim asserted against the insured is covered by the policy. ***United Servs. Auto. Ass’n v. Morris***, 154 Ariz. 113, 117, 741 P.2d 246, 250 (1987). Insurers must defend claims that are “potentially not covered and those that are groundless, false and fraudulent.” *Id.* If there is potential coverage for even one of the claims and not others, an insurer must provide a complete defense. ***Transamerica Ins. Grp. v. Meere***, 143 Ariz. 351, 360, 694 P.2d 181, 190 (1984). The analysis begins with the allegations of the complaint, but insurers must consider additional available information in assessing the duty to defend. Generally, if the complaint alleges that plaintiff sustained some sort of “property damage,” then the obligation to defend is triggered unless there are exclusions that apply.

In ***Lennar Corp. v. Auto Owners Ins. Co.***, 214 Ariz. 255, 151 P.3d 538 (2007), the court defined an “occurrence” under an insurance policy stemming from property damage caused from faulty workmanship. It also defined an insurer’s duty to defend claims of property damage occurring during the policy (even if a similar property manifested damage prior to the policy). And it defined an insurer’s obligation to investigate occurrences and rebut coverage when an insured makes a factual showing that a claim is covered. Multiple insurers claimed that neither faulty workmanship nor the natural consequences thereof constituted an “occurrence.” The insurers argued that the definition of an “occurrence” is limited to an accident, not a subcontractor’s intentional performance of faulty work. The court rejected this argument, holding that while faulty work alone does not constitute an occurrence, property damage resulting from faulty work may constitute an occurrence giving rise to coverage.

CGL Policies

Commercial General Liability (CGL) policies were never intended to cover the costs of fixing an insured/contractor's faulty construction. The purpose of CGL policies is not to act as a performance bond, but rather to cover damages caused by fortuitous events. As discussed below, faulty workmanship is not deemed a "fortuitous event." Prior to the construction defect litigation boom, faulty construction was usually handled in an informal manner between the contractor and the owner, with the contractor fixing its own defective work at its own expense to avoid litigation.

To trigger coverage under a CGL policy, the complaint must seek to recover for "property damage" caused by an "occurrence." In *U.S. Fidelity & Guar. Corp. v. Advance Roofing & Supply Co.*, 163 Ariz. 476, 788 P.2d 1227 (Ct. App. 1989), Homeowners Association hired Advance to install 250 new roofs on its buildings for \$253,000. Advance installed only 40 new roofs, and those roofs leaked and were defective. When sued for breach of contract and unjust enrichment, Advance asked its insurer to defend, but the insurer declined coverage asserting there was no "property damage" or "occurrence." The court of appeals agreed with USF&G and held that the complaint did not state a claim for "property damage," nor was the claim for faulty workmanship an "occurrence" because it was not an "accident."

To get around this ruling, plaintiffs' complaints now allege negligence claims and seek "property damage," to ensure that insurance coverage is triggered. Property damage is defined under most policies as physical injury to tangible property or loss of use of tangible property. Therefore, complaints now allege damages for costs to repair, as well as damages caused by the faulty workmanship, e.g. rain water leaked through defective roof damaging hardwood floor (property damage). Claims for faulty workmanship alone do not trigger insurance coverage, so there must also be consequential damages resulting from the faulty workmanship for coverage to be triggered. This position was reaffirmed in *Lennar Corp. v. Auto Owners Ins. Co.*, 215 Ariz. 255, 151 P.3d 538 (2007).

In *Desert Mountain Props. Ltd. P'ship v. Liberty Mut. Fire Ins. Co.*, 225 Ariz. 194, 236 P.3d 421 (Ct. App. 2010), the court of appeals clarified that for coverage to exist, the relevant inquiry is whether an "occurrence" has caused "property damage" – not whether the ultimate claim lies in contract or tort.

Faulty Workmanship

Generally, insurance does not cover the cost to repair or replace the insured's faulty workmanship. However, if property damage was caused to other areas of the building as a result of the faulty workmanship – such as the drywall, carpet or personal property, those damages are covered. This could include damages for loss of use or diminution in value as long as these damages flowed from the non-excluded property damage.

A different outcome might occur if the insured is a contractor who retained subcontractors, and the subcontractors caused the faulty workmanship. Enter the "Products-Completed Operation

Hazard” provision. “Products-Completed Operation Hazard” is defined as all property damage occurring away from premises the contractor owns or rent which arise out of work performed by the contractor or on the contractor’s behalf. *Double AA Builders, Ltd. v. Preferred Contractors Ins. Co., LLC*, 241 Ariz. 304, 306, 386 P.3d 1277, 1279 (Ct. App. 2016). A majority of courts has held that if all of the elements of the “Products-Completed Operation Hazard” provision are met (i.e. the damages arose after the operations were completed), coverage can exist for the subcontractor’s faulty workmanship performed on behalf of the insured/contractor. The apparent purpose of such a provision is to provide coverage for fortuitous latent defects caused by someone other than the insured.

Insurance coverage for faulty workmanship claims can be very complex and hinge upon the specific damages alleged and incurred, and also the specific language of the insurance policy. An insurer must analyze the claims against the insured separately from the claims against the insured’s subcontractors to ensure that it does not inappropriately deny coverage or reserve its rights on damages that should be covered.

SURETY ISSUES

What is a Surety Bond?

When someone acts as a surety, he or she essentially promises to pay for the performance of a contract or the debt of another party if that party does not perform his or her contract, or does not pay a debt secured by the surety bond. There are many types of surety bonds in use today. Contract surety bonds are bonds issued by a surety for a principal, guaranteeing performance of some obligation in connection with a construction project. The bond can be issued for a general contractor, a subcontractor or a sub-subcontractor. If the principal on the bond is the general contractor, the obligee (i.e., the person to whom the guarantee runs), is the owner of the project. If the principal on a surety bond is a subcontractor, then the obligee is the general contractor, and if the principal is a sub-subcontractor, the obligee is the subcontractor with whom the sub-sub has a contract.

Essentially, there are three types of contract bonds: bid bonds, performance bonds and payment bonds. Each of these bonds has conditions, and each has “penal sum” (i.e., the limit of the liability of the surety is limited to the amount specified in the bond). Liability of the surety on each of these bonds is limited by the penal sum of the bond.

RISKS AND OBLIGATIONS

Bid Bond

A bid bond is intended to keep frivolous bidders out of the bidding process by securing that the successful bidder will enter into the contract and provide the required performance and payment bonds. If the lowest bidder fails to honor these commitments, the owner is protected, up to the amount of the bid bond. The bid bond may be a forfeiture bond where the surety is liable to the

owner for a fixed amount, regardless of the damages to the owner, or, more commonly, the surety is liable under the bid bond for the lower of the bid bond penalty or the difference between the contractor's low bid and the contract price the owner must pay to the firm awarded the contract.

Performance Bond

A performance bond is issued after the contractor is awarded the contract. Technically, the performance bond is a joint and several promise by the surety and the bond principal to the obligee that the principal will fully and faithfully perform all its obligations in the contract. Essentially, this bond guarantees that if the contractor does not perform the contract in accordance with the plans and specifications and the terms of the contract, the owner will have a cause of action against the surety to secure completion of the project.

Often, the bond itself lists the surety's options upon the contractor's default. Under the Performance Bond published by the American Institute of Architects, if a surety exercises any of the listed options, the liability of the surety is limited to the penal sum of the bond. Other, more simplified versions of performance bonds might not include specific options for the surety. However, the traditional options of a surety are incorporated into the bond by a matter of custom. These options are as follows:

Finance the contractor. Under this option, the surety provides the defaulting contractor with sufficient funds to complete the job and pay its bills.

Undertake completion. Under this option, the surety contracts with either the original contractor or a new contractor to complete the project, regardless of expense. The surety simultaneously enters into a takeover agreement with the owner, under the terms of which the surety agrees to hire a contractor and complete the project in accordance with the terms of the contract documents.

Tender a new contractor to the owner. Under this option, the surety puts the completion contract out for bid and then tenders the lowest responsible bid to the owner. The owner, rather than the surety, enters into the completion contract with the contractor.

Choose the "negotiation/litigation" option. Although not strictly an option, the surety frequently decides that it (a) has no liability to the bond obligee, or (b) has insufficient information to honor or deny the claim and therefore leaves the completion of the project in the hands of the owner. The surety then either negotiates a settlement with the owner covering the cost of completion and losses the owner has sustained by reason of the contractor's breach, or the parties go to court.

Payment Bond

A payment bond protects laborers, material suppliers and subcontractors against non-payment for services provided at a construction project. Recovery under a payment bond, however, is

subject to restrictions and limitations imposed by statute, contract and/or the bond itself. *See, e.g., American Cas. Co. of Reading, PA v. D.L. Withers Constr.*, 204 Ariz. 382, 64 P.3d 210 (Ct. App. 2003) (holding that the general contractor was not a proper “claimant” on the bond when attempting to recover monies paid out to a substitute contractor to finish work for a breaching subcontractor who had originally obtained the bond). Since mechanic’s liens cannot be placed against public property, the payment bond might be the only protection these claimants have if they are not paid for the goods and services they provide to the project.

CONSTRUCTION LOAN AGREEMENT ISSUES

In *Great Western Bank v. LIC Development, LLC*, 238 Ariz. 470, 362 P.3d 1037 (Ct. App. 2015), the court of appeals held that a construction financing agreement that expressly obligates the lender to make loans is a binding commitment. Great Western Bank terminated its financing agreement with the developer before its agreed-upon expiration. As the developer was unable to obtain alternate financing, it defaulted on its loan. Great Western foreclosed and sued the developer’s guarantors for the balance. The guarantors filed a counterclaim, seeking affirmative relief for the lost profits resulting from Great Western’s early termination. Great Western argued that the financing agreement was not binding and was only guidance for financing, at Great Western’s discretion. The court of appeals disagreed, and held, based on long-established contract principles, that the agreement was binding regardless of the fact that loan requests were subject to case-by-case approval.

INDEMNITY ISSUES

Common Law Indemnity

Common law indemnity and implied contractual indemnity are equitable theories of recovery often sought by general contractors against subcontractors. This theory of recovery is available only in the absence of a written indemnity agreement. Generally speaking, any equitable theory of indemnity shares the same basis – one party’s obligation to make good a loss or damage another party has incurred.

Arizona expressly recognizes the principles of common law indemnity expressed by the RESTATEMENT (FIRST) OF RESTITUTION § 76 and § 78 (now encompassed in the RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT, §§ 22 and 23). The general rule is that a person who, in whole or in part, has discharged a duty he owes, but which as between himself and another should have been discharged by the other, is entitled to indemnity from the other, unless the payor is barred by the wrongful nature of his conduct. In Arizona, this means the plaintiff in a common law indemnity action generally must show: (1) it “discharged a legal obligation owed to a third party”; (2) for which the “indemnity defendant was also liable”; and (3) as between the two, “the obligation should have been discharged by the [indemnity] defendant.” *KnightBrook Ins. Co. v. Payless Car Rental Sys. Inc.*, 243 Ariz. 422, 424, 409 P.3d 293, 295 (2018).

Common law indemnity is an all-or-nothing proposition. This means that if the party seeking

indemnity is at fault for the damages, it is not entitled to common law indemnity at all. See *Evans Withycombe, Inc. v. W. Innovations, Inc.*, 215 Ariz. 237, 241, 159 P.3d 547, 551 (Ct. App. 2006) (“One seeking [a common law right to] indemnity ‘must be proven free from negligence’ ” in order to make any claim to indemnity.”). However, the nature of the fault must be more than just technical fault; in order to avoid liability under a common law indemnity theory it must be shown that the party seeking indemnity was a proximate cause of the underlying damages. See *Transcon Lines v. Barnes*, 17 Ariz. App. 428, 435, 498 P.2d 502, 509 (1972) (holding that indemnity plaintiff was more than just technically liable and therefore not entitled to indemnity).

TRANSFERRING THE RISK THROUGH AN INDEMNIFICATION CLAUSE

Due to the variety of risks encountered on a construction project, most construction contracts contain various risk transfer clauses that typically pass the risk to the contractor in the best position to guard against it. The most common way to transfer risk is through an indemnity clause. An indemnity clause is an agreement whereby the subcontractor (indemnitor) agrees to indemnify and defend the general contractor (indemnitee) for any loss arising out of the subcontractor’s work. In analyzing an indemnity agreement and its effect, close attention must be paid as to whether the agreement purports to require indemnification for the general contractor’s own negligence. When an indemnity provision is contained within a contract, it is called an express indemnity provision. When an express indemnity provision is present, it precludes any argument that common law indemnity (or implied indemnity) applies. *Grubb & Ellis Mgmt. Servs. v. 407417 B.C. LLC*, 213 Ariz. 83, 89, 138 P.3d 1210, 1217 (Ct. App. 2006).

In addition, if the terms of the indemnity provision are clear and unambiguous, courts will generally deem them to be conclusive. *Amberwood Dev., Inc. v. Swann's Grading, Inc.*, 2017 WL 712269, at *2 (Ariz. Ct. App. 2017). This could apply regardless of whether the loss occurred by reason of the indemnitee’s negligence, or for any reason other than the sole negligence or willful misconduct of the indemnitee. *Id.* For example, should the indemnity provision require the subcontractor to indemnify a general contractor for claims simply “arising out of or in connection with” the subcontractor’s work, courts will likely find that the subcontractor must do so, even if the general contractor was also negligent. *Id.* Courts are unlikely to impose requirements not explicitly included in the indemnity provision. *Id.* at *3.

SPECIFIC INDEMNITY AGREEMENTS

An indemnity agreement might attempt to require the subcontractor to indemnify the general contractor for the general contractor’s sole negligence, even if the subcontractor had no negligence of its own. These types of indemnity agreements are invalid in Arizona by statute and thus no longer effective in transferring the risk from the general contractor to the subcontractor. See A.R.S. § 34-226 and § 32-1159. A.R.S. § 32-1159 was further amended to invalidate indemnity agreements that require the subcontractor to indemnify the general contractor for the sole negligence of the general contractor’s agents, employees, or indemnitees.

Importantly, however, Arizona has determined that an insurance agreement requiring the subcontractor to purchase insurance covering the general contractor for its sole negligence does not offend the anti-indemnity statute. See *United States Fid. & Guar. Co. v. Farrar's Plumbing & Heating Co.*, 158 Ariz. 354, 762 P.2d 641 (Ct. App. 1988).

Although our courts will not allow a contractor to seek indemnity for its sole negligence, they will uphold an indemnity agreement whereby the subcontractor agrees to indemnify the general contractor for a loss caused by the general contractor's contributory negligence. See *Cunningham v. Goettl Air Conditioning, Inc.*, 194 Ariz. 236, 980 P.2d 236 (1999). An example of this type of provision is as follows:

Subcontractor agrees to hold harmless and indemnify General Contractor against all liability, costs, expenses, claims and damages General Contractor may at any time suffer or sustain or become liable for by reason of any accidents, damages or injuries to defenses or property or both, in any manner arising from the work performed under this subcontract, **regardless of whether such liability, costs, expenses, claims and damages are caused in part by any negligent act or omission of General Contractor**, its officer, agents, or employees.

These are "specific" indemnity agreements. In *Washington Elementary Sch. Dist. v. Baglino Corp.*, 169 Ariz. 58, 817 P.2d 3 (1991), the court examined a written indemnity agreement specifically stating that the obligation to indemnify applied "regardless of whether or not [the injury] is caused in part by a party indemnified hereunder." There, Baglino's negligence caused falling debris which injured a person on the job site. The school district was also partially negligent for inadequate supervision. The school district tendered its defense to Baglino and Baglino refused. Focusing on the words "caused in part" in the indemnity provision, the court held that the provision "clearly and unequivocally" indicated the parties' intent for indemnity to apply notwithstanding the indemnitee's active (contributory) negligence.

Given the foregoing, a general contractor need not provide clear and unambiguous terms in an indemnity provision to cover its own active or contributory negligence. *Id.* at 61, 817 P.2d 6. If the indemnity provision includes language sufficiently broad enough to encompass a general contractor's negligence, it likely will require the subcontractor to indemnify the general contractor regardless of the general contractor's actual or contributory negligence. *Id.* at 61-2, 817 P.2d 6-7. ("By using such broad language ["regardless of whether the injury is caused in part by a party indemnified"], it appears that the parties contemplated coverage for any type of damage caused by the negligent behavior of the indemnitor, even though also caused in part by the active negligence of the party indemnified."). However, this does not impact the requirement that the indemnity provision must clearly and unequivocally indicate that one party is to be indemnified.

