ARIZONA SUPREME COURT
ORAL ARGUMENT CASE SUMMARY

YOLANDA E. QUIHUIS AND ROBERT QUIHUIS v.
STATE FARM MUTUAL AUTOMOBILE INSURANCE CO.
CV-14-0093-CQ

PARTIES

Plaintiffs-Appellants: Yolanda E. and Robert Quihuis

Defendant-Appellee: State Farm Mutual Automobile Insurance Co.

FACTS:

Norma Bojorquez ("Norma") and Carol Cox ("Carol") were coworkers in Nogales, Arizona. Norma bought a 1994 Jeep Cherokee (the "Jeep") for her daughter, Iliana Bojorquez ("Iliana"), from Carol. By January 9, 2008, Carol and Norma had executed a written sales agreement for the Jeep which called for eight monthly installments totaling $3,000. Carol gave Norma the only set of keys to the Jeep, and Norma drove the car home. Norma gave the keys to Iliana so that Iliana could drive the Jeep at her pleasure. Carol did not transfer the Jeep's title certificate to Norma because she thought it necessary to retain the title certificate as collateral until Norma paid off the Jeep. Carol and her husband (the "Coxes") never retook possession of the Jeep.

The Coxes maintained insurance coverage on the Jeep through a policy with State Farm (the "Policy"). The Policy provided liability coverage for bodily injury caused by accident resulting from the use of cars owned by the Coxes, including the Jeep. The Policy covered the Coxes and permissive users of their cars if the use was within the scope of their consent. The Policy also imposed a duty to defend on State Farm. The Coxes did not cancel the Policy until January 29, 2008.

On January 22, 2008, Iliana was driving the Jeep when it collided with a car driven by Yolanda Quihuis. In Arizona state court, Yolanda Quihuis and her husband, Robert Quihuis, sued Iliana for negligence and the Coxes for negligent entrustment. The negligent entrustment claim relied on the Coxes' alleged ownership of the Jeep at the time of the accident. State Farm refused to defend the Coxes because the Jeep's ownership had transferred to Norma before the accident.

On October 29, 2009, the Coxes, the Bojorquezes (Iliana's parents), the Quihuises, and Dairyland Insurance, which insured the Bojorquezes, entered into a *Damron* agreement entitled "Assignment of Rights, Agreement Not to Execute." In pertinent part, they stipulated that the Coxes owned the Jeep at the time of the accident, that Iliana was incompetent to drive a motor

vehicle and her negligence caused the accident, and that the Coxes should have known that Iliana was incompetent to drive and therefore should not have entrusted the Jeep to her. The Coxes and Bojorquezes agreed to damages in the amount of $275,000. The Coxes assigned their rights under the Policy to the Quihuises, who agreed not to execute upon a judgment against the Coxes or the Bojorquezes. The parties also agreed to request a default judgment to terminate the case. On December 31, 2009, the state court entered default judgment in the amount of $350,000—$325,000 for Yolanda's injuries and $25,000 for Robert Quihuis' loss of consortium.

The Quihuises, standing in the Coxes' shoes, then brought a declaratory judgment action against State Farm in Arizona state court for indemnification and failure to defend. State Farm removed the case to the United States District Court for the District of Arizona.

In November 2011, the district court granted State Farm's motion for summary judgment. Applying Arizona law, the district court held that the default judgment did not preclude State Farm from litigating the question of whether the Coxes owned the Jeep at the time of the accident for two reasons. First, a conflict of interest existed between the Coxes and State Farm, which denied preclusive effect to the issues in the default judgment. Specifically, the court held it was in State Farm's interest to prove that the Bojorquezes owned the Jeep at the time of the accident, while the Coxes were best served to admit ownership in order to obtain an agreement from the Bojorquezes not to execute any judgment against them. Second, the court held that only issues determinative of liability and damages are preclusive in this context; issues relating to coverage are open for relitigation. Consequently, State Farm could litigate the question of coverage, and the court held that the undisputed facts established that the Bojorquezes owned the Jeep at the time of the accident as a matter of law.

The Quihuises timely appealed, contending there was no conflict of interest between the Coxes and State Farm, and that Arizona case law establishes that an insurer may not litigate an issue determinative of coverage if that issue is also determinative of liability and was stipulated to as part of a *Damron* agreement that resulted in entry of a default judgment. They also contended that ownership of the Jeep was a genuine issue of material fact.

