

CASE SUMMARY

Himes v. Safeway Insurance Co.,
66 P.3d 74 (Ariz. Ct.App. 2003)

Recently, the Arizona Court of Appeals published a decision which will have a significant and favorable impact on cases involving collaborative agreements between insureds and third-party claimants. These agreements, often referred to in Arizona as *Damron* or *Morris* agreements, result in the insured consenting to liability and assigning the third-party claimant with the insured's breach of contract and bad faith claims against the insurer, in exchange for a covenant not to execute against the insured. Through this arrangement, third-party claimants have often succeeded in inflating damage awards imposed against insurers, by depriving the insurer of the opportunity to fully contest damages. The Court of Appeals, in *Himes v. Safeway Insurance Co.*, 66 P.3d 74 (Ariz. Ct.App. 2003), responded to this problem. This letter will explain and summarize the ruling.

REASONABLENESS HEARINGS AND THE *HIMES* CASE

As I stated earlier, a particular concern insurers have had about *Damron/Morris* agreements is the inflated damages usually provided in these agreements. Typically, the parties either stipulate to the amount of damages, or agree that the trial judge will determine damages at an uncontested default hearing. In either event, the defendant who is receiving a covenant not to execute has no incentive to seriously challenge any amount of damages sought by the plaintiff. The *Himes* court addressed this directly, issuing a detailed ruling providing much-needed guidance to trial courts on the proper manner in which to conduct "reasonableness hearings" pursuant to *Damron/Morris* agreements.¹

Himes arose out of a serious traffic accident in which the insured, Steven Botma, collided with the daughter of the plaintiff/claimant, Patricia Himes. Himes' daughter, Holly Castano, suffered from a diffused axonal injury to the brain resulting in spastic quadraparesis, *i.e.*, incomplete paralysis in all four limbs. Botma had an auto liability policy with Safeway Insurance, with \$15,000 per person/\$30,000 per accident limits. Soon after receiving the claim, Safeway tendered its policy limits, which were accepted as counsel for Himes and Castano investigated other possible liability. However, the Safeway adjustor believed he had an agreement with Castano's/Himes' attorney that the limits would be accepted as soon as he decided how to proceed against any other

¹ In using the term "*Damron/Morris* agreements," the Court made it clear that its opinion applies to "any agreement between a third-party claimant and insured whereby the insured consents in any fashion to liability and enters into an agreement providing the third-party claimant with the insured's breach of contract and bad faith claims against the insurer in exchange for a covenant not to execute against the insured."

possible defendants. Himes, on behalf of her daughter, filed suit against Botma, as well as General Motors Corporation, for an alleged manufacturing defect in the car's passenger seat. Safeway retained counsel for Botma, who filed an answer with a counterclaim to enforce the policy limits settlement. The counterclaim proceeded to trial, which resulted in a verdict that a settlement was not reached. Following this ruling, Himes entered into a *Damron/Morris* agreement with the insured, whereby the insured consented to have judgment entered against him in the amount of \$12 million, and assigned his rights against Safeway to Himes. In exchange, Himes agreed not to execute against the insured's personal assets.

Himes settled her lawsuit against GM, and the trial court prepared to enter judgment against Botma pursuant to the Botma-Himes agreement. To challenge the stipulated amount in damages, Safeway filed a motion to hold an evidentiary "reasonableness" hearing. At this hearing, Himes presented evidence including testimony by Botma's lawyer that the settled amount was reasonable. Safeway presented evidence that a reasonable amount against Botma was only \$3-4.5 million. Following the hearing, the trial court initially found that only \$9 million in damages had been established as reasonable, but later modified that, following a motion to reconsider by Himes, by adopting the full \$12 million figure. Thus, judgment was entered against Botma in the amount of \$12 million.

On appeal by Safeway, the Arizona Court of Appeals attacked the trial court's method and reasoning in arriving at the \$12 million figure, and clarified several points of law and procedure to govern all future reasonableness hearings in Arizona. Unless the Arizona Supreme Court decides to review the Court of Appeals decision, this decision and opinion will remain binding on all parties for the foreseeable future in Arizona, and may serve to influence courts in other States as well.

A. Who holds the burden of proof?

The Court of Appeals first criticized the trial court's approach to the burden of proof on damages, particularly a statement by the trial court that, upon the presentation of evidence by Himes that damages were \$12 million, it was not "appropriate for [the trial court] to substitute its belief of what was reasonable *absent evidence to the contrary*" (emphasis added.) In other words, the Court of Appeals observed, the trial court had in effect given Himes a legal *presumption* that \$12 million was a reasonable number, and imposed a duty on Safeway to overcome that presumption with evidence that the number was unreasonable. This, the Court of Appeals stated, bluntly, was in error. The correct burden, noted the Court, is "squarely on the insured to prove reasonableness of the settlement amount that is either stipulated to or sought." A trial judge may not merely "pass" on a stipulated amount, and it is the claimant who "has an affirmative duty of proof that the agreement is reasonable."