General Indemnity Agreements

When language in an indemnity agreement does not specifically address the effect the indemnitee's negligence will have upon the indemnitor's duty to indemnify, the agreement is

usually considered a “general” indemnity agreement. *Estes Co. v. Aztec Constr., Inc.*, 139 Ariz. 166, 168, 677 P.2d 939, 942 (Ct. App. 1983). Under a general indemnity provision, if the general contractor seeking indemnity was actively (or contributorily) negligent, then it is not entitled to recover from the subcontractor. However, if the indemnitee was merely passively negligent (the classic example is where one party has only vicarious liability for the negligence of another) then the general indemnity clause is still valid. A subcontractor could argue that a developer and/or general contractor is not entitled to indemnity at all under a general indemnity agreement if it is found to be negligent at all. *Herstam v. Deloitte & Touche, LLP*, 186 Ariz. 110, 118, 919 P.2d 1381, 1389 (Ct. App. 1996).

Regardless of the type of indemnity provision, an indemnity agreement is often insufficient to guarantee an effective risk transfer because the subcontractor might not have the financial resources to satisfy its indemnity obligation. As a result, most general contractors require their subcontractors to purchase insurance coverage to cover the risks transferred by the indemnity agreement. As added protection for the general contractor, the construction contract might require the subcontractor to name the general contractor as an Additional Insured under the its Commercial Liability Policy (CGL).

SUBCONTRACTORS BOUND BY PROVISIONS INCORPORATED INTO CONTRACT EVEN IF NOT RECEIVED

Subcontractors have additional responsibilities when executing their subcontract agreements. In *Weatherguard Roofing Inc. v. D.R. Ward Constr.*, 214 Ariz. 344, 152 P.3d 1227 (Ct. App. 2007), the court held that a contract between a subcontractor and general contractor that “incorporated the attached general conditions” were a binding part of the prime contract even though the general conditions were not provided to the subcontractor. The general conditions contained an arbitration provision which the subcontractor did not receive and of which it was not aware. The court held that even though the general conditions were not attached, the subcontractor could have and should have made an effort to obtain them.

Transferring Risk Through an Additional Insured Endorsement

As mentioned above, an indemnity agreement can effectively protect a contractor from the many forms of liability it might encounter on a construction project. But the extent of this protection is limited to the subcontractor’s financial resources. Thus, to guarantee protection, many construction contracts require the subcontractor to name the general contractor as an Additional Insured under its Commercial Liability Policy (CGL). Most subcontractors fulfill this contractual obligation by purchasing a broad form additional insured endorsement. A typical endorsement reads as follows:

“Who is an insured” is amended to include as an insured the person or organization shown in the Schedule as an insured, but only with respect to liability arising out of your work (or your operations) for that insured by or for you or premises owned by or rented to you.

The subcontractor can also have the general contractor named as an additional **named** insured. Generally, this affords coverage to the general contractor on par with the coverage afforded to the named insured/subcontractor. An additional insured is entitled to a defense even absent a showing of actual causation. *Regal Homes, Inc. v. CNA Ins. Co.*, 217 Ariz. 159, 163, 171 P.3d 610, 615 (Ct. App. 2007). All that is needed is a connection between the work performed and the alleged harm.

When a general contractor is included as an additional insured (rather than an additional **named** insured) through an additional insured endorsement, the issue often arises as to what extent the policy provides coverage for the general contractor's sole or direct liability. In *Double AA Builders, Ltd. v. Preferred Contractors Ins. Co., LLC*, 241 Ariz. 304, 386 P.3d 1277 (Ct. App. 2016), the court of appeals held that the additional insured's coverage was limited under the policy and its definitions. "[A]n Additional Insured receives coverage for conduct of the Named Insured and certain of those acting on the Named Insured's behalf, and the Additional Insured is itself treated like a Named Insured, with coverage for its own conduct, only if such conduct relates to the Additional Insured's performance of ongoing operations for the original Named Insured." *Id.* at 307, 386 P.3d 1280. The additional insured's coverage is also limited in that it is co-extensive with that of the named insured; it cannot be greater. *Id.*

Other jurisdictions have also based their decisions on the language of the additional insured endorsement. For example, where the language is ambiguous, some courts have found that coverage for the additional insured was not limited to additional insured's vicarious liability. *See, e.g., Dayton Beach Park No. 1 Corp. v. Nat'l Union Fire Ins. Co.*, 175 A.D.2d 854, 573 N.Y.S.2d 700 (1991). In *Dayton Beach*, the policy provided that an additional insured would be covered "only with respect to liability arising out of operations performed for [additional insured] by or on behalf of named insured." The court held that coverage to the additional insured was not limited to the additional insured's vicarious liability for named insured's negligence.

In *Consolidation Coal Co. v. Liberty Mut. Ins. Co.*, 406 F. Supp. 1292 (W.D. Pa. 1976), an additional insured was named, "but only with respect to acts or omissions of the named insured in connection with the named insured's operation." The named insured's employee was injured and alleged that the additional insured was solely negligent. The court found that the additional insured was not covered under the named insured's policy, because the most appropriate construction of the policy was that the additional insured was insured under the policy only when the negligent acts of the named insured caused the loss. To interpret the endorsement in a way that found coverage for the additional insured's direct liability, said the court, would transform the "but only" language into "arising out of."

Arizona courts have so far looked to the policy language to determine the extent of coverage for additional insureds. Insurance carriers will often take the position that the additional insured has no right to expect coverage for its own negligence, especially if the accident arose out of activities unrelated to the named insured's performance. In future cases, Arizona courts will likely continue to enforce the parties' intentions, but such intentions are not always clear. Thus, the best way to avoid this problem is to ensure there is a clear written understanding among the contracting

parties, as well as the carrier, as to what liabilities are intended to be covered under the additional insured language.

ENFORCEABILITY OF ARBITRATION PROVISIONS

In *Harrington, et al., vs. Pulte Home Corp.*, 211 Ariz. 241, 119 P.3d 1044 (Ct. App. 2005), the court of appeals upheld the enforceability of arbitration clauses between plaintiff homeowners and defendant developers/vendors. The court initially focused on the homeowner’s “reasonable expectations” and looked at seven critical factors. Those factors were:

1. Prior negotiations between the parties;
2. What can be inferred from the circumstances;
3. Are the terms bizarre or oppressive;
4. Does a term eviscerate the non-standard terms explicitly agreed upon;
5. Does the term eliminate the dominant purpose of the transaction;
6. Whether the provision can be understood; and
7. Whether there are any other factors relevant to what the parties reasonably expected.

The contract terms in this case were in large, easy to read font and not hidden or obscured. Nor were the specific terms bizarre or oppressive; they were in fact congruent with the public policy favoring alternative dispute resolution. The court determined that there was no reasonable belief that the homeowners would not have entered into the contract had they known the clause was present. As such the homeowners were bound by the arbitration clause and had waived their right to a jury trial.

If you have questions regarding the information in this chapter, please contact the authors or any JSH attorney.

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CHAPTER 20: PRODUCT LIABILITY LAW

STRICT LIABILITY

When a product is involved in an injury-causing event, the injured person can file a lawsuit based on a number of theories including negligence, breach of warranty and breach of contract. However, the strongest basis for a suit is strict liability. Unlike the typical negligence lawsuit, the burden of proof is much easier for a plaintiff in a strict products liability lawsuit. The plaintiff need only prove that the defendant manufactured the product and that it was defectively designed or manufactured when delivered to the plaintiff. Failure to provide proper instructions or warnings with the product may also form the basis for a product liability suit. Under strict liability, the manufacturer of a defective product may be liable notwithstanding its exercise of all possible care during the manufacturing process, even if the user/consumer did not buy the product from or enter into any contract with seller.

Arizona has codified the common law of products liability in A.R.S. §§ 12-681 to -689. In addition to Arizona's statutory scheme for products liability cases, there is also a very detailed Restatement covering products liability, The RESTATEMENT (THIRD) OF TORTS: PROD. LIAB. (1998), which the courts are now interpreting. However, the applicability of the products liability Restatement is likely to be limited in Arizona because our courts generally look to the Restatement in the absence of controlling authority; and here Arizona has a settled body of product liability law. *See, e.g., Antone v. Greater Ariz. Auto Auction*, 214 Ariz. 550, 555, 155 P.3d 1074, 1080 (Ct. App. 2007) (refusing to consider whether to adopt Restatement Third § 20 because outcome "rests on settled principles of Arizona law"); *Gariby ex rel. Fleming v. Evenflo Co.*, 2012 WL 506742, at *3, n.4 (Ariz. Ct. App. Feb. 16, 2012) ("Gariby has not provided us with any authority suggesting Restatement § 13 has been adopted in Arizona or that Arizona otherwise recognizes liability for a successor's post-sale failure to warn.").

Arizona statutes provide definitions for use in products liability actions:

- "Manufacturer" means a person or entity that designs, assembles, fabricates, produces, constructs or otherwise prepares a product or component part of a product before its sale to a user or consumer.
- "Product" means the individual product or any component part of the product that is the subject of a product liability action.
- "Seller" means a person or entity, including a wholesaler, distributor, retailer or lessor, engaged in the business of leasing any product or selling any product for resale, use or consumption. Individuals such as auctioneers are not considered "sellers" for products liability purposes. *Antone*.

- “State of the Art” means the technical, mechanical and scientific knowledge of manufacturing, designing, testing or labeling the same or similar products which was in existence and reasonably feasible for use at the time of manufacture.

If the plaintiff can successfully prove a strict liability case, he is entitled to regular tort damages (including damage caused by the defective product to other property, lost wages, medical expenses, and pain and suffering). The plaintiff is not, however, entitled to recover for pure “economic loss,” meaning lost profits and the cost of replacing the defective product itself. Damage or injury to a person need not necessarily occur in order to recover for damage to other property; plaintiff may recover if the defect is unreasonably dangerous to persons or other property. *Salt River Project v. Westinghouse Elec. Corp.*, 143 Ariz. 368, 694 P.2d 198 (1984), *abrogated on unrelated grounds by Phelps v. Firebird Raceway, Inc.*, 210 Ariz. 403, 111 P.3d 1003 (2005); *Arrow Leasing Corp. v. Cummins Ariz. Diesel, Inc.*, 136 Ariz. 444, 666 P.2d 544 (Ct. App. 1983).

Punitive damages are recoverable only if plaintiff can show that the defendant acted with an “evil mind.” Evidence that the defendant knew about previous accidents, or that the defendant’s product was unreasonably dangerous, but continued to market it without correcting the defect(s), can show an evil mind warranting punitive damages. But continuing to market a product after several accidents occurred is not enough to show the evil mind necessary for punitive damages in a products liability action. *Piper v. Bear Med. Sys., Inc.*, 180 Ariz. 170, 883 P.2d 407 (Ct. App. 1993), *superseded by statute on unrelated grounds as stated in Watts v. Medicis Pharm. Corp.*, 236 Ariz. 511, 342 P.3d 847 (Ct. App. 2015), *vacated on other grounds*, 239 Ariz. 19 (2016).

STRICT LIABILITY THEORIES

Arizona has adopted the view of the RESTATEMENT (SECOND) OF TORTS, § 402A that defendants are strictly liable for unreasonably dangerous products. To establish a *prima facie* case for strict liability, a plaintiff must prove that: (1) the defendant manufactured the product; (2) the product was sold in a defective condition; (3) the defective product created an unreasonable danger to plaintiff when used in a reasonably foreseeable manner; (4) the product reached plaintiff without substantial change in its condition; (5) plaintiff sustained damages; and (6) the defect in the product proximately caused the damage. See *Jimenez v. Sears, Roebuck & Co.*, 183 Ariz. 399, 904 P.2d 861 (1995); *Anderson v. Nissei ASB Mach. Co.*, 197 Ariz. 168, 3 P.3d 1088 (Ct. App. 1999).

Defective Design

A product is defectively designed if the plaintiff can demonstrate that the product failed to perform as safely as an ordinary consumer would expect when used in an intended or reasonably foreseeable manner. A product is also considered defective in design if the plaintiff proves that the product’s design proximately caused his injury and the defendant fails to prove, in light of relative factors, that on balance the benefits of the challenged design outweigh the risk inherent in such a design. *Moorer v. Clayton Mfg. Corp.*, 128 Ariz. 565, 627 P.2d 716 (Ct. App. 1981). If the

plaintiff proves the product is defective, he need not prove fault on the part of the defendant in order to recover. He still must prove, however, that the defective design proximately caused his damages.

Defective Manufacture

A plaintiff can recover for damages caused by a defectively manufactured product by proving that the product, though properly designed, left the product in a condition other than intended, and that the defective condition of the product was the proximate cause of the accident. As discussed above, under the theory of strict liability, a plaintiff does not need to prove the defendant's fault to recover.

Failure to Warn

Manufacturers and sellers of products have a duty to warn of dangers inherent in the intended use of a product, as well as dangers that can be reasonably anticipated. *Kavanaugh v. Kavanaugh*, 131 Ariz. 344, 641 P.2d 258 (Ct. App. 1981). In Arizona, inadequate instructions or warnings make a product defective when adequate instructions or warnings from the manufacturer could have reduced or avoided the foreseeable risks of harm posed by the product. *Powers v. Taser Int'l, Inc.*, 217 Ariz. 398, 174 P.3d 777 (Ct. App. 2007). Not only must manufacturers provide adequate operating instructions, but they must also warn of the possible consequences resulting from the failure to follow the instructions. The court will consider the adequacy of the warning label, print size, color and conspicuousness, and the language of the warning. *Brown v. Sears, Roebuck & Co.*, 136 Ariz. 556, 667 P.2d 750 (Ct. App. 1983); *Shell Oil Co. v. Gutierrez*, 119 Ariz. 426, 581 P.2d 271 (Ct. App. 1978), *abrogated on unrelated grounds by Conklin v. Medtronic, Inc.*, 245 Ariz. 501, 431 P.3d 571 (2018). Under the learned intermediary doctrine, "the manufacturer's duty to warn is ordinarily satisfied if a proper warning is given to the specialized class of people that may prescribe or administer the product." *Watts v. Medicis Pharm. Corp.*, 239 Ariz. 19, 365 P.3d 944 (2016) (under learned intermediary doctrine, drug manufacturer discharged its duty to public to warn about dangerous propensities of drug if it properly warned administering physician of contraindications and possible side effects of the drug). In *Watts*, the Arizona Supreme Court held that the learned intermediary doctrine does not violate Arizona's anti-abrogation clause, Ariz. Const. art. 18, § 6, because the doctrine is a common law doctrine, not a statutory one, and it does not abrogate a right to recover for damages. It simply provides a means for a manufacturer to fulfill its duty to warn by warning the learned intermediary.

PRODUCT LIABILITY DEFENSES

Statutory Affirmative Defense

A.R.S. § 12-683 lists certain affirmative defenses available in a products liability action. A defendant is not liable if he can prove any of the following:

- The plans or designs for the product or the methods and techniques of manufacturing, inspecting, testing or labeling of the product conformed with the state-of-the-art at the time the product was first sold by the defendant. See statutory definition of “state of the art,” above.
- The proximate cause of the incident was an alteration or modification of the product that was not reasonably foreseeable, made by a person other than the defendant and subsequent to the time the product was first sold by the defendant.
- The proximate cause of the incident was the use or consumption of the product that was for a purpose, in a manner or in an activity other than that which was reasonably foreseeable or was contrary to any express and adequate instructions or warnings appearing on or attached to the product or on its original container or wrapping, if the intended consumer knew or with the exercise of reasonable and diligent care should have known of such instructions or warnings.

While not technically an affirmative defense, A.R.S. § 12-686 precludes the plaintiff from introducing evidence of any change in the design, methods or manufacturing, or methods of testing the product or any similar product subsequent to the defendant’s date of sale, to prove the product was defective. The statute also prohibits the plaintiff from introducing evidence of advancements or changes in the state of the art after the product was first sold by the defendant. Such evidence may be admissible for other purposes, such as showing the feasibility of precautionary measures. See “Evidence of Subsequent Remedial Measures” below. The permissible constitutional scope of this statute was interpreted in *Readenour v. Marion Power Shovel*, 149 Ariz. 442, 719 P.2d 1058 (1986), and must be examined in light of *Dart v. Wiebe Mfg., Inc.*, 147 Ariz. 242, 709 P.2d 876 (1985), which adopted the “hindsight” test when determining whether a product is unreasonably dangerous. The “hindsight” test has been described as the “prudent manufacturer” test because the factfinder must evaluate the reasonableness of the manufacturer’s conduct. A dangerously defective product would be one that a reasonable person would not put into the stream of commerce if he had knowledge of its harmful character. The test, therefore, focuses on the quality of the product and whether or not it was unreasonable for a manufacturer with knowledge of the product to have put the product on the market after considering all risk/benefit factors. *Dart*. But see *Powers v. Taser Int’l, Inc.*, 217 Ariz. 398, 174 P.3d 777 (App. 2007) (refusing to extend hindsight test in failure to warn strict liability cases); *Perez v. S. Pac. Transp. Co.*, 180 Ariz. 187, 883 P.2d 424 (Ct. App. 1993) (hindsight test does not apply to strict liability cases involving abnormally dangerous activities).

