INSURANCE LAW

Insurance Attorney's Liability for Fraud

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The Second District of the California Court of Appeal issued a decision which extends liability to insurance coverage attorneys in matters in which they fraudulently misrepresent the existence or the amount of insurance coverage available for a judgment. The case of *Shafer v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone* (2003) 107 CalApp.4th 54 arose out of interesting and somewhat common facts.

Truck Insurance insured Tri-County Builders. Tri-County was sued by its customer, Shafer, for issues relating to defective work, non-performance and fraud arising out of a remodel job. Truck responded to the complaint (actually an arbitration demand) by advising its insureds that it was reserving its rights on all non-covered claims (intentional acts, willful acts, punitive damages and non-accidental occurrences). When the insureds (Tri-County) properly responded by requesting that they be represented by CUMIS counsel because of the reservation of rights letter (see Civil Code §2860 and *San Diego Federal Credit v. CUMIS Ins. Society, Inc*. (1984) 162 C.A.3d 358), Truck sought the opinion of an insurance coverage attorney, Lance LaBelle at Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone ("LaBelle"). LaBelle and Truck decided to do an end run on Tri-County's demand for an independent defense attorney ("CUMIS") by sending out a new reservation of rights letter that no longer raised "non-accidental/occurrence" exceptions. Eliminating the policy exclusions in the reservation of rights ended the potential "CUMIS" conflict and ended the insured's right to an independent defense attorney paid for by the insurer.

The case went to binding arbitration and resulted in a $336,302.31 judgment which included $25,000 in punitive damages and findings that Tri-County had acted fraudulently. Truck, through LaBelle, advised Shafer that only $120,000 was covered and that the balance was not covered because the arbitrators had found that "the insured never intended to complete the project" on time or for the contract price at the inception. LaBelle then went on to cite the "occurrence" language of the policy and Insurance Code §533. LaBelle made no mention of the second reservation of rights letter in which Truck had waived the occurrence language.

Truck and LaBelle believed they had safely side-stepped both the CUMIS defense and $150,000 of liability owed to Shafer. Shafer sued under the direct action statute, Insurance Code §11580, naming Truck, his attorney, LaBelle, individually and LaBelle's firm, Berger, Kahn, Shafton, Moss, Figler,

Simon & Gladstone, in fraud causes of action. The trial court sustained Attorney LaBelle's demurrer to the fraud claim based on the argument that "no duty" was owed to his adversary Shafer and that it was up to Shafer to protect his own interests in determining the extent of Tri-County's coverage.

The Court of Appeal soundly rejected Attorney LaBelle's "no duty" argument by pointing out that under Insurance Code §11580 Shafer was a beneficiary under the Truck policy **after** the judgment and that Truck and LaBelle had an obligation to treat Shafer as an insured and not as "an opposing participant."

The court went on to reject Attorney LaBelle's contention that he could make false statements and suffer no consequences:

> **While in general an attorney's professional duty of care extends only to dealings with his own client and to intended beneficiaries of the legal work performed, these limitations upon liability for negligence . . . do not apply to liability for fraud. [Citation.]" (*Jackson v. Rogers & Wells* (1989) 210 Cal.App.3d 336, 345, citing *Goodman v. Kennedy* (1976) 18 Cal.3d 335, 346.)**
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> **In California it is well established that an attorney may not, with impunity, either conspire with a client to defraud or injure a third person or engage in intentional tortious conduct toward a third person . . .**
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> **Thus, the case law is clear that a duty is owed by an attorney not to defraud another, even if that other is an attorney negotiating at arm's length.**

The court drew an important distinction between negligence and fraud. Attorney LaBelle owed no duty to be careful toward Shafer, but he did owe a duty not to intentionally mislead Shafer by not disclosing the existence of the second reservation of rights in which he and Truck withdrew the "