Because the Ninth Circuit agrees with the district court that the undisputed facts establish the Coxes were not the owners of the Jeep at the time of the accident, the outcome of this appeal depends on the scope of the default judgment's preclusive effect. More specifically, according to the Ninth Circuit, the issue is whether the stipulation (and the subsequent default judgment) between the Coxes and Bojorquezes that the Coxes owned the Jeep prevents State Farm from litigating coverage under the Policy on the basis that the Coxes did not own the Jeep. The Ninth Circuit disagrees with the Quihuises that Arizona case law conclusively decides the preclusion issue.

The Ninth Circuit seeks the Arizona Supreme Court's guidance because of a potential conflict between *United Services Auto. Ass'n v. Morris*, 154 Ariz. 113, 741 P.2d 246 (1987), and the court of appeals' opinion in *Associated Aviation Underwriters v. Wood*, 209 Ariz. 137, 98 P.3d 572 (App. 2011). The Ninth Circuit explains as follows:

> Arizona cases are unclear on the answer to the specific question at issue here, namely whether an insurer who declines to defend its insured can be estopped from raising a coverage defense in a subsequent action based on a default judgment entered pursuant to a *Damron* agreement that included a stipulation between the third-party plaintiffs and the insured. Basic principles of collateral estoppel, *see Chaney Bldg. Co. v. City of Tucson*, 716 P.2d 28, 30 (Ariz. 1986), and the principles of indemnity law set forth by the Arizona Supreme Court in *Morris*, 741 P.2d at 253, indicate that an insurer may generally raise a coverage defense notwithstanding the stipulation. On the other hand, the collateral estoppel principles adopted by the Arizona Court of Appeals in *Wood*, indicate that an insurer is estopped from raising a coverage defense where "the 'coverage' issues [the insurer] seeks to litigate hinge on facts and law bearing directly on the insureds' liability, and those issues were completely subsumed in the consent judgment [albeit not actually litigated or determined by a trier of fact] in the underlying tort actions." 98 P.3d at 585.
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> The Arizona Court of Appeals' holding in *Wood* can be read to either fill a gap left unresolved by the Arizona Supreme Court in *Morris* or to conflict with *Morris*'s admonition that settlement agreements should not be used to manufacture coverage that the insured did not purchase, *Morris*, 741 P.2d at 253, and *Chaney*'s principle that default judgments are not accorded collateral estoppel effect, 716 P.2d at 30. In *Wood*, the Arizona Court of Appeals applied [in the settlement agreement context] the collateral estoppel rule enunciated in [*Farmers Ins. Co. v. Vagnozzi*, 138 Ariz. 443, 448, 675 P.2d 703, 708 (1983) (holding that "where there is a conflict of interest between an insured and his insurer, the parties will not be estopped from litigating in a subsequent proceeding those issues as to which there was a conflict of interest")]. . . . *Wood* involved a mass-tort litigation in which a number of plaintiffs sued the City of Tucson and its Airport Authority for environmental harms. 98 P.3d at 578–79. . .

Quihuis, 2014 WL 1328305, pp. 8, 12.

QUESTION FOR CERTIFICATION:

> Whether a default judgment against insured defendants that was entered pursuant to a *Damron* agreement that stipulated facts determinative of both liability and coverage has (1) collateral estoppel effect and precludes litigation of that issue in a subsequent coverage action against the insurer, as held in *Associated Aviation Underwriters v. Wood*, 98 P.3d 572 (Ariz. Ct. App. 2004), or (2) no preclusive or binding effect, as suggested in *United Services Automobile Association v. Morris*, 741 P.2d 246 (Ariz. 1987)

DEFINITIONS:

Certified Question: A certified question is a formal request for an opinion by the Arizona

Supreme Court from a federal or tribal court before which litigation is actually pending. A court will certify a question when it is required to decide a matter that turns on Arizona law, but Arizona's law is unclear or uncertain. The procedures for certifying a question to the Arizona Supreme Court are set forth in Arizona Supreme Court Rule 27.

Damron Agreement: "A *Damron* agreement refers to a settlement agreement between an insured and an injured party in circumstances where the insurer has declined to defend a suit against the insured. In such an agreement, the insured agrees to liability for the underlying incident and assigns all rights against the insurance company to the injured party. The injured party, in turn, agrees to relieve the insured of all liability and recover only against the insurance company. *See Damron v. Sledge*, 460 P.2d 997 (Ariz. 1969). When the insurer defends a suit against the insured under a reservation of right, such agreements are sometimes referred to as *Morris* agreements. *See United Servs. Auto. Ass'n v. Morris*, 741 P.2d 246, 252 (Ariz. 1987)." For simplicity, [the federal court] refer[s] to any agreement of this sort as a *Damron* agreement." *Quihuis, 2014 WL 1328305 n. 1*.