Federal Preemption

In 2008, the United States Supreme Court ruled that a preemption clause in the Medical Device Amendments of 1976, shields medical device makers from state law product liability claims where the product has been approved by the FDA. *Riegel v. Medtronic, Inc.*, 552 U.S. 312 (2008). Although this decision has been widely viewed as a victory for product manufacturers and

business interests, it will likely be confined to the area of medical devices and have little impact on the vast majority of product liability cases.

More recently, in 2018, the Arizona Supreme Court ruled that federal law impliedly preempted a patient's failure to warn claim against medical device manufacturer. **Conklin v. Medtronic, Inc.**, 245 Ariz. 501, 431 P.3d 571 (2018). The court explained that state law claims based solely on noncompliance with federal regulatory framework are impliedly preempted because Congress intended the federal regulations to be enforced by the federal government. The court further explained that the defendant has the burden of establishing preemption.

This past year, the Arizona Supreme Court held that federal law did not preempt a state tort law claim based on an auto manufacturer's alleged failure to install automatic emergency braking in a vehicle that collided with the plaintiff's stopped car, injuring her and killing her four-year-old daughter. **Varela v. FCA US LLC**, 252 Ariz. 451, 505 P.3d 244 (2022). In so holding, the court overruled an earlier Arizona case, **Dashi v. Nissan North America, Inc.**, 247 Ariz. 56, 445 P.3d 13 (Ct. App. 2019), that had come to the opposite conclusion. The court reasoned in part that after *Dashi*, the National Highway Transportation Safety Administration had issued two notices of proposed rulemaking explicitly disavowing a preemptive intent. 505 P.3d at 261.

COMMON LAW DEFENSES

Causation

Causation is the most complex and uniquely challenging issue in most products liability cases. To recover in any products liability case, a plaintiff must prove that the product was the cause of the accident. In some cases, causation is easily established by the testimony of the plaintiff or eyewitnesses, and by the logical inferences readily drawn by a lay jury without reference to expert testimony. In other cases, however, proof of causation involves a host of issues and complex inferences, which require expert testimony.

Under Arizona law, a plaintiff must prove, by a preponderance of the evidence, that defendant's act or omission was the proximate cause of the accident. In **Robertson v. Sixpence Inns of Am., Inc.**, 163 Ariz. 539, 546, 789 P.2d 1040, 1047 (1990), the Arizona Supreme Court reiterated the definition of causation:

The proximate cause of an injury is that which, in a natural and continuous sequence, unbroken by any efficient intervening cause, produces an injury, and without which the injury would not have occurred.

The plaintiff has the burden of proving causation. **Purcell v. Zimbelman**, 18 Ariz. App. 75, 500 P.2d 335 (1972). Causation must be shown to be probable and not merely possible. **Kreisman v. Thomas**, 12 Ariz. App. 215, 469 P.2d 107 (1970); **Salt River Valley Water Users' Ass'n v. Blake**, 53 Ariz. 498, 90 P.2d 1004 (1939). To establish causation, a plaintiff need not show that a defendant's actions were a "large" or "abundant" cause of the plaintiff's injuries, but plaintiff must demonstrate that the result would not have occurred without the defendant's conduct.

Robertson, 163 Ariz. at 546, 789 P.2d at 1047. Importantly, there may be more than one proximate cause depending on the circumstances. See ***Brand v. J. H. Rose Trucking Co.***, 102 Ariz. 201, 205, 427 P.2d 519, 523 (1967).

Comparative Fault

Although Arizona abolished joint and several liability in 1987, it was not until 2007 that the Supreme Court held that the three exceptions to the abolition of joint and several liability (acting in concert; agency; and duties created by the Federal Employer's Liability Act) do not apply to strict products liability cases. ***State Farm Ins. Cos. v. Premier Manufactured Sys., Inc.***, 217 Ariz. 222, 172 P.3d 410 (2007). The distribution chain does not establish a principal-agent relationship between manufacturers and sellers. Furthermore, each entity in a chain of distribution of a defective product has committed its own "actionable breach of legal duty." Each entity is liable for its own actions because it distributed a defective product; it is not liable because of its relationship to others. Thus, comparative fault principles apply even in strict products liability cases. But this does not mean that indemnification rights between sellers and manufacturers are not available. Those rights are discussed next.

Indemnification/Contribution

A.R.S. § 12-684 provides for indemnification and tender of defense in a products liability context. In any product liability action where a manufacturer refuses to accept a tender of defense from the seller, the manufacturer shall indemnify the seller for any judgment rendered against the seller and shall also reimburse the seller for reasonable attorney's fees and costs incurred by the seller in defending such action.

The manufacturer is entitled to indemnity from the seller unless the seller had knowledge of the defect, or unless the seller modified the product, the modification was a substantial cause of the accident, and the modification was not authorized or requested by the manufacturer. A.R.S. § 12-684; ***McIntyre Refrigeration, Inc. v. Mepco Electra***, 165 Ariz. 560, 799 P.2d 901 (Ct. App. 1990). Arizona also recognizes common law indemnity rights. ***Foremost-McKesson Corp. v. Allied Chem. Co.***, 140 Ariz. 108, 680 P.2d 818 (Ct. App. 1983).

As is noted above and in earlier chapters, Arizona has abolished joint and several liability for the most part. In ***Watts v. Medicis Pharm. Corp.***, *supra*, the Arizona Supreme Court ruled that the learned intermediary doctrine (which allows manufacturers to discharge their duty to warn by warning a learned intermediary) is not incompatible with Arizona's comparative fault scheme. However, there are statutorily defined circumstances where joint and several liability still exists. See A.R.S. § 12-2506(D). If a defendant is found jointly and severally liable, that defendant may seek contribution from a joint tortfeasor. See A.R.S. § 12-2501, *et. seq.*

Misuse by the Plaintiff/Contributory Fault

In Arizona, contributory negligence is not applicable to strict liability cases because consumers have no duty to guard against product defects when using a product properly. However, a

plaintiff may be comparatively at fault by misusing the product, which can diminish plaintiff's recovery. ***Jimenez v. Sears, Roebuck & Co.***, 183 Ariz. 399, 904 P.2d 861 (1995). Misuse can be a defense if the plaintiff's use of the product in a manner other than that which was reasonably foreseeable caused the incident. Such misuse may be characterized as unanticipated, unforeseeable or unintended. The "misuse of product" defense also applies if the use was contrary to any express and adequate instructions or warnings appearing on or attached to the product or its original container or wrapping, of which the injured person knew or with the exercise of reasonable and diligence should have known. A.R.S. § 12-683(3); ***Gosewisch v. Am. Honda Motor Co.***, 153 Ariz. 400, 405–07, 737 P.2d 376, 381–83 (1987), *superseded by statute as stated in Jimenez*, 183 Ariz. 339, 904 P.2d 861 (1995).

Alteration of Product (by Anyone)

A defendant can avoid liability by proving that the product was altered in a manner not reasonably foreseeable, by a person other than the defendant, after the defendant first sold the product. This defense was codified in A.R.S. § 12-683(2). The alteration constitutes a complete bar to recovery only if the alteration was the sole proximate cause of the injury. If it was only a contributing cause, the jury should determine the relative degree of fault attributable to the alterations. See ***Jimenez v. Sears, Roebuck & Co.***, 183 Ariz. 399, 904 P.2d 861 (1995); ***Gosewisch v. Am. Honda Motor Co.***, 153 Ariz. 400, 407, 737 P.2d 376, 383 (1987), *superseded by statute as stated in Jimenez*, 183 Ariz. 339, 904 P.2d 861 (1995); see also A.R.S. § 12-2506(F)(2).

Statute of Repose

Originally, A.R.S. § 12-551 precluded product liability actions commenced twelve years after the product was first sold for use or consumption. The Arizona Supreme Court, however, ruled A.R.S. § 12-551 unconstitutional as in conflict with Ariz. Const. article 18, § 6. ***Perez v. S. Pac. Transp. Co.***, 180 Ariz. 187, 883 P.2d 424 (Ct. App. 1993) (discussing ***Hazine v. Montgomery Elevator Co.***, 176 Ariz. 340, 861 P.2d 625 (1993)).

Other Defenses

Compliance with industry or company standards when the product was manufactured is not an affirmative defense, but it may be relevant to show that such standards represent the "state of the art." See ***Hohlenkamp v. Rheem Mfg. Co.***, 134 Ariz. 208, 655 P.2d 32 (Ct. App. 1982); ***Anderson v. Nissei ASB Mach Co.***, 197 Ariz. 168, 3 P.3d 1088 (1999); ***Dart v. Wiebe Mfg., Inc.***, 147 Ariz. 242, 709 P.2d 876 (1985). See "State of the Art" defense, discussed above.

Disclaimers of tort liability are generally not recognized in Arizona. A waiver of contractual liability will be given effect only if the would-be plaintiff is found to have intentionally relinquished a known right. ***Salt River Project v. Westinghouse Elec. Corp.***, 143 Ariz. 368, 694 P.2d 198 (1984), *abrogated on unrelated grounds by Phelps v. Firebird Raceway, Inc.*, 210 Ariz. 403, 111 P.3d 1003 (2005). In all probability, disclaimer releases and/or waivers will not bar a product liability action.

Privity of contract is not required between the parties. Thus, it almost always fails as a defense. See *Vineyard v. Empire Mach. Co.*, 119 Ariz. 502, 581 P.2d 1152 (Ct. App. 1978).

COMMON PROBLEMS FOR PRODUCT LIABILITY DEFENDANTS

Subsequent Remedial Measures

Evidence that a manufacturer has changed the design of its product since the date of the accident, especially if the new design makes the product safer, can be detrimental to the defense. A jury is inclined to wonder why such measures were not taken before the accident, and could conclude that the accident would not have occurred had such measures been previously taken. Courts and legislatures have recognized that the jury can misconstrue the mere fact that a defendant has improved its product as an admission of liability. Therefore, Arizona has enacted several statutes addressing this concern. Arizona Rule of Evidence 407 bars evidence of subsequent remedial measures in all lawsuits, not just product liability suits. However, its rationale certainly extends to product suits:

When measures are taken that would have made an earlier injury or harm less likely to occur, evidence of the subsequent measures is not admissible to prove negligence; culpable conduct; a defect in a product or its design; or a need for a warning or instruction. But the court may admit this evidence for another purpose, such as impeachment or—if disputed—proving ownership, control, or the feasibility of precautionary measures.

The exception that arises most often in the product scenario is “feasibility of precautionary measures.” This often becomes intertwined with the state of the art defense. When the defendant attempts to prove that the product was state of the art at the time it was manufactured, the plaintiff may attempt to show that other safety measures were available at the time and were subsequently instituted, thereby defeating the state of the art defense. The defendant must show such improvements were not feasible. This generally means technological and economic feasibility rather than whether it was physically possible to provide a safer product. See *Readenour v. Marion Power Shovel*, 149 Ariz. 442, 719 P.2d 1058 (1986).

A.R.S. § 12-686, addressed earlier, provides that evidence of advancements or changes in the state of the art after the product was first sold is inadmissible to prove a defective design. Plaintiff also cannot prove the design is defective by introducing evidence of subsequent changes in the product’s design or manufacturing/testing methods. *Johnson v. State*, 224 Ariz. 554, 233 P.3d 1133 (2010). This type of evidence may, however, be used for other purposes, specifically, to rebut the state of the art defense (if raised by the defendant).

A.R.S. § 12-687 provides that if the defendant conducts a product safety analysis or review and takes remedial measures as a result, the plaintiff may not use the analysis to prove negligence or other culpable conduct or that the product was defective. The plaintiff may, however, use the analysis for other purposes, such as to prove the feasibility of precautionary measures or for impeachment. This type of safety analysis also cannot be used against the defendant to prove punitive damages, unless the plaintiff can show that the study was undertaken in bad faith and

for the purpose of affecting the litigation. This statute further provides that such safety analyses are generally discoverable unless they qualify as a trade secret. A.R.S. § 44-401(4) defines a trade secret as the following:

Information, including a formula, pattern, compilation, program, device, method, technique or process, that both derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use [and] [i]s the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

Other Accidents

Plaintiffs often try to show a product is defective by pointing to other accidents. Other accident evidence might be relevant to show the defendant knew the product was defective but took no steps to cure the defect, thereby posing the issue of punitive damages to the jury. See **Piper v. Bear Med. Sys., Inc.**, 180 Ariz. 170, 883 P.2d 407, 417 (Ct. App. 1993), *superseded by statute on unrelated grounds as stated in Watts v. Medicis Pharm. Corp.*, 236 Ariz. 511, 342 P.3d 847 (Ct. App. 2015), *vacated on other grounds*, 239 Ariz. 19 (2016).

Defendants should object to the admissibility of other accident evidence as irrelevant and prejudicial under Rule 403. Product liability actions are complex enough, and delving into the causation and technical evidence surrounding other accidents could cause a tremendous waste of time and distract from the true issues central to the case. This is especially true when the other accidents are not substantially similar to the accident in question. As the circumstances and conditions of the other accidents become less similar to the accident in question, the probative force of the evidence decreases. See **Vegodsky v. City of Tucson**, 1 Ariz. App. 102, 399 P.2d 723 (1965).

Recalls

Plaintiffs also can seek to admit evidence of product recalls, arguing that they constitute an admission by the company that the product was defective. See, e.g., **Farner v. Paccar, Inc.**, 562 F.2d 518 (8th Cir. 1977). A recall can be either voluntary or involuntary (government-mandated). In either event, defendant could argue that the policy underlying the “subsequent remedial measure” statutes should prevent admission of the evidence. That is, public policy supports encouraging companies to keep their products as safe as possible, and to keep potentially harmful products out of the hands of the consumer. **Johnson v. State**, 224 Ariz. 554, 233 P.3d 1133 (2010). *But see Farner*, 562 F.2d at 527 (admitting recall notices; the exclusionary rule governing subsequent remedial measures is inapplicable in a strict liability case because it serves no deterrent function). Defendant can also argue the recall is irrelevant unless it is for the exact same product at issue and relates to the same geographical area to which the recall was directed. See, e.g., **Brethauer v. Gen. Motors Corp.**, 221 Ariz. 192, 197, 211 P.3d 1176, 1181 (Ct. App. 2009) (affirming trial court’s refusal to admit recall evidence as irrelevant and prejudicial). Finally, the

defendant can try a hearsay objection, though that will not succeed if the court deems the recall to be an admission of a party opponent. *Farner*.

If admitted, the recall notices are admissible only against the issuer (usually the manufacturer), not the distributors or retailers who may also be named in the suit.

If evidence of the recall is admitted, the defendant can argue the plaintiff was at fault if she ignored the recall and was injured. Additionally, the recall might have been issued due to an intervening cause, such as problems with shipping. In these cases, a portion of fault can be assessed against the party actually causing the defect. The defendant can also argue that the recall is not an admission of a defect *per se*; but is a sincere effort to place public safety above financial concerns.

FOREIGN DEFENDANTS

In our global economy, representation of foreign defendants is increasing. This is a larger problem for plaintiffs than defendants (generally speaking), as plaintiffs need to establish jurisdiction and properly serve foreign defendants, which can be a daunting task. In this respect, when representing a foreign defendant, the first thing defense counsel should do is closely examine jurisdiction and service to ensure it was properly effectuated in accordance with the laws of both Arizona as well as the foreign country.

If jurisdiction and service were proper, defense counsel might consider a motion to dismiss based on the doctrine of *forum non conveniens*. If granted, the plaintiff might abandon the case rather than be forced to litigate in a foreign country. The statute of limitations might bar a subsequent action as well. The foreign jurisdiction's laws could protect its corporations and disfavor American tort litigants.

CONCLUSION

The topics discussed in this chapter address only some of the varied issues that can and do arise in a strict product liability suit. A firm understanding of the basic issues that often arise is necessary before embarking on the more complex issues involving discovery and the use of expert witnesses that eventually present themselves in a product liability suit.

If you have questions regarding the information in this chapter, please contact the authors or any JSH attorney.