Importantly, in supporting her position, Himes relied on a California Supreme Court case, *Pruyn v. Agricultural Insurance Company*², which had shifted the burden of proof

² 42 Cal.Rptr. 2d 296 (1995)

to the insurer to prove the unreasonableness of a stipulated amount. Flatly dismissing the *Pruyn* argument, the Arizona Court held, “This is not the law in Arizona... We reject it.” The Court also made clear that trial courts have a duty to determine a specific amount the parties have proven with evidence, as opposed to finding merely a “range” of damages which appear reasonable and permitting the parties any amount they choose within that general “range.” Thus, the Court not only clarified that the burden of proof belonged to the claimant, but it imposed a narrow and precise duty of trial courts to draw a conclusion as to a specific amount.

B. What standard governs?

The *Himes* Court did not stop, as it arguably could have, by merely criticizing the trial court’s approach to the burden of proof and remanding the matter back for further review. Instead, the Court promulgated additional guidelines to impose upon the trial court and the parties in correctly applying the burden of proof. The Court first noted that “the primary purpose of a reasonableness hearing is to attempt to re-create the same result that would have occurred if there were an arm’s-length negotiation on the merits of the case between interested parties.” Relying on the Arizona Supreme Court’s holding in *United Servs. Auto Ass’n v. Morris*³, the Court ruled:

The test as to whether the settlement was reasonable and prudent is what a reasonably prudent person in the insureds' position would have settled for on the *merits* of the claimant's case. **The "reasonably prudent person" referenced in this test means a person who has a stake in the outcome. It means a person who is making decisions as though the money that pays the settlement comes from his or her own pocket.** This is not a test of what a reasonably prudent person would settle the case for with someone else's funds. It is what a "reasonably prudent person" would pay from his or her own resources, assuming they are sufficient, "on the merits" of the case. For purposes of determining reasonableness in a *Damron/Morris* agreement, a "reasonably prudent person" is defined as a person who (1) has the ability to pay a reasonable settlement amount from his or her own funds and (2) makes a settlement decision as though the settlement amount came from those personal funds.⁴ (Emphasis added)

The Court then continued by outlining a number of specific factors the trial court should use in determining what is “reasonable.” Those factors, borrowed from a Washington Court of Appeals opinion, are:

- (1) the releasing of the person's damages;
- (2) the merits of the releasing person's liability theory;

³ 154 Ariz. 113, 741 P.2d 246 (1987)

⁴ It should be noted that, having stated this rule, the Court was very clear in considering inadmissible any evidence an insurer may want to present on the insured’s financial status, as evidence of what the insured “would have settled for” had he had a direct financial stake in the outcome.

- (3) the merits of the released person's defense theory;
- (4) the released person's relative faults;
- (5) the risks and expenses of continued litigation on the merits;
- (6) any evidence of bad faith, collusion, or fraud;
- (7) the extent of the releasing person's investigation and preparation of the case;
and
- (8) the interests of the parties not being released.

Himes, 66 P.3d at 85, *citing Chaussee v. Maryland Cas. Co.*, 803 P.2d 1339 (Wash. App. 1991). This list of factors is not exclusive, but trial courts are directed to consider these and other factors as relevant to the key question at stake: “whether the evidence would assist the reasonably prudent person, acting as though the person were dealing with sufficient funds from his or her own pocket, in determining what a reasonable settlement amount would have been.”

C. Effect on insurers and conclusion

Streamlining the *Himes* opinion to its central holding as applied here, if an insurer desires to challenge a stipulated settlement amount between an insured and third-party claimant as unreasonable, the trial court will be required to give the insurer a full and fair opportunity at an evidentiary hearing *prior to* entry of any judgment⁵, to contest the reasonableness of the agreement. Under *Himes*, the burden will be expressly and clearly imposed upon the insured and third-party claimant to prove damages in their stipulated amount, after considering the 8 factors referenced above. This additional guidance and clarification from the *Himes* decision will greatly assist insurers in challenging the reasonableness of the amount set forth by such arrangements.

An additional factor the *Himes* court chose not to address was whether such a reasonableness hearing could be disposed of by a jury and not by a trial judge. The right to a determination of facts by a jury in civil court is a matter of constitutional law in Arizona, and many other States. See ARIZ. CONST. Art. 6, § 17. Since the issue was not raised on appeal in *Himes*, however, the Court did not rule on it. Nonetheless, *Himes* paves the way for a strong argument in future cases that, not only should reasonableness hearings strongly impose the burden of proof on third-party claimants and insureds, but that such hearings should be the subject of a jury trial rather than by a trial judge. If such a practice were adopted in Arizona, it, too, would be helpful to insurers.

If you have any questions about this case, please contact [Neil Singh](#) or [David Bell](#) by email. If you would like to read the complete opinion of the Arizona Supreme Court, please [click here](#) to read an Adobe Acrobat version of the case.

⁵ *Himes*, 66 P.3d at 86-87.