ARIZONA SUPREME COURT
ORAL ARGUMENT CASE SUMMARY

KnightBrook Insurance Company and Knight Management Insurance Services, LLC, v. Payless Car Rental System Incorporated and PCR Venture of Phoenix LLC, CV-17-0156-CQ
855 F.3d 1072 (May 5, 2017)
(Order Certifying Question)

PARTIES:

Plaintiffs/Counter-Defendants: KnightBrook Insurance Company and Knight Management Insurance Services, LLC ("**KnightBrook**")

Defendants/Counter-Plaintiffs: Payless Car Rental System Incorporated and PCR Venture of Phoenix LLC ("**Payless**")

FACTS:

Mr. Bovre rented a car from Payless. The car rental agreement included a $30,000 basic liability insurance policy required under Arizona law. He claims he was also promised Supplemental Liability Insurance ("**SLI**") coverage, which had an additional daily charge, although the Payless car rental agent did not obtain Bovre's initials accepting or waiving coverage. His rental car collided with Mr. and Mrs. McGill, motorcyclists who were injured in the accident.

The McGills filed a personal injury lawsuit against Bovre and made a $1.5 million policy-limits demand, which they calculated as the $30,000 basic policy, $500,000 under his personal policy, and $970,000 under the SLI coverage. KnightBrook denied Bovre's request for SLI coverage, explaining in a letter that "you did not purchase the optional Supplemental Liability Insurance coverage at the time of the rental." KnightBrook did not defend Bovre under a reservation of rights or file a declaratory judgment action over the coverage dispute.

Bovre entered into a *Damron* agreement with the McGills. They received the $30,000 policy limits from the basic policy and $500,000 from Bovre's personal policy; he stipulated to an $8 million judgment against him and assigned his bad-faith claim to the McGills; and they agreed not to collect from him.

Under threat of an $8 million insurance bad-faith claim, KnightBrook then settled by purchasing McGills' (previously Bovre's) claims against Payless, paying McGills $970,000 and promising them a percentage of what it recovered against Payless. KnightBrook pursued Payless for Bovre's negligence and breach of contract claims. It also sought equitable indemnification for the $970,000 it paid, arguing that Payless' employee was at fault. The dispute played out in U.S. District Court, where Judge Campbell ruled that KnightBrook was entitled to indemnity from Payless. *KnightBrook Ins. Co. v. Payless Car Rental Sys., Inc.*, 100 F. Supp. 3d 817 (D. Ariz. 2015).

Payless claims the District Court's ruling deprived it of any ability to defend, and it would have shown at trial that Bovre, a seasoned traveler, had no reason to believe he was receiving the SLI free of charge. Also, any liability Payless had (no more than $1 million) was not coextensive with KnightBrook, because KnightBrook's ($8 million) exposure for insurance bad faith arose out of its initial denial of Bovre's claim and was not a claim against Payless. Payless also claims that KnightBrook could only seek indemnity if its settlement had discharged Payless' liability.

Judge Campbell determined that KnightBrook was not required to prove with certainty that it or Payless was subject to a legal obligation; KnightBrook needed only to show it discharged "an obligation or supposed obligation" for which it became responsible because of the fault of the other and it made the payment "in the justifiable belief that [a] duty existed," citing the Restatement (First) of Restitution § 78 (1937). *KnightBrook*, 100 F. Supp. 3d at 827.

The Ninth Circuit designated its Order Certifying a Question to the Supreme Court of Arizona "For Publication," 855 F.3d 1072 (2017).

CERTIFIED QUESTION(S):

1. Whether Arizona equitable indemnity law incorporates § 78 of the Restatement (First) of Restitution; and if so,

2. Whether equitable indemnity under § 78 requires that the indemnity plaintiff's liability to the underlying plaintiff have been coextensive with the indemnity defendant's liability to the underlying plaintiff.

DEFINITIONS:

***Damron* Agreement:** In *Damron v. Sledge*, 105 Ariz. 151 (Ariz. 1969), this Court examined whether an agreement between an insured driver (defendant) and the injured claimants (plaintiffs) terminated the automobile insurer's duty to defend. This Court held that where the driver's insurer refused to defend the driver in a personal injury action and the driver assigned to the plaintiffs whatever bad-faith claim he had against the insurer for failing to defend, such an agreement was not collusive. Therefore, the plaintiffs could pursue both the personal injury claim and the bad faith claim against the driver's insurer.

Equitable Indemnification: Indemnification is the right of one party to collect from another the damages it owes to a third party. An obligation is "equitable" if it is not agreed to in a contract, but under certain legal principles it arises due to the circumstances of the situation.

Restatement (First) of Restitution § 78 provides, in relevant part:

> A person who with another became subject to an obligation or supposed obligation upon which, as between the two, the other had a prior duty of performance, and who has made payment thereon although the other had a defense thereto,
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> (a) is not entitled to restitution if he became subject to the obligation without the consent or fault of the other;

> (b) is entitled to restitution if he became subject to the obligation with the consent of or because of the fault of the other and, if in making payment, he acted
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> . . .
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> (ii) in the justifiable belief that such duty existed....