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CHAPTER 21: TRUCKING AND TRANSPORTATION

FEDERAL MOTOR CARRIER REGULATIONS

Historical Overview

The dangers associated with large trucks traveling on public thoroughfares were recognized as early as 1935. That year, Congress enacted the Motor Carrier Act, which created the Bureau of Motor Carriers of the Interstate Commerce Commission (ICC). *See* 40 U.S.C. §§ 1-27, 301-327 (1994). The commission was charged with developing and enforcing safety regulations in the trucking industry. In response, the commission developed the Federal Motor Carrier Safety Regulations (FMCSRs). *See* 49 C.F.R. §§ 301-399. Although the trucking industry was extensively deregulated in the 1980s, and the licensing and monitoring of professional truck drivers have been transferred to the states, the FMCSRs remain the sole safety standard that drivers and motor carriers must follow in operating commercial motor vehicles. These regulations apply to everyone who operates a commercial motor vehicle in interstate, foreign, or intrastate commerce, and to all their employers, and each professional truck driver and motor carrier is required to comply with FMCSRs §§ 383, 390-397, and 399 at all times. *See Id.* §§ 390.1, 390.3.

Incorporation of the FMCSRs into State Law

Almost every state has incorporated all or substantially all of the FMCSRs, often simply by reference. Arizona is no exception. Specifically, under Arizona Administrative Code § R17-5-202, Arizona has incorporated the following sections of the FMCSRs:

Section 379: Preservation of Records

This section details which records a motor carrier is required to retain, how the records are to be retained and how long they are to be retained. This preservation rule still applies even if a trucking company dissolves, depending on when the accident occurred that leads to litigation, and when the company was on notice of potential litigation.

Section 382: Controlled Substances and Alcohol Use and Testing

Drivers are prohibited from reporting for duty or remaining on duty if they have a blood alcohol concentration (BAC) of .04 or greater. Drivers are also prohibited from performing safety-sensitive functions if they have consumed any controlled substances. Drivers may not refuse a drug or alcohol test if it is part of the program set up and run in accordance with the regulations.

Section 383: Commercial Driver's License Standards; Requirements and Penalties

This section requires anyone who operates a commercial motor vehicle to possess a commercial driver's license and forbids a commercial driver from having more than one commercial driver's license at a time.

Section 385: Safety Fitness Procedures

This section establishes the FMCSA's procedures to determine the safety fitness of motor carriers, to assign safety ratings, to direct motor carriers to take remedial action when required, and to prohibit motor carriers receiving a safety rating of unsatisfactory from operating a commercial motor vehicle.

This section also establishes the safety assurance program for a new entrant motor carrier initially seeking to register with FMCSA to conduct interstate operations and the consequences that will occur if the new entrant fails to maintain adequate basic safety management controls.

Last, this section establishes the safety permit program for a motor carrier to transport the types and quantities of hazardous materials listed in §385.403.

Section 390: General Applicability and Definitions Section

Under this section, carriers are subject to federal on-site reviews of vehicle inspection and maintenance procedures and records, driver qualifications and hours of service compliance, accident histories, and related subjects. Following a review, carriers receive a "safety fitness" rating of satisfactory, conditional, or unsatisfactory. Certain aspects of the company's operating authority can be terminated for carriers that are judged unsatisfactory.

This section also requires that all commercial vehicles must be marked so as to identify the name or trademark of the trucking company, the location of the company's principal place of business, and the vehicle identification number (USDOT #). The side of the vehicle must display the "ICC M.C." number for the company under whose authority the vehicle is being operated.

Section 391: Qualification of Drivers

This section provides criteria that drivers must meet in order to be hired by a trucking company. According to these requirements, a driver must be at least 21 years old; able to read and speak the English language sufficient to understand traffic control signs and police officers, and to complete entries on reports and records; able to safely operate the vehicle; able to determine whether cargo is securely loaded; physically qualified to operate a commercial motor vehicle (CMV) and possess a valid medical certificate; hold only one valid commercial driver's license; complete an application form for employment; provide the employer with a list of prior traffic violations; pass a road test or equivalent under § 391.33; and not be disqualified under the federal regulations.

A carrier is required to maintain a driver's qualification file on each driver it employs. The driver's qualification file must be retained as long as the driver is employed and for three years thereafter with some limited exceptions. A carrier does not have to maintain a driver's qualification file on any driver who is not regularly employed by the carrier if the

driver is employed regularly by another carrier and the other carrier certifies in writing that the driver is fully qualified to operate a commercial vehicle.

The FMCSRs also require a motor carrier to maintain a “paper trail” and to do the following: (1) verify the driving history within 30 days after the initial hire, including submission of an inquiry to every state agency that has issued a CDL to the driver during the last three years; (2) investigate driver’s employment record for previous three years and maintain all materials obtained in the investigation in the driver’s qualification file; (3) maintain a post-hire employment file on each driver; (4) have the driver submit to a pre-employment drug screen; (5) enforce a random drug screen procedure in place to occur over the time of the employment; (6) continue to supervise drivers, including a review of each driver’s driving record and traffic violations at least once every 12 months after the initial hire and investigation; (7) audit driver logs and closely monitor the hours drivers work to ensure they file correct logs and do not drive for more than the maximum hours allowed; (8) refrain from encouraging drivers to speed or otherwise violate the FMCSRs (the FMCSRs state that a carrier shall not mandate deliveries in such a short amount of time as to require a driver to exceed speed limits to timely complete the trip); (9) inspect, repair, and maintain vehicles under their control and maintain repair records; and (10) retain a driver’s log book for six months.

Section 392: Driving of Commercial Vehicles

Commercial vehicles operate in compliance with all state and local laws. If the federal regulations impose a stricter standard than do state or local laws, the federal regulations control. A driver cannot drive and an employer cannot require or allow the driver to drive if his/her ability or alertness is so impaired or likely to become impaired through illness, fatigue or other cause to make operation of a commercial vehicle unsafe. Moreover, a driver is not permitted to speed in excess of the local, posted speed limit, nor may a carrier permit or require that the driver speed.

Section 393: Parts and Accessories Necessary for Safe Operation

This section deals with the details of equipment and cargo safety.

Section 395: Hour of Service for Drivers

In 2004, the U.S. Department of Transportation’s Federal Motor Carrier Safety Administration (FMCSA) changed the hours of service rules to provide drivers with better opportunities to sleep in hopes of reducing accidents attributed to fatigued drivers. Drivers are allowed to drive up to 11 hours, but only after a break of at least 10 consecutive hours off-duty. A driver cannot drive after being on duty for more than 14 consecutive hours, including break times. Basically, once a driver is on duty, he has 14 hours in which he may drive, regardless of break time, and after the 14 hours, he must go off-duty for ten hours before he can drive again. This means a driver must have 10 hours of off-duty time after his 11 hours of on-duty driving time. These 10 hours may be split into two segments. If a motor carrier operates seven days a week, its drivers may be on duty for up to 70 hours in an eight-day period. Drivers for motor carriers that operate

fewer than seven days a week may not be on duty more than 60 hours in any seven consecutive days. However, the on-duty seven- or eight-day cycle restarts if a driver remains off duty for at least 34 consecutive hours.

In 2011, FMCSA imposed a qualification to the 34-hour off duty restart rule, which allowed drivers to restart the calculation of their 60- or 70-hour limit by taking an off-duty period of at least 34 consecutive hours. Drivers are therefore authorized to resume use of the previous, unlimited restart provision; that is assuming that 168 or more, consecutive hours have passed since the beginning of the last off-duty period. When a driver takes more than one off-duty period of 34 or more consecutive hours with a period of 168 consecutive hours, he or she must indicate in the Remarks section of the record of duty status which such off-duty period is being used to restart the calculation of 60 hours in seven consecutive days or 70 hours in 8 consecutive days.

The carrier must closely monitor the hours its drivers work to ensure that they do not operate a CMV for more than the maximum number of hours. Furthermore, carriers are prohibited from encouraging drivers to speed or otherwise violate the FMCSRs. To ensure compliance with these regulations, a driver must keep a “record of duty status” – more commonly referred to as the “log.” In any case involving a tractor-trailer accident, the log is always an item the plaintiff requests and which the defendant and its insurance carrier should review, because it contains important and valuable information – not just the hours of service. Typically, only the last eight days of logs are relevant to a given accident that results in litigation, due to the 60/70 hour rules denoted above.

Section 396: Inspection, Repair, and Maintenance

This section deals with the inspection, repair and maintenance requirements for commercial vehicles. The FMCSRs require that every motor carrier shall inspect, repair and maintain, or cause to be systematically inspected, repaired, and maintained all motor vehicles subject to its control. The records shall be retained where the vehicle is either housed or maintained for a period of one year and for six months after the vehicle is no longer under the control of the motor carrier. These records will be made available to the federal DOT or state police for inspection during a compliance audit.

Section 397: Transportation of Hazardous Materials, Driving and Parking Rules

This section states that the previous sections apply to a motor carrier when he/she is transporting hazardous materials that require placarding under the FMCSRs. Vehicles containing hazardous materials must be driven and parked in compliance with the laws of the jurisdiction in which it is being operated.

Section 399: Employee Safety and Health Standards

This section provides requirements for truck and truck-tractor access – specifically, step, handhold, and deck requirements on commercial motor vehicles. These requirements are intended to enhance the safety of motor carrier employees.

LIABILITY CONSIDERATIONS UNIQUE TO THE MOTOR CARRIER

General Overview

The FMCSRs prescribe every standard of safety for motor carriers and drivers who operate commercial motor vehicles in interstate, foreign, or intrastate commerce. Any deviation exposes the motor carrier and driver to liability, including punitive damages. Drivers and carriers may be jointly and severally liable for violating the regulations. In addition, motor carriers may be liable for their violation of these regulations under the theories of respondeat superior, negligent hiring and retention, negligent entrustment, and negligent vehicle maintenance.

Standard of Care

Common carriers formerly were required to exercise the highest degree of care practicable under the circumstances. This was known as the Common Carrier Rule and it imposed a higher standard of care than the duty to exercise reasonable care with which a typical person must comply. Failing to adhere to the higher standard meant the common carrier was negligent and could be held liable for damages caused by its failure to meet the heightened standard. The rationale behind the heightened standard was that passengers are completely dependent on common carriers to take safety precautions. **Lowrey v. Montgomery Kone, Inc.**, 202 Ariz. 190, 195, 42 P.3d 621, 626 (Ct. App. 2002). This reasoning dates back to “the age of steam railroads,” when common carriers were far more hazardous. *Id.*

Arizona has since rejected the heightened standard for common carriers. Now, the ordinary negligence standard of reasonable care under the circumstances applies to common carriers. **Nunez v. Prof'l Transit Mgmt. of Tucson, Inc.**, 229 Ariz. 117, 119, 271 P.3d 1104, 1106 (2012); *Lowrey, supra*. In *Nunez*, the Supreme Court reiterated that even though a common carrier is now only held to the standard of a reasonable person under the circumstances, the common carrier's duty could extend beyond the mere obligation not to create a risk of harm. Instead, common carriers have a duty to avoid harm from risks created by others. **Ft. Lowell–NSS Ltd. P'ship v. Kelly**, 166 Ariz. 96, 101, 800 P.2d 962, 967 (1990).

Vicarious Liability for Motor Carriers

Vicarious liability is a doctrine that imposes liability on a motor carrier for the negligent acts of its employees. When determining whether vicarious liability applies, the first consideration must be whether state or federal law controls the analysis. If a motor carrier's employee negligently caused damages while operating an interstate carrier, federal law applies. **Planet Ins. Co. v. Transp. Indem.**, 823 F.2d 285, 288 (9th Cir. 1987). If the employee operated a carrier on a purely intrastate route, state law will control.

Classifying a shipment as intrastate or interstate depends on the “essential character of the commerce” and is “ascertained from all of the facts and circumstances surrounding the transportation.” **S. Pac. Transp. Co. v. ICC**, 565 F.2d 615, 617 (9th Cir. 1977). Typically, if the final

intended destination at the time the shipment begins is another state, all legs of the shipment are considered interstate, even portions that only occur within state lines. *Project Hope v. M/V IBN SINA*, 250 F.3d 67, 74-75 (2d Cir. 2001). Transportation of goods in interstate commerce begins when the goods are delivered to a carrier and the goods retain their character as goods in interstate commerce until they are finally delivered to the customer. *Walling v. Jacksonville Paper Co.*, 317 U.S. 564, 567-68 (1943), superseded by statute as stated in *Wirtz v. Melos Const. Corp.*, 408 F.2d 626 (2d Cir. 1969); *S. Pac. Terminal Co. v. ICC*, 219 U.S. 498 (1911). Additionally, some courts have held that if a carrier is registered for either interstate or intrastate commerce, federal vicarious liability laws apply, even if the underlying incident occurred during a purely intrastate trip. *Cox v. Bond Transp., Inc.*, 249 A.2d 579, 587 (N.J. 1969). Arizona courts have yet to directly address this issue, but Arizona and Ninth Circuit cases have cited to *Cox*. See *Zamalloa v. Hart*, 31 F.3d 911, 914 (9th Cir. 1994); *Transp. Indem. Co. v. Carolina Cas. Ins. Co.*, 133 Ariz. 395, 397, 652 P.2d 134, 136 (1982); *Wilson v. Riley Whittle, Inc.*, 145 Ariz. 317, 321, 701 P.2d 575, 580 (Ct. App. 1984).

Vicarious Liability Under Arizona Law

If an employee negligently causes damages during a purely intrastate trip, traditional Arizona common law will decide whether the employer is vicariously liable through the theory of respondeat superior. *Bruce v. Chas Roberts Air Conditioning*, 166 Ariz. 221, 226, 801 P.2d 456, 461 (Ct. App. 1990). Respondeat superior applies if the negligent actor was an employee of the motor carrier and was acting within the scope of his or her employment at the time of the negligent conduct. *Id.* Under state vicarious liability law, an employer is not responsible through respondeat superior for the acts of its independent contractor, unless the employer owes a non-delegable duty. *Wiggs v. City of Phoenix*, 198 Ariz. 367, 369-70, 10 P.3d 625, 627 (2000). An employee acts within the scope of employment when: (1) the conduct is of the type the defendant hired the employee to perform; (2) the conduct occurs within the authorized time and space limits; and (3) the employee acts in furtherance of the employer's purpose. *Love v. Liberty Mut. Ins. Co.*, 158 Ariz. 36, 38, 760 P.2d 1085, 1087 (Ct. App. 1988); *Smithey v. Hansberger*, 189 Ariz. 103, 106, 938 P.2d 498, 501 (Ct. App. 1996).

Commuting To and From Work

Arizona law typically focuses its respondeat superior inquiry on whether the employer had control over the employee when the employee acted negligently. *Carnes v. Phoenix Newspapers, Inc.*, 227 Ariz. 32, 38, 251 P.3d 411, 417 (Ct. App. 2011). Because an employer typically does not have control over an employee while commuting to and from work, Arizona cases generally find that an employee does not act within the scope of employment while commuting. *Faul v. Jelco, Inc.*, 122 Ariz. 490, 492, 595 P.2d 1035, 1037 (Ct. App. 1979). There are two exceptions.

The first exception, the "dual purpose" doctrine, may give rise to vicarious liability if the employee performs concurrent services for himself and his employer while commuting to or from work. *Faul*, 122 Ariz. at 492, 595 P.2d at 1037. Concurrent services are those that would have

required a separate trip by a different employee, had the commuting employee not performed the task. *Id.* The second exception that may give rise to vicarious liability while an employee is commuting to and from work is the special hazard doctrine. ***Kerr v. Indus. Comm'n***, 23 Ariz. App. 106, 108, 530 P.2d 1139, 1141 (1975). This exception provides that if an employee encounters risks while traveling to and from work, which can be distinguished from the risks that are shared with the general public, his or her commute may be considered within the scope of employment.

Special Errands

The “special errand” principle can also create vicarious liability. *Love*, 158 Ariz. at 39, 760 P.2d at 1088. Under this principle, if an employee engages in a special errand at the employer’s request, the employer remains vicariously liable, even if the errand involves work different from the type of work the employee usually performs. *Id.*

Vicarious Liability Under Federal Law and Placard Liability

Aside from the doctrine of respondeat superior, federal law will hold a motor carrier vicariously liable if it has control of the vehicle and is responsible for operating the vehicle in compliance with its ICC authorization. ***Zamalloa v. Hart***, 31 F.3d 911, 913-14 (9th Cir. 1994); ***C.C. v. Roadrunner Trucking, Inc.***, 823 F. Supp. 913, 918 (D. Utah 1993). This means that an independent contractor driving a truck leased to a trucking company is still an employee of the trucking company, and thus, the trucking company is subject to vicarious liability. See ***Wilson v. Riley Whittle, Inc.***, 145 Ariz. 317, 320-21, 701 P.2d 575, 580 (Ct. App. 1984).

In Arizona, there can be more than one statutory employer. See *Zamalloa*, 31 F.3d at 914-15 (stating the common carrier whose placards are on a truck is irrefutably presumed to be a statutory employer). Even where the trucking company and independent driver failed to establish a written trip lease, an oral trip lease can establish an additional statutory employer relationship, even where the truck driver had not loaded the cargo or affixed the carrier’s placard. *Id.* at 917; *Wilson*, 145 Ariz. at 321, 701 P.2d at 579. The intent of this regulation is to prevent the operation of unregulated, uninsured or underinsured vehicles on interstate trips by making the lessee liable for operation of trip-leased vehicles. ***Transp. Indem. Co. v. Carolina Cas. Ins. Co.***, 133 Ariz. 395, 397, 652 P.2d 134, 136 (1982).

Negligent Hiring, Training and Retention

An employer may be held directly liable for negligent hiring and retention of an employee if: (1) the employer knew or should have known of the risk of hiring a particular employee; and (2) the employer’s negligence proximately caused the plaintiff’s injury. See RESTATEMENT (SECOND) OF THE LAW OF AGENCY, § 213. The FMCSRs require that an employer conduct a background investigation on applicant drivers and maintain records regarding each driver. Failure to comply with these regulations provides the basis for a claim of negligent hiring, supervision and retention. However, plaintiffs are precluded from recovering against an employer unless they first prevail on underlying negligence claims against an employee. If the employee is not negligent, even the

most severe injury cannot give rise to employer liability for negligent hiring, supervision and retention. **Mulhern v. City of Scottsdale**, 165 Ariz. 395, 398, 799 P.2d 15, 18 (Ct. App. 1990).

A claim for negligent hiring and retention is separate and independent of a claim for respondeat superior because negligent hiring is a direct claim against the employer, whereas respondeat superior is a claim for vicarious liability. **Quinonez ex rel. Quinonez v. Andersen**, 144 Ariz. 193, 197, 696 P.2d 1342, 1346 (Ct. App. 1984). Liability under respondeat superior arises because of the relationship between the parties, while liability for negligent hiring, training or retention arises because the employer had reason to believe that the employment would cause an undue risk of harm. *Id.* This means that in some cases a claim for negligent hiring, training or retention can succeed even though a claim for respondeat superior would fail. For example, if an employee was not acting within the scope of employment, the plaintiff cannot recover under respondeat superior, but may still be able to recover from an employer under a theory of negligent hiring. **Pruitt v. Pavelin**, 141 Ariz. 195, 202-03, 685 P.2d 1347, 1354 (Ct. App. 1984). Distinguishing the different claims also becomes important for purposes of the admissibility of evidence. As *Quinonez* illustrated, an employee's driving record is inadmissible to prove whether he was negligent and ran a red light, but it is admissible to determine whether the employer hired an incompetent driver. *Quinonez*, 144 Ariz. at 197, 696 P.2d at 1346.

Negligent Entrustment

Arizona recognizes the tort of negligent entrustment. **Powell v. Langford**, 58 Ariz. 281, 285, 119 P.2d 230, 232 (1941); **Lutfy v. Lockhart**, 37 Ariz. 488, 491, 295 P. 975, 976 (1931). Negligent entrustment arises when the owner of a dangerous instrumentality loans it to another person. **Powell**, 58 Ariz. at 285, 119 P.2d at 232; **Alosi v. Hewitt**, 229 Ariz. 449, 457, 276 P.3d 518, 526 (Ariz. Ct. App. 2012). Plaintiff must then prove that the entrusted instrumentality is inherently dangerous. An automobile or truck is such an instrumentality when entrusted to a person incompetent to drive it. *Id.*; **Tellez v. Saban**, 188 Ariz. 165, 171, 933 P.2d 1233, 1239 (Ct. App. 1996).

To succeed on a claim for negligent entrustment of a vehicle, plaintiff must show that the defendant owned or controlled the vehicle, the defendant gave the driver permission to operate the vehicle, the driver was incompetent to drive safely because of his or her physical or mental condition, and the defendant knew or should have known this, and the entrustment caused damages. **Acuna v. Kroack**, 212 Ariz. 104, 109, 128 P.3d 221, 226 (Ct. App. 2006). The owner of the vehicle must have known or had reason to know that the driver was incompetent to drive the vehicle. *Id.* at 109, 128 P.3d at 226. A plaintiff can establish that the employer knew or should have known of the employee's incompetence by reason of age, inexperience, habitual recklessness, or otherwise. **Estate of Hernandez by Hernandez-Wheeler for & on Behalf of Hernandez v. Arizona Bd. of Regents**, 177 Ariz. 244, 254, 866 P.2d 1330, 1340 (1994); **Powell**, 58 Ariz. 281, 119 P.2d 230. If the driver then negligently injures another, the owner might be liable for negligent entrustment. *Acuna*, 212 Ariz. at 110, 128 P.3d at 227 (Ct. App. 2006). Negligent entrustment involves concurrent acts of negligence by the person entrusting the vehicle and the person entrusted with the vehicle. **Quintero v. Cont'l Rent-A-Car Sys., Inc.**, 9 Ariz. App. 488, 491,

453 P.2d 999, 1002 (1969). But if an employer can prove that the employee's use of the vehicle at the time of the accident was unauthorized, there is no liability for negligent entrustment. ***Davis v. Vumore Cable Co.***, 14 Ariz. App. 411, 414, 484 P.2d 23, 26 (Ct. App. 1971); *see also* ***Neihaus v. Sw. Groceries, Inc.***, 127 Ariz. 287, 288, 619 P.2d 1064, 1066 (Ct. App. 1980).

Negligent Maintenance

While a claim for respondeat superior, negligent employment, and negligent entrustment will fail if the employee is found to not have acted negligently, other direct negligence claims against an employer, such as negligent maintenance, can succeed even if the employee did not act negligently. ***Miracle Mile Bottling Distrib. Co. v. Drake***, 12 Ariz. App. 439, 440, 471 P.2d 741, 742 (1970). The employee in *Miracle* crashed a truck owned by the employer into another vehicle after running a red light due to brake failure. The employer was found to be liable for failure to repair its truck, even though the jury determined the employee did not act negligently. In order to recover under negligent maintenance, a plaintiff must show a causal connection between an alleged defect in the vehicle and the injury sustained. ***McCullum v. UPS Ground Freight Inc.***, 2012 WL 3758837 (D. Ariz. August 30, 2012).

Liability for Unauthorized Passengers

Generally, an employer will not be liable for injuries to an unauthorized passenger riding in the employer's truck if the passenger rides in knowing violation of the employer's policy forbidding passengers. *See e.g.*, ***Reisch v. M&D Terminals***, 180 Ariz. 356, 358, 884 P.2d 242, 244 (Ct. App. 1994) (employer not liable for injuries sustained by the driver's spouse who was riding in truck in knowing violation of employer's rule against carrying passengers). This situation is distinguishable from the situation where the unauthorized passenger is an innocent or unknowing participant. *Id.* at 359, 884 P.2d at 245. Arizona courts have yet to decide whether or under what circumstances a trucking company would be liable to innocent, unauthorized passengers.

A driver's violation of the employer's no passenger rule does not negate coverage for the driver under the employer's insurance policy. *Reisch*, 180 Ariz. at 365, 884 P.2d at 251.

Negligence Per Se

Drivers and motor carriers may be jointly and severally liable for violating the regulations. Arizona has adopted FMCSR's §§ 391-397. *See* Arizona Administrative Code R17-5-202 through 2012. Thus, in Arizona, as in most jurisdictions, a violation of these regulations, which were adopted for the public's safety, may be negligence per se and may establish the violator's civil liability.

If a driver or carrier fails to comply with a law that protects public safety and the failure to comply is the proximate cause of another's injury, the failure to comply constitutes actionable negligence per se. ***Brand v. J. H. Rose Trucking Co.***, 102 Ariz. 201, 205, 427 P.2d 519, 523 (1967). Before the negligence per se doctrine can apply, injured parties must show they are members of the class that the statute or ordinance was intended to protect. In addition, an injured party must show that the injuries suffered were of the kind that the statute was enacted to prevent. *See* ***Sullivan***

v. Pulte Home Corp., 237 Ariz. 547, 354 P.3d 424, 427 (Ct. App. 2015). Furthermore, the party must show that the statute or ordinance prescribes or proscribes the conduct at issue and that this conduct proximately caused the alleged harm. *Christy v. Baker*, 7 Ariz. App. 354, 356, 439 P.2d 517, 519 (1968). In *Cameron v. Westbrook*, 2012 WL 385633, at *8 (Ariz. Ct. App. Feb. 7, 2012), the court suggested in dicta that it might be appropriate to include the FMCSR in a negligence per se jury instruction if a party offered appropriate foundation describing the origin, context, and application of the FMCSR.

Punitive Damages in Trucking Cases

An award of punitive damages requires a showing that the defendants' conduct was much more than negligent; it must be outrageous and against all acceptable societal norms, similar to that found in criminal behavior. *Rawlings v. Apodaca*, 151 Ariz. 149, 162, 726 P.2d 565, 578 (1986). It requires "conscious action of a reprehensible character." *Linthicum v. Nationwide Life Ins. Co.*, 150 Ariz. 326, 331, 723 P.2d 675, 680 (1986). When determining whether punitive damages can be awarded, the focus is not on how horrific the accident was, but on the defendant's attitude and conduct. *Volz v. Coleman Co.*, 155 Ariz. 567, 570, 748 P.2d 1191, 1194 (1987); see also *Gurule v. Illinois Mut. Life & Cas. Co.*, 152 Ariz. 600, 601-02, 734 P.2d 85, 86-87 (1987). The purpose of punitive damages is to punish the defendant and deter others from engaging in similar conduct, rather than to compensate the plaintiff.

Some litigants have argued that cases after *Linthicum* clarified that a punitive damage claim requires evidence only of an evil mind, not of an evil hand. They argue that evil hand evidence is only an alternative, indirect method of proving evil mind. See, e.g., *Gurule*, 152 Ariz. at 602, 734 P.2d at 87 ("Even if the defendant's conduct was not outrageous, a jury may infer evil mind if defendant deliberately continued his actions despite the inevitable or highly probable harm that would follow."). The Arizona Supreme Court is expected to resolve the issue in *Swift Transp. Co. of Ariz., LLC v. Carman*, No. CV-20-0119-PR (petition for review granted August 27, 2020). There, plaintiffs did not contend that the truck driver's conduct was outrageous. But they sought punitive damages and financial information relating to his employer, Swift, arguing that their allegations of the driver's failure to act reasonably (for example by allegedly driving too fast in the rain) entitled them to seek punitive damages.

Application in Arizona

A jury will be instructed on punitive damages and may award them only if the defendant has acted with an evil mind. *White v. Mitchell*, 157 Ariz. 523, 528, 759 P.2d 1327, 1332 (Ct. App. 1988). A driver operating a truck he or she knows is in dangerous condition and that continued operation will result in a substantial risk to pedestrians or other motorists meets the requirement of acting with an evil mind. *Id.* at 529, 759 P.2d 1333. In *White*, however, the driver's employer did not act with an evil mind because the trucking company was not aware of and did not consciously disregard the risk of harm. *Id.*

Proof that a driver exceeded a speed limit is insufficient by itself to support punitive damages. **Quintero v. Rogers**, 221 Ariz. 536, 542, 212 P.3d 874, 880 (Ct. App. 2009). But if exceeding the speed limit is combined with swerving and weaving in and out of traffic, and the driver has admitted to being reckless, a jury may be instructed on punitive damages. *Id.* In an unreported Arizona decision, a trucking company faced punitive damages on evidence that it allowed its drivers to exceed federal regulations regarding maximum allowable hours, and that driver fatigue caused a fatal accident. **McAchrn v. Knight Transp., Inc.**, 2009 WL 888539 (Ariz. Ct. App. April 2, 2009). If the jury believed this evidence, then it could conclude that the company, by allowing and even encouraging a driver to violate regulations regarding maximum allowable hours, “acted to serve his or its own interests, having reason to know and consciously disregarding a substantial risk that the conduct might significantly injure the rights of others, thus engaging in reprehensible conduct and acting with an evil mind.” *Id.*

Vicarious Liability for Punitive Damages

An employer may be required to pay punitive damages for the acts of an employee under the doctrine of *respondeat superior*. **Hyatt Regency Phoenix Hotel v. Winston & Strawn**, 184 Ariz. 120, 140, 907 P.2d 506, 526 (1995). This encourages employers to control the actions of its employees. *But see White v. Mitchell*, 157 Ariz. 523, 529, 759 P.2d 1327, 1333 (Ct. App. 1988) (upholding punitive damages against the driver and vacating punitive damages against the employer because the trucking company was not aware of and did not consciously disregard a substantial and unjustifiable risk that significant harm would occur).

Employers can be responsible for greater punitive damages than the employee. In **Wilson v. Riley Whittle, Inc.**, 145 Ariz. 317, 319, 701 P.2d 575, 577 (Ct. App. 1984), an intoxicated, independent driver collided with another truck and killed the other driver. The trucking company was held vicariously liable through *respondeat superior* under placard liability and the jury awarded \$350,000 punitive damages against the employer and \$10,000 against the employee. *Id.* at 322, 701 P.2d at 580.

The United States Supreme Court has provided general guidelines to prevent punitive damages from becoming excessive and thus violating due process. *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 575 (1996). Arizona law has followed suit. **Sandpiper Resorts Dev. Corp. v. Global Realty Invs., LLC**, 904 F. Supp. 2d 971, 986-87 (D. Ariz. 2012). When awarding punitive damages, the most important consideration is the reprehensibility of the defendant’s actions, but juries may also consider the wealth of the person or entity against whom the punitive damages are awarded. *Id.* This explains why a carrier may be required to pay more in punitive damages than the driver. Punitive damages should also have an appropriate relationship to the compensatory damages awarded. A general rule of thumb is that punitive damages should not be more than four times the compensatory damages. **Arellano v. Primerica Life Ins. Co.**, 235 Ariz. 371, 379, 332 P.3d 597, 605 (Ct. App. 2014).

A deceased’s employer can be vicariously liable for punitive damages as long as the deceased was acting in the course and scope and in furtherance of his or her employers business when the

tort was committed. See *Haralson v. Fisher Surveying Inc.*, 201 Ariz. 1, 6-7, 31 P.3d 114, 119-120 (2001).

INSURANCE COVERAGE ISSUES UNIQUE TO COMMERCIAL TRUCKING

Motor Carrier Financial Responsibility

A.R.S. §§ 28-4031 to 28-4039 address Vehicle Insurance and Financial Responsibility. A person or entity that commercially operates a vehicle in excess of twenty thousand pounds must comply with the provisions of this article and a person or entity that commercially operates a vehicle in excess of twenty-six thousand pounds must have a liability insurance policy in the minimum amount of \$750,000. A.R.S. §§ 28-4032, -4033. The purpose of these requirements is to provide compensation for injured motorists. A person wishing to operate heavy commercial vehicles in Arizona must provide to the Arizona Department of Transportation proof of an insurance policy meeting the minimum requirements.

If the insurer certifies that a person has the requisite insurance and this certification results in permission from the Arizona Department of Transportation to operate, but the policy in actuality does not meet the requirements of these statutes, the policy may be deemed to be amended to meet the minimum requirements. See *McCandless v. United S. Assur. Co.*, 191 Ariz. 167, 171, 953 P.2d 911, 915 (Ct. App. 1997). In other words, in Arizona, the financial responsibility law can trump an insurer's scheduled vehicle limitation. For example, in *McCandless*, the insured defendant obtained an insurance policy from the insurer protecting three vehicles with a policy limit of \$750,000 per accident for covered vehicles. But the defendant had approximately 100 additional vehicles that were not covered; and one of the uninsured vehicles was in an accident severely injuring the plaintiff. The court held that under Arizona's financial responsibility law, the insurer was required to cover the insured's use of any motor vehicle.

Loading and Unloading of a Vehicle

Loading and unloading a vehicle is considered "use" and is therefore covered by the liability insurance applicable to the vehicle as long as the person "using" the vehicle is covered by the policy. See *Mission Ins. Co. v. Aid Ins. Servs.*, 120 Ariz. 220, 221, 585 P.2d 240, 241 (1978); *Chavez v. Arizona Sch. Risk Retention Trust, Inc.*, 227 Ariz. 327, 329, 258 P.3d 145, 147 (Ct. App. 2011); *Granite State Ins. Co. v. Transamerica Ins. Co.*, 148 Ariz. 111, 113, 713 P.2d 312, 314 (Ct. App. 1985).

Because loading and unloading is considered "use" and is covered, policies often exclude anyone other than the carrier's employees from coverage "while moving property to or from a covered auto." There has been a growing trend for businesses whose employees or invitees are injured while loading and unloading a tractor-trailer to seek coverage for their independent negligence under the motor carrier's insurance policy despite the exclusions. These businesses argue that the exclusions violate Arizona's financial responsibility law. See *Mission Ins. Co. v. Aid Ins. Servs.*, 120 Ariz. 220, 221-22, 585 P.2d 240, 241-42 (1978) (stating the exclusion of non-employees of

the named insured in the policy conflicted with the financial liability law and was therefore void and unenforceable).

Mission, however, was decided before the enactment of Arizona’s financial responsibility statute applicable to commercial vehicles. Thus, its analysis focused on the statute applicable to personal vehicles, which required coverage for all permissive users (which would include anyone who was injured while in “use” of the vehicle). The statute enacted for commercial vehicles does not require such coverage for permissive users and, therefore, *Mission* is arguably no longer applicable. Compare A.R.S. § 28-4009 with A.R.S. § 28-4033. ***Wilshire Ins. Co. v. Home Ins. Co.***, 179 Ariz. 602, 606, 880 P.2d 1148, 1152 (Ct. App. 1994), held that Arizona’s financial responsibility law does not require complete coverage for permissive users of a commercial vehicle. In that case, the court upheld the common carrier’s insurance policy exclusion for anyone other than the trucking company’s employees or a lessee or borrower or their employees while loading or unloading a covered vehicle. *Id.* at 605, 880 P.2d at 1151. The trucker’s insurer was not liable for injuries caused when another company’s employees unloaded a truck covered by the insurer.

McCandless v. United Southern Assurance Company, 191 Ariz. 167, 171, 953 P.2d 911, 915 (Ct. App. 1997), though focused on different issue, criticized *Wilshire*. In *McCandless*, the insurer argued the policy was cancelled because the insured misrepresented the number of vehicles operating under its authority. The court held that fraud discovered after the accident does not cancel coverage. As authority for this proposition, the court cited former A.R.S. § 28-1170(F)(1),⁸ which says that the policy may not be cancelled after the occurrence of the injury or damage. This is where *Wilshire* comes in. The insurer in *McCandless* argued that A.R.S. § 28-1170 does not apply to commercial vehicles because that section is in the part of the financial responsibility law that deals with private vehicles. Remember, this was the successful argument in *Wilshire* regarding permissive drivers. The court in *McCandless*, however, distinguished the two situations: unlike the private vehicle statute, A.R.S. § 28-1170 expressly makes the non-cancellation rule applicable to all policies “required by this chapter.” A.R.S. § 28-1170(F)(1). The chapter includes the entire financial responsibility law pertaining to both private and commercial vehicles. In reaching this ruling, the *McCandless* court was critical of *Wilshire*’s broad reasoning, but did not reject (indeed, did not even address) *Wilshire*’s holding that the statute requiring coverage for permissive users does not apply to commercial vehicles.

The “Mechanical Device” Exclusion

The “Mechanical Device” exclusion should also be considered in cases involving the loading and unloading of vehicles. This exclusion typically says that damage caused while using a mechanical device to load or unload a vehicle is not covered, unless the device is attached to the covered auto.

The first issue is whether the exclusion applies. In part, resolution of this issue may depend on whether the facts ultimately show that something other than the use of the mechanical device

⁸ A.R.S. § 28-1170 is now renumbered A.R.S. § 28-4009.

caused the injury. Thus, whether this exclusion will apply ultimately will depend on the facts. The second issue is, assuming the exclusion applies, whether it violates the financial responsibility law. Arizona has yet to address this issue, but, *Truck Ins. Exchange v. Home Ins. Co.*, 841 P.2d 354, 358 (Colo. Ct. App. 1992), held such an exclusion void because the injuries arose from a covered use of the truck and the exclusion narrows the circumstances under which compulsory coverage applies. In *Truck*, however, the court focused on a financial responsibility statute that requires coverage for all permissive users and held that exclusion was invalid because it would deny coverage to a permissive user. As discussed above, Arizona's statute applicable to commercial vehicles does not require coverage for all permissive users, so there is a strong argument this exclusion remains valid under Arizona law. See *Travelers Indem. Co. v. General Star Indem. Co.*, 157 F. Supp. 2d 1273, 1288 (S.D. Ala. 2001) (enforcing the mechanical device exclusion).

THE MCS-90 ENDORSEMENT (THE ULTIMATE MONKEY WRENCH)

Any policy that insures a licensed interstate motor carrier must have what is known as an MCS-90 endorsement attached to it. The endorsement creates an obligation to the public to pay any judgment resulting from negligence in the operation, maintenance or use of motor vehicles, even if the specific vehicle is not identified or covered under the insurance policy to which the endorsement is attached. *John Deere Ins. Co. v. Nueva*, 229 F.3d 853, 857 (9th Cir. 2000). This means that the MCS-90 endorsement obligates an insurer to pay judgments against the named insured that the policy does not otherwise cover, regardless of coverage defenses or allocation issues arising under the policy. Even if the endorsement is not physically attached to the policy, the court will impute the terms of the MCS-90 endorsement into the policy as a matter of law. See *Transport Indem. Co. v. Carolina Cas. Ins. Co.*, 133 Ariz. 395, 406, 652 P.2d 134, 145 (1982).

Who is an Insured Under the MCS-90

Cases involving an MCS-90 endorsement typically turn on promoting the overriding public policy considerations behind the MCS-90 endorsement. The endorsement originated in the idea that the public must be protected when a licensed carrier uses interchanged, leased or substitute vehicles to transport goods under federal operating authority. With this purpose in mind, courts have extended coverage through the MCS-90 endorsement for leased or non-owned vehicles, as well as for permissive users of non-covered vehicles. *John Deere Ins. Co. v. Nueva*, 229 F.3d 853, 857 (9th Cir. 2000). To clarify, an MCS-90 endorsement creates a duty on the part of the insurer to indemnify its named insured for injuries negligently caused to the public, even if the underlying incident is not covered under policy.

In response to decisions expanding coverage, the Federal Motor Carrier Safety Administration (FMCSA) has issued regulatory guidance indicating that the term "insured" as used in both the MCS-90 and the MCS-82 is defined as the motor carrier named in the policy of insurance and surety bond. The FMCSA made it clear that these endorsements were not intended to satisfy judgments against any party other than the carrier named in the endorsement or surety bond, or its fiduciary. Other jurisdictions have followed this regulatory guidance, calling into question

the validity of precedents like *Nueva*. Arizona and the Ninth Circuit have yet to reach such a decision and therefore, continue to uphold *Nueva* as good law.

Duty to Defend Under the MCS-90

The purpose of MCS-90 is not to “create a windfall for the insured.” Thus, the MCS-90 does not create a duty to defend if no such duty exists under the policy. See *Harco Nat’l Ins. Co. v. Bobac Trucking, Inc.*, 107 F.3d 733, 736 (9th Cir. 1997). However, the MCS-90 also does not negate a separate duty to defend that exists under the terms of the policy. The *Harco* court held that the MCS-90 endorsement did not affect the rights of the insurer and the insured as between each other.

Right to Reimbursement Under the MCS-90

The MCS-90 endorsement gives the insurer the right to seek reimbursement from the insured carrier for “any payment by the company on account of any accident, claim or suit involving a breach of the terms of the policy, and for any payment that [the insurer] would not have been obligated to make under the provisions of the policy except for the agreement contained in” the endorsement. Under both Arizona’s financial responsibility laws and the MCS-90, if an insurer is required to pay a judgment only by reason of the endorsement (and the insurer would not otherwise be obligated to pay under the policy), the insurer has a right of reimbursement against the motor carrier. See A.R.S. § 28-4009; see also *Harco*, 107 F.3d at 736. The insurer may seek reimbursement for both judgments and settlements prior to the entry of a judgment. An insurer should reserve his/her right to seek reimbursement by giving written notice to the insured motor carrier that coverage may not exist under the policy and that the insurer will seek to recoup from the insured any amounts expended to resolve the case.

The Effect of the MCS-90 on the Priority of Coverages

Because authorized carriers commonly use leased vehicles to haul goods, most of the reported cases—not surprisingly—involve such leased vehicles and disputes concerning the applicability of “other insurance” clauses. There are numerous conflicting judicial decisions regarding the effect of the MCS-90 on the determination of primary coverage in accidents involving leased vehicles, which might be insured by multiple policies. Simply stated, the issue is whether the existence of the MCS-90 endorsement in a lessee’s policy makes that policy primary as a matter of law. What if the other policy involved is a commercial automobile policy purchased by the leased driver which does not have an MCS-90 endorsement, yet states it is to be primary?

The Arizona Supreme Court addressed this issue in *Transport Indem. Co. v. Carolina Cas. Ins. Co.*, 133 Ariz. 395, 406, 652 P.2d 134, 145 (1982). The court held that an MCS-90 endorsement does nothing more than negate limiting provisions, such as excess clauses, in the policy to which it is attached, but it does not make the policy primary over other policies that by their own terms provide primary coverage. In *Transport Indemnity*, the driver of a leased tractor was involved in an accident. At the time, the driver was under dispatch of the lessee, an interstate carrier licensed by the Interstate Commerce Commission. The court held that because the truck driver was

dispatched with an interstate load by a licensed ICC carrier, the insurer for the ICC motor carrier provided “primary coverage to the minimum limits required by law.” Other Arizona cases are in accord. *See, e.g., Canal Ins. Co. v. United States Fidelity & Guar. Co.*, 149 Ariz. 578, 579, 720 P.2d 963, 964 (Ct. App. 1986) (holding that the lessee’s policy was primary because the MCS-90 endorsement nullified the limiting language in the policy); *Transamerica Ins. Co. v. Maryland Cas. Co.*, 166 Ariz. 219, 220, 801 P.2d 454, 455 (Ct. App. 1990) (holding the lessee involved in an informal trip lease was required to carry primary liability insurance).

Transport Indemnity reasoned that the legal effect of the ICC/DOT regulations is to make the driver of the leased vehicle the statutory employee of the interstate carrier/lessee. The carrier/lessee then becomes vicariously liable to the public for the negligent operation of the leased vehicle. Having assumed by operation of law the exclusive possession, control, and use of the vehicle, and full responsibility for its operation, the interstate carrier/lessee must also have adequate insurance coverage. If this were not the case, the federal regulations would be meaningless, and the objective of providing financial protection to the public and shippers would not be accomplished. Accordingly, under Arizona law, the lessee’s/carrier’s policy that contains the MCS-90 endorsement must provide primary coverage for any loss its dispatched leased driver causes.

The analysis, however, does not end here. Indeed, the requirement that the ICC/DOT carrier assume full control and responsibility for the leased vehicle does not mean that the owner and/or operator of the leased vehicle are without insurance coverage. The confusion inherent in this situation is exacerbated by conflicting policy provisions and exclusions among the policies along with the tendency of each insurer to claim that its coverage is excess only and that the others are primary. While there has yet to be an Arizona decision that discusses the precise issue of whether a second policy issued to the owner and/or driver, such as a commercial automobile policy, may be considered co-primary with the interstate motor carrier’s policy, the dicta in *Transport Indemnity* suggests that both parties will be considered co-primary:

We do not go so far as to hold that federal law imposes upon the lessee’s insurer the status of sole primary insurer. There may be other primary insurers, depending upon the terms of the lessor’s insurance contract. (Citations omitted). And there may be indemnification agreements between lessor, lessee and other respective insurers. (Citations omitted). Where they exist, these rights may be enforced by action for contribution or indemnity, but such actions will not ordinarily delay disposition of the tort claim by enforcement of the primary liability which the lessee and its insurer must bear.

Transport Indem., 133 Ariz. at 405-406, 652 P.2d at 144-145. This language indicates that Arizona courts will look to the language of any other policies in effect, and will decide whether they are primary or excess based on the policy language. Assuming the owner and/or driver’s policy clearly purports to be primary, it will likely be held co-primary with the carrier’s policy under Arizona law. The loss, therefore, would then be prorated based on the respective liability limits of the respective policies as dictated by the policy provisions.

If you have questions regarding the information in this chapter, please contact the authors or any JSH attorney.

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CHAPTER 22: THE LAW OF HOMEOWNERS' ASSOCIATIONS

OVERVIEW

Litigation involving Homeowners' Associations (HOA) is a very diverse and unpredictable area of law. Typically, the litigants are emotionally invested in the suit and tend to make decisions based on emotions rather than logic and objectivity. Also, they often are representing themselves *pro se* or have been able to induce a family member or family friend to represent them. This compounds the emotionally charged atmosphere because litigants are not receiving unbiased counsel on the issues.

The most common situation giving rise to a lawsuit against an HOA is when an HOA denies a plaintiff's application for a variance on their property which would allow them to construct (or keep) a prohibited element. Such variance requests can range from paint color, to the placement or height of a perimeter wall or trees, and structures that block a neighbor's view. With these types of claims, plaintiff usually claims to be singled out and treated differently than other neighbors. Not surprisingly, many of these claims arise soon after a vote by the HOA Board to change previous CC&R's and enact new rules that restrict or eliminate a previously enjoyed right. In addition, litigation can arise from an HOA's failure to comply with its rules and regulations, or to act reasonably.

In *Kalway v. Calabria Ranch HOA, LLC*, 252 Ariz. 532, 506 P.3d 18 (2022), the Arizona Supreme Court held that an HOA could may rely on a general-amendment-power provision in its covenants, conditions, and restrictions ("CC&Rs") to place restrictions on homeowners' use of their property only with respect to those restrictions for which the HOA's original declaration provided sufficient notice. Allowing substantial, unforeseen, and unlimited amendments, said the court, would alter the nature of the covenants to which the homeowners originally agreed. There, the general-purpose statement in Calabria Ranch's original declaration--to "protect[] the value, desirability, attractiveness and natural character of the Property"--was too broad and subjective to give notice of future amendments. Below is a general discussion of the basics of HOA formation and regulation.

FORMATION AND REQUIREMENTS

Membership

HOA's fall into one of two categories: condominiums, where homeowners share proportionally in the ownership of common areas; or planned communities, where common areas are owned by the HOA itself. The difference is important with regard to which law will apply to the homeowners and the HOA.

Arizona law defines an association as “a nonprofit corporation or unincorporated association of owners that is created pursuant to a declaration to own and operate portions of a planned community and that has the power under the declaration to assess association members to pay the costs and expenses incurred in the performance of the association’s obligations under the declaration.” A.R.S. § 33-1802(1). A “planned community” is a “real estate development which includes real estate owned and operated by a nonprofit corporation or unincorporated association of owners, created for the purpose of managing, maintaining or improving property, and in which the owners of separately owned lots, parcels or units are mandatory members and are required to pay assessments to the association for these purposes. A.R.S. § 33-1802(4).

As a nonprofit corporation, an HOA’s articles of incorporation or bylaws may establish the procedures for new and continued membership in the HOA. *See* A.R.S. § 10-3601(A). A person cannot be admitted as a member without that person’s express or implied consent to membership. A.R.S. § 10-3601(B). Implied consent occurs through ownership of a lot or unit in the community, and constructive notice of mandatory membership occurs because of recorded declarations. Members may resign at any time, unless the articles of incorporation or bylaws require all owners to be mandatory members of the nonprofit corporation/association.

A member may be expelled or suspended, under A.R.S. § 10-3621, according to a procedure set forth in the articles of incorporation or the bylaws, by an agreement between the association and member, or by a procedure that is “otherwise appropriate.” “Otherwise appropriate” procedures are valid only if: (1) a written notice stating the reasons is provided to the member at least 15 days before the expulsion, suspension or termination; (2) an opportunity for the member to be heard, orally or in writing, at least five days before the effective date of the expulsion, suspension or termination by a person or persons authorized to decide that the proposed expulsion, suspension or termination should not take place is provided to the member; and (3) the termination, expulsion or suspension is fair and reasonable taking into consideration all of the facts and circumstances. All written notices must be sent to the member’s last address shown in the association’s records, and the member has six months to file a lawsuit challenging the action. Suspension does not relieve a member from obligations for dues, or fees assessed that resulted before the suspension. These “otherwise appropriate” procedures come into play only if there are no procedures set forth in the articles of incorporation or bylaws.

General Powers

Unless limited by the articles of incorporation, the HOA has perpetual duration and the same powers as individuals to do all things necessary or convenient to carry out its affairs. A.R.S. § 10-3302 lists the powers that nonprofit corporations such as community associations possess. Those applicable to community associations include: (1) sue and be sued, complain and defend in its corporate name; (2) purchase, receive, lease or otherwise acquire and own, hold, improve, use and otherwise deal with real or personal property or any interest in property wherever located; (3) sell, convey, mortgage, pledge, lease, exchange and otherwise dispose of all or any part of its property; (4) make contracts and borrow money and the power to secure its obligations by mortgage or other encumbrance of its property or income; (5) impose dues, assessments,

admission and transfer fees on its members; and (6) do any other act not inconsistent with law that furthers the activities and affairs of the corporation.

In *Sycamore Hills Estates Homeowners Association, Inc. v. Zablony*, 250 Ariz. 479, 481 P.3d 705 (Ct. App. 2021), the court of appeals rejected the HOA's argument that two-year-old a settlement agreement it had entered into with a homeowner, Zablony, was invalid because the HOA did not "have authority" under the CC&Rs to enter into it. In the settlement agreement, the HOA had affirmed that "[t]he individual(s) who have signed this Agreement on behalf of their respective entities hereby certify that they have the right and full corporate authority to enter into this Agreement on behalf of their entities." Moreover, A.R.S. § 10-3304(A) states that "[e]xcept as provided in subsection B of this section, the validity of the corporate action shall not be challenged on the ground that the corporation lacks or lacked power to act." Subsection B states that only a member can bring such a challenge, and the Association was not a "member." *Id.* at 484-85.

Meetings and Voting

Meetings must take place at least once per calendar year. They may be called by the president, a board majority, or 25% of the voting members. Notices for annual, regular, or special meetings must be provided to those members entitled to vote at least 10 days, but not more than 60 days before the meeting in compliance with the Arizona Condominium Act and planned community statutes. A.R.S. § 10-3706 allows a member to waive the notice of a meeting by signing a document and delivering it for inclusion in the minutes or filing it in the records. Notice must be hand delivered or delivered via US mail. For meetings of the board of directors, only 48-hour notice is necessary.

All meetings of the association must be open to all members. There are four specific exceptions to the open meeting requirement, where the board may close the meeting to the executive session. These exceptions are: (1) when receiving advice of legal counsel; (2) when discussing pending or potential litigation; (3) when personal, health, or finance issues are discussed with respect to an individual member; and (4) when discussing matters related to job performance, health, compensation, or complaints directed against any individual working for the association or under the direction of the association.

Unless otherwise provided by the articles of incorporation or bylaws, all members of the HOA will have the same rights and obligations with respect to all matters. A.R.S. § 10-3610. The articles or bylaws may establish classes of membership with different rights or obligations (e.g., weighted voting for single-family residence owners compared to townhouse unit owners).

A quorum of members must be present, in person or by proxy, at a membership meeting in order to conduct business. If the articles of incorporation or bylaws do not state what constitutes a quorum, the default is 10% of eligible voters. A.R.S. § 10-3722. If a quorum is established, the vote of the majority will constitute an action of the members at large. A.R.S. § 10-3723. The only time proxies are permitted in community associations is during the period of declarant control. A.R.S. §§ 33-1250, 33-1812.

Special Requirements for Condominium Units (A.R.S. 33-1201 et seq.)

Condominiums are governed by the Arizona Condominium Act, codified at A.R.S. § 33-1201 through § 33-1270. Arizona law allows a condominium to be created by the recording of a declaration. A.R.S. § 33-1211. This declaration is commonly referred to as the Covenant, Conditions and Restrictions (CC&R's) of the association. This declaration must be indexed in the name of the condominium, the association, and as required by law. The declaration may contain any matter the "declarant" deems appropriate. A.R.S. § 33-1215. A.R.S. § 33-1217 controls the voting rights for condominium units. It establishes that the declaration is not required to, but *may* provide that: (1) varying allocations of votes be made dependent on matters indicated in the declaration; (2) cumulative voting is allowed when electing members of the board of directors only; and (3) class voting is allowed on specific issues that affect the class if necessary to protect valid interests of the class.

Assessments and Dues

Homeowners pay assessments of the HOA on a monthly, quarterly or annual basis. Money paid by a homeowner must first be applied to the principal of the assessment and then to late charges and penalties. HOA's must provide a written statement of unpaid assessments within 15 days of a homeowner's request in writing. HOA's can only foreclose on a home if the owner is at least one year overdue on assessments, or he/she owes \$1,200 or more, excluding reasonable collection fees, attorney's fees, and late fees.

LIABILITY

Breach of Contract

Deed restrictions limiting development to "residential" development are enforceable in Arizona. *Cont'l Oil Co. v. Fennemore*, 38 Ariz. 277, 299 P. 132 (1931) (deed restrictions may be enforced in equity by any of the grantees against the others when "as a part of a general scheme of improvement restrictions are inserted in all of the deeds governing the purposes for which the land may be used.").

Other contract documents produced by HOA's include articles of incorporation, bylaws, and a declaration of covenants, conditions and restrictions (most commonly referred to as CC&R's). The HOA can also adopt rules that interpret the CC&R's or bylaws.

HOA's can levy fines for the violation of a rule. Fines cannot be used to form the basis of a foreclosure action. To collect the fines, a homeowner must either voluntarily pay the fine, or the HOA must file a lawsuit to collect. HOA's must first offer the homeowner a hearing with the board of directors before issuing a fine. If no hearing is given or offered, the fine is not enforceable.

DERIVATIVE ACTIONS

Derivative actions are civil suits brought by members in “the right of the corporation.” A.R.S. §§ 10-3630 to 10-3637 address derivative suits. Members having 25% of the voting power, or 50 members, whichever is less, can bring an action in superior court to procure a judgment in favor of the association. The provisions of these statutes are procedural and dictate when an action can be commenced and what must be done for the action to be dismissed.

DAMAGES

Contract Damages

Restrictive covenants are enforceable as contracts. When a grantee accepts a deed containing restrictions, he assents to them and is bound to perform them. *Heritage Heights Home Owners Ass’n v. Esser*, 115 Ariz. 330, 333, 565 P.2d 207, 210 (Ct. App. 1977).

Enforcement of restrictive covenants is governed by equitable principles. An injunction is an equitable remedy that allows the court to promote equity between the parties. *Ahwatukee Custom Estates Mgmt. Ass’n Inc. v. Turner*, 196 Ariz. 631, 2 P.3d 1276 (Ct. App. 2000).

Equitable Estoppel

Plaintiffs seeking equitable relief must have “clean hands” when attempting to enforce restrictive covenants in Arizona. *McRae v. Lois Grunow Mem’l Clinic*, 40 Ariz. 496, 14 P.2d 478 (1932). A plaintiff can be estopped from enforcing the covenants and receiving equitable relief if she does not have “clean hands,” and if her conduct would make it unjust to grant her relief. *McRae*. A person may, however, be entitled to enforce a restrictive covenant even though she has been on notice of violations inflicting no substantial injury. *Whitaker v. Holmes*, 74 Ariz. 30, 243 P.2d 462 (1952). The right to enforce will not be lost by failing to take steps to restrain innocuous violations when the violation in a particular case causes substantial injuries. *Whitaker*.

A “change in circumstances” or “change in use” can also negate enforceability of restrictive covenants. If the use to which property in a neighborhood is being put is such that it is no longer residential property, it would be inequitable to allow restrictions where the changed condition did not result from a breach, but from other causes. *Cont’l Oil Co. v. Fennemore*, 38 Ariz. 277, 299 P. 132 (1931). If the surrounding area is so fundamentally changed as to frustrate the original purposes of the restrictions, equity will not enforce them. *Murphey v. Gray*, 84 Ariz. 299, 327 P.2d 751 (1958). Permitting frequent violations may also cause the restrictive covenants and neighborhood scheme to be considered abandoned. *O’Malley v. Cent. Methodist Church*, 67 Ariz. 245, 195 P.2d 444 (1948). Violations of separate and unrelated covenants cannot be used to show a “waiver” of a different restrictive covenant at issue, however. The violations must be of “a character and extent to indicate an abandonment of the entire restrictive plan.” *Condos v. Home Dev. Co.*, 77 Ariz. 129, 267 P.2d 1069 (1954).

Express non-waiver provisions can be used in restrictive covenants. These provisions can aid in gaining injunctions and enforcing the covenants. An express non-waiver provision cannot be overcome if a complete abandonment of the entire restrictive covenant occurs. ***Burke v. Voicestream Wireless Corp. II***, 207 Ariz. 393, 87 P.3d 81 (Ct. App. 2004). Absent a complete abandonment, the provision will be enforced according to its terms. See *Burke*.

ATTORNEY'S FEES

The prevailing party is entitled to a mandatory award of attorney's fees and costs in an action to foreclose on a lot or unit for unpaid assessments. A.R.S. § 33-1256. Most CC&R's also state that the lien and personal obligation come with reasonable attorney's fees.

If the statutory requirement is embodied in the deed restrictions, the court must abide the contract as long as the restriction is valid. A provision stating that a community who hires an attorney is entitled to "all" of its attorney's fees, and like provisions, will not be enforced to authorize unreasonable or clearly excessive attorney's fees. See ***McDowell Mountain Ranch Cmty. Ass'n, Inc. v. Simons***, 216 Ariz. 266, 165 P.3d 667 (Ct. App. 2007).

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CHAPTER 23: TRIBAL LAW

There are twenty-one (21) federally recognized Indian tribes in Arizona. They are:

- Ak-Chin Indian Community
- Cocopah Indian Tribe
- Colorado River Indian Tribes
- Fort McDowell Yavapai Nation
- Fort Mojave Indian Tribe
- Gila River Indian Community
- Havasupai Tribe
- Hopi Tribe
- Hualapai Tribe
- Kaibab Bank of Paiute Indians
- Pascua Yaqui Tribe
- Pueblo of Zuni
- Quechan Tribe
- Salt River Pima-Maricopa Indian Community
- San Carlos Apache Tribe
- San Juan Southern Paiute Tribe
- Tohono O’odham Nation
- Tonto Apache Tribe
- White Mountain Apache Tribe
- Yavapai-Apache Nation
- Yavapai-Prescott Indian Community

Generally, each tribe has its own constitution, laws, government, and courts, and each operates differently. Native American tribes are considered “sovereign governments,” and as a general rule, tribes have authority to regulate their own members.

SOVEREIGN IMMUNITY

Generally, tribes can be sued only when Congress has authorized the suit or the tribe has waived its immunity. *Kiowa Tribe of Oklahoma v. Manufacturing Technologies, Inc.*, 523 U.S. 751 (1998). Because of this, many tribes have tort codes or procedures that must be followed in order to sue the tribe, similar to the pre-suit requirements for suing a governmental entity in Arizona. Each one is different, and the specific procedures and rules of the tribe should be considered.

The Arizona Supreme Court recently adopted a test for determining whether a tribal entity is a “subordinate economic organization” entitled to sovereign immunity. In *Hwal’Bay Ba: J Enterprises, Inc. v. Jantzen*, 248 Ariz. 98, 458 P.3d 102 (2020), the Arizona Supreme Court held that a rafting trip operator tribal entity failed to meet its burden of demonstrating that it was a subordinate economic organization of the Hualapai Tribe for purposes of sovereign immunity.

The test the court adopted is a test of six-non-exclusive factors: (1) the entity's creation and business form; (2) the entity's purpose; (3) the business relationship between the tribe and the entity; (4) the tribe's intent to share immunity with the entity; (5) the financial relationship between the entity and the tribe; and (6) whether immunizing the entity furthers federal policies underlying sovereign immunity. If the entity meets its burden of showing that the factors collectively weigh in favor of finding the entity is a subordinate economic organization of the tribe, the entity is cloaked with sovereign immunity, unless that protection has been waived or abrogated by Congress. If not, the entity is not immune from suit. *Id.* at 106, 458 P.3d at 110.

Congress has restricted tribal immunity when a tribe or tribal entity has liability insurance. Congress has mandated that tribes, tribal organizations, and tribal contractors must carry liability insurance. 25 U.S.C. § 5321(c)(1). Any such policy of insurance must contain a provision that the insurance carrier cannot assert sovereign immunity as a defense; but the waiver extends only to claims that are covered and within policy limits. 25 U.S.C. § 5321(c)(3)(A).

TRIBAL COURT JURISDICTION

One of the most common issues that arises in civil suits filed in tribal court between tribes or tribal members and non-Indians is whether the tribal court has jurisdiction over the case. Tribal jurisdiction is a question of federal law. ***Nat'l Farmers Union Ins. Companies v. Crow Tribe of Indians***, 471 U.S. 845, 852 (1985). The analysis can be complicated, and depends on several factors, including the status of the parties (tribal member or not), the nature of the claim (affecting Indian sovereignty or not), and the location of the incident (occurring on tribal or non-tribal property).

Principles of Tribal Court Jurisdiction over Non-Indians

Generally, Native American tribes have authority over their own tribal members and land that they control within the reservation. ***Plains Commerce Bank v. Long Family Land and Cattle Co.***, 554 U.S. 316, 327 (2008). As part of their sovereignty, the tribes “retain power to tax activities on the reservation, including certain activities by non-members,” to determine tribal membership, and to regulate domestic relations among members. *Id.*

An Indian tribe's inherent sovereign powers do not extend to the activities of nonmembers of the tribe, especially on non-tribal land within the borders of a reservation. ***Montana v. United States***, 450 U.S. 544, 565 (1981). Indian tribes' sovereign power “centers on the land held by the tribe and on tribal members within the reservation.” *Plains Commerce Bank*, 554 U.S. at 327. “By virtue of their incorporation into the United States, [a] tribe's sovereign interests are now confined to managing tribal land, protecting tribal self-government, and controlling internal relations.” *Id.* at 334. There is a presumption that a tribe has no jurisdiction over a non-member. *Plains Commerce Bank*, 554 U.S. at 330.

In *Montana*, the Court laid out two exceptions to the general rule that an Indian tribe has no adjudicative authority over a non-member. 450 U.S. at 565. First, a tribe may regulate, “through

taxation, licensing, or other means, the activities of nonmembers who enter consensual relationships with the tribe or its members, through commercial dealing, contracts, leases, or other arrangements.” This exception requires not only a consensual relationship between the non-member and the tribe or its member, but also non-member conduct on the reservation that implicates the tribe’s sovereign interests. *Plains Commerce Bank*, 554 U.S. at 332.

The second *Montana* exception allows tribal jurisdiction over non-member conduct that threatens or has a direct impact on “the right of reservation Indians to make their own laws and be ruled by them.” *Strate v. A-1 Contractors*, 520 U.S. 438, 457-58. This exception is a narrow one and applies only to conduct that “imperil[s] the subsistence of the tribal community.” *Plains Commerce Bank*, 554 U.S. at 341.

Having said that, the U.S. Supreme Court in *United States v. Cooley*, ___ U.S. ___, 141 S. Ct. 1638 (2021), recently reiterated that tribal officers have authority under *Montana*’s second exception to detain temporarily and to search non-Indian persons traveling on public rights-of-way running through a reservation for potential violations of state or federal law. When the “jurisdiction to try and punish an offender rests outside the tribe, tribal officers may exercise their power to detain the offender and transport him to the proper authorities.” And ancillary to the authority to transport a non-Indian suspect is the authority to search that individual prior to transport. More importantly, recognizing a tribal officer’s authority to investigate potential violations of state or federal laws that apply to non-Indians whether outside a reservation or on a public right-of-way within the reservation protects public safety without implicating concerns about applying tribal laws to non-Indians.

The Ninth Circuit recognizes a third basis under which a tribal court may exercise jurisdiction over a non-member. That is the “right to exclude” analysis. The right to exclude stems from the tribe’s right, as a landowner, to occupy its land and exclude all others. See *Strate v. A-1 Contractors*, 520 U.S. at 438 (tribes lack power to “assert [over non-Indian fee land] a landowner’s right to occupy and exclude”); *Nevada v. Hicks*, 533 U.S. 353, 359 (2001) (“Both *Montana* and *Strate* rejected tribal authority to regulate nonmembers’ activities on land over which the tribe could not “assert a landowner’s right to occupy and exclude.”). Not surprisingly, then, to date the Ninth Circuit has applied the right to exclude analysis to cases where a non-member was occupying or physically present on tribal land. See, e.g., *Water Wheel Camp Recreational Area, Inc. v. LaRance*, 642 F.3d 802, 813 (9th Cir. 2011) (tribal jurisdiction existed where non-member lessee of tribal land failed to pay rent); *Window Rock Unified Sch. Dist. v. Reeves*, 861 F.3d 894, 898 (9th Cir. 2017) (finding plausible tribal jurisdiction over non-member school districts operating on tribal property).

The U.S. Supreme Court has stated that the power to exclude analysis does not exist independent of the *Montana* presumption against jurisdiction discussed above. See *Nevada v. Hicks*, 533 U.S. at 360 (*Montana* test applies regardless of land ownership; overturning the Ninth Circuit’s refusal to use the *Montana* presumption in favor of a “power to exclude” analysis). See also *Plains Commerce Bank*, 554 U.S. at 331 (“[t]he status of the land is relevant insofar as it bears on the application of *Montana*’s exceptions.”). The Ninth Circuit, however, is of the opinion that *Nevada v. Hicks*—which held there was no tribal jurisdiction over state officers enforcing state law on

tribal property—should be narrowly limited to its facts. *See, e.g., Window Rock Unified Sch. Dist. v. Reeves*, 861 F.3d at 896 (exhaustion of tribal court remedies required for claims against state school district operating on tribal land; claims “implicate[d] no state criminal law enforcement interests,” so tribal jurisdiction was plausible “under our court’s interpretation of *Nevada v. Hicks*.”). Other courts do not agree with the Ninth Circuit’s very narrow interpretation of *Nevada v. Hicks*. *See, e.g., Stifel, Nicolaus & Co. v. Lac du Flambeau Band of Lake Superior Chippewa Indians*, 807 F.3d 184, 207 (7th Cir. 2015) (Ninth Circuit’s conclusion that the *Montana* test applies only to conduct on non-Indian land cannot “be reconciled with the language that the Court employed in *Hicks* and *Plains Commerce Bank*.”).

In the *Cooley* case, *supra*, the U.S. Supreme Court relied on *Montana*’s second exception, rather than the right to exclude, to support the tribal officer’s authority to stop and detain a potential criminal suspect on a public roadway within the reservation. *Id.* at 1444.

Two recent federal cases in our jurisdiction applied these precepts. In *Knighton v. Cedarville Rancheria of N. Paiute Indians*, 922 F.3d 892, 894–95 (9th Cir. 2019), the Ninth Circuit held that the tribal court had jurisdiction to adjudicate tribal claims against a nonmember tribal administrator who had engaged in fraud and malfeasance to the tribe’s great detriment. The tribe’s jurisdictional authority over these claims derived from its sovereign power to exclude non-members, from its “inherent sovereign power to protect self-government and control internal relations,” from the employment relationship between the administrator and the tribe (under *Montana*’s first exception), and because the administrator’s conduct imperiled the subsistence of the tribal community (under *Montana*’s second exception).

In *Employers Mut. Cas. Co. v. Branch*, 381 F. Supp. 3d 1144, 1146 (D. Ariz. 2019), *aff’d sub nom. Employers Mut. Cas. Co. v. McPaul*, 2020 WL 2316616 (9th Cir. May 11, 2020), the Arizona district court held there was no tribal jurisdiction over an insurance company that simply sold a policy to a tribal member. Instead, said the court, jurisdiction over non-members has been limited to instances in which a non-member was physically present on tribal land and thereafter engaged in the conduct giving rise to liability. To the extent the Ninth Circuit has suggested an insurance company may be sued in tribal court despite the absence of any physical presence on tribal land, its decisions have been limited to circumstances where the policyholder was a tribal member and the insurance company engaged in conduct specifically directed toward the reservation. The Ninth Circuit affirmed, reasoning that the insurance company’s “relevant conduct—negotiating and issuing general liability insurance contracts to non-Navajo entities—occurred entirely outside of tribal land, tribal court jurisdiction cannot be premised on the Navajo Nation’s right to exclude.”

Exhaustion of Tribal Court Remedies

If a non-Indian defendant who has been sued in tribal court wants to challenge the tribal court’s jurisdiction, generally that challenge must first occur in tribal court. In other words, the defendant is required to “exhaust his tribal court remedies” before seeking relief in federal court. To exhaust one’s tribal court remedies means challenging tribal court jurisdiction in the tribal trial court and

then appealing to the tribal appellate court. *Iowa Mut. Ins. Co. v. LaPlante*, 480 U.S. 9, 17 (1987) (“At a minimum, exhaustion of tribal remedies means that tribal appellate courts must have the opportunity to review the determinations of the lower tribal courts.”).

Tribal court exhaustion is not a jurisdictional bar, but rather a prerequisite to a federal court's exercise of its jurisdiction. In other words, if a tribal court defendant files a suit in federal court challenging the tribal court's exercise of jurisdiction over him, and the federal court believes the defendant must first exhaust his tribal court remedies, the federal court can stay its proceedings and retain jurisdiction pending the exhaustion of tribal court remedies. *Burlington Northern R. Co. v. Crow Tribal Council*, 940 F.2d 1239, 1245 n. 3 (9th Cir. 1991). This rarely happens as a practical matter, however, because it can take years to fully exhaust tribal court remedies.

There are four exceptions to the exhaustion requirement:

(1) an assertion of tribal jurisdiction is motivated by a desire to harass or is conducted in bad faith; (2) the action is patently violative of express jurisdictional prohibitions; (3) exhaustion would be futile because of the lack of adequate opportunity to challenge the court's jurisdiction; or (4) it is plain that no federal grant provides for tribal governance of nonmembers' conduct on land covered by *Montana's* main rule.

Iowa Mut. Ins. Co. v. LaPlante, 480 U.S. 9, 19, n.12 (1987); *Strate v. A-1 Contractors*, 520 U.S. 438, 459 n. 14 (1997); *Grand Canyon Skywalk Dev., LLC v. 'Sa' Nyu Wa Inc.*, 715 F.3d 1196, 1200 (9th Cir. 2013). Under the fourth exception, first enunciated in *Strate*, exhaustion is not required when “tribal court jurisdiction does not exist under [the federal cases of] *Montana* and *Strate*,” and remand would only delay a final judgment. *Burlington N. R. Co. v. Red Wolf*, 196 F.3d 1059, 1065 (9th Cir. 1999), *as amended on denial of reh'g* (Jan. 6, 2000). This seems to be the most frequently-used argument by parties looking to avoid the exhaustion requirement.

Federal Courts Can Ultimately Decide the Tribal Jurisdiction Issue

After exhausting tribal court remedies (or if exhaustion is not required), the non-member defendant who has been sued in tribal court may file a complaint in federal court seeking a declaration of no tribal jurisdiction, and an injunction preventing the tribal court proceedings from going forward. *See, e.g., Window Rock Unified Sch. Dist. v. Reeves*, 861 F.3d 894 (9th Cir. 2017). Whether the tribal court possesses jurisdiction necessarily turns on the allegations contained in the tribal court complaint; and the federal court will decide the issue as a matter of federal law, based on the record established in tribal court. *Norton v. Ute Indian Tribe of the Uintah & Ouray Reservation*, 862 F.3d 1236, 1245 n.3 (10th Cir. 2017).

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CHAPTER 24: INTELLECTUAL PROPERTY

OVERVIEW

Intellectual property law (“IP Law”) is the area of law that deals with legal rights to scientific inventions and artistic works. In a nutshell, IP Law protects inventors and artists by controlling who gets to use these “intangible assets.” Ultimately, the purpose of IP Law is to give an incentive for people to create and invent things that will in turn benefit society. IP Law is governed by both federal and state law. There are three main categories of IP Law: Patent; Copyright; and Trademark.

PATENTS

A patent is the legal right (often called a “limited monopoly”) to an original invention. It provides inventors with the exclusive right to make, use, offer to sell, or sell a particular invention in the United States for 20 years. During the term of the patent, no one else can make, sell, offer to sell, distribute, or otherwise use the patented invention without permission.

Section 101 of the Patent Act, 35 U.S.C. § 100 *et seq.*, specifies four independent categories of inventions or discoveries that are eligible for protection: processes, machines, manufactures, and compositions of matter. ***Bilski v. Kappos***, 561 U.S. 593, 602 (2010). The patent-eligibility inquiry is only a threshold test. *Id.* Even if an invention qualifies as a process, machine, manufacture, or composition of matter, in order to receive protection the claimed invention must also be: (1) novel; (2) nonobvious; and (3) fully and particularly described. See 35 U.S.C. §§ 102 (novel); 103 (nonobvious); and 112 (particularly described).

Not every new invention or discovery may be patented. Certain things are “free for all to use.” ***Bonito Boats, Inc. v. Thunder Craft Boats, Inc.***, 489 U.S. 141, 151 (1989). Patents are not available for the “laws of nature, physical phenomena, and abstract ideas.” ***Diamond v. Chakrabarty***, 447 U.S. 303, 308 (1980). These exceptions are consistent with the notion that a patentable process must be “new and useful.” *Id.*

“In order to prove direct infringement, a patentee must either point to specific instances of direct infringement or show that the accused device necessarily infringes the patent in suit.” ***ACCO Brands, Inc. v. ABA Locks Mfr. Co.***, 501 F.3d 1307, 1313(Fed.Cir. 2007). Direct infringement may be shown through direct or circumstantial evidence. ***Moleculon Research Corp. v. CBS, Inc.***, 793 F.2d 1261, 1272 (Fed.Cir. 1986).

Section 271(b) of the Patent Act also allows for liability for indirect infringement: “[w]hoever actively induces infringement of a patent shall be liable as an infringer.” To establish liability under section 271(b), a patent holder must prove that once the defendants knew of the patent, they “actively and knowingly aid[ed] and abett[ed] another’s direct infringement.” However, “knowledge of the acts alleged to constitute infringement” is not enough. The “mere knowledge

of possible infringement by others does not amount to inducement; specific intent and action to induce infringement must be proven.” *DSU Med. Corp. v. JMS Co.*, 471 F.3d 1293, 1305 (Fed.Cir. 2006). Lastly, Section 271(c) establishes contributory infringement liability, for those who sell components they know will be used in an infringing products.

COPYRIGHTS

Copyrights protect an owner’s right to their original works of authorship. Works covered by copyright include paintings, photographs, writings, print, architecture, software, performances, music, choreography, and movies. Copyright protection includes: (1) the right to reproduce; (2) the right to create derivative works; (3) the right to distribute; and (4) the right to publicly perform. Copyright protection does not extend to mere ideas, systems, concepts, principles, or discoveries in their abstract forms.

A copyright exists in all original works of authorship from the moment the work is fixed in a tangible medium of expression (e.g., photo, song, writing, etc.). Formal registration of the copyright is not necessary for an owner to have copyright protection. But registration (federal or state) raises a rebuttable presumption that the owner has a valid and enforceable copyright for the work. In addition, formal registration allows the owner to seek attorney’s fees and statutory damages if someone infringes the copyright.

A copyright plaintiff must prove (1) ownership of the copyright; and (2) infringement – that the defendant copied protected elements of the plaintiff’s work. *Smith v. Jackson*, 84 F.3d 1213, 1218 (9th Cir. 1996). Absent direct evidence of copying, proof of infringement involves fact-based showings that the defendant had “access” to the plaintiff’s work and that the two works are “substantially similar.” *Id.* Such proof creates a presumption of copying, which the defendant can then attempt to rebut by proving independent creation. *Three Boys Music Corp. v. Bolton*, 212 F.3d 477, 486 (9th Cir. 2000).

Substantial similarity is inextricably linked to the issue of access. In what is known as the “inverse ratio rule,” courts “require a lower standard of proof of substantial similarity when a high degree of access is shown.” *Smith*, 84 F.3d at 1218. Absent proof of access, a copyright plaintiff can still make out a case of infringement by showing that the songs are “strikingly similar.” *Baxter v. MCA, Inc.*, 812 F.2d 421, 423, 424 n. 2 (9th Cir. 1987).

Proof of substantial similarity is satisfied by a two-part test of extrinsic similarity and intrinsic similarity. *Sid and Marty Krofft Television Productions, Inc. v. McDonald’s Corp.*, 562 F.2d 1157, 1164 (9th Cir. 1977). Initially, the extrinsic test requires the plaintiff to identify concrete elements based on objective criteria. *Smith*, 84 F.3d at 1218. The extrinsic test often requires analytical dissection of a work and expert testimony. *Apple Computer, Inc. v. Microsoft Corp.*, 35 F.3d 1435, 1442 (9th Cir. 1994). Once the extrinsic test is satisfied, the factfinder applies the intrinsic test. The intrinsic test is subjective and asks “whether the ordinary, reasonable person would find the total concept and feel of the works to be substantially similar.” *Pasillas v. McDonald’s Corp.*, 927 F.2d 440, 442 (9th Cir. 1991).

TRADEMARKS

A trademark is a word, symbol, design, logo, lettering, or phrase used to identify a particular manufacturer or seller's products and distinguish them from the products of another. It is an identifier that distinguishes one company, or its products, from others.

Like copyrights, there is no requirement to register the trademark to be entitled to protection. Trademark protection can be established by regularly using a mark in connection with a business or product. However, registering the mark provides a legal presumption of ownership.

Unlike a patent, a trademark can last forever. A valid and enforceable trademark provides the exclusive rights to make and sell products that use the trademark.

In order to be a valid and enforceable trademark, the mark must be distinctive – that is, it must be capable of identifying the source of a particular good. In determining whether a mark is distinctive, courts group marks into four categories based on the relationship between the mark and the underlying product: (1) arbitrary or fanciful; (2) suggestive; (3) descriptive; or (4) generic. Because the marks in each of these categories vary with respect to their distinctiveness, the requirements for, and degree of, legal protection afforded a particular trademark will depend upon the category in which it falls.

An arbitrary or fanciful mark is a mark that bears no logical relationship to the underlying product. For example, the word "Apple" has no inherent relationship to its products (electronic devices).

A suggestive mark is a mark that evokes or suggests a characteristic of the underlying good. For example, the word "Netflix" is suggestive of online films, but does not specifically describe the product. Some imagination is needed to associate the word with the underlying product. At the same time, however, the word is not totally unrelated to the underlying product. Like arbitrary or fanciful marks, suggestive marks are inherently distinctive and are given a high degree of protection.

A descriptive mark is a mark that directly describes, rather than suggests, a characteristic or quality of the underlying product (e.g., its color, odor, function, dimensions, or ingredients). It tells us something about the product. Unlike arbitrary or suggestive marks, descriptive marks are not inherently distinctive and are protected only if they have acquired "secondary meaning." Descriptive marks must clear this additional hurdle because they are terms that are useful for describing the underlying product, and giving a particular manufacturer the exclusive right to use the term could confer an unfair advantage.

A descriptive mark acquires secondary meaning when the public primarily associates that mark with a particular producer, rather than the underlying product. Thus, for example, the term "Holiday Inn" has acquired secondary meaning because the consuming public associates that term with a particular provider of hotel services, and not with hotel services in general. The public need not be able to identify the specific producer; only that the product or service comes from a single producer. When trying to determine whether a given term has acquired secondary

meaning, courts will often look to the following factors: (1) the amount and manner of advertising; (2) the volume of sales; (3) the length and manner of the term’s use; and (4) results of consumer surveys. **Zatarain’s, Inc. v. Oak Grove Smokehouse, Inc.**, 698 F.2d 786 (5th Cir. 1983).

Finally, a generic mark is a mark that describes the general category to which the underlying product belongs. For example, the term “Computer” is a generic term for computer equipment. Generic marks are entitled to no protection under trademark law. Thus, a manufacturer selling “Computer” brand computers (or “Apple” brand apples, etc.) would have no exclusive right to use that term with respect to that product. Generic terms are not protected by trademark law because they are simply too useful for identifying a particular product. Giving a single manufacturer control over use of the term would give that manufacturer too great a competitive advantage. Under some circumstances, terms that are not originally generic can become generic over time (a process called “genericity”), and thus become unprotected. In **United States Patent and Trademark Office v. Booking.com B.V.**, ___ U.S. ___, 140 S. Ct. 2298 (2020), the U.S. Supreme Court ruled that “Booking.com” was not generic for federal trademark registration purposes.

If a party owns the rights to a trademark, that party can sue others for trademark infringement. 15 U.S.C. §§ 1114, 1125. The standard is “likelihood of confusion.” Specifically, infringement exists if the use of the mark by another is likely to cause consumer confusion as to the source of goods or as to the sponsorship or approval of such goods. In deciding whether consumers are likely to be confused, courts will typically look to a number of factors, including: (1) the strength of the mark; (2) the proximity of the goods; (3) the similarity of the marks; (4) evidence of actual confusion; (5) the similarity of marketing channels used; (6) the degree of caution exercised by the typical purchaser; and (7) the defendant’s intent. **Polaroid Corp. v. Polarad Elect. Corp.**, 287 F.2d 492 (2d Cir. 1961). A plaintiff in a trademark infringement suit is not required to show willful infringement of plaintiff’s trademark as a precondition to a profits award. **Romag Fasteners, Inc. v. Fossil, Inc.**, ___ U.S. ___, 140 S. Ct. 1492 (2020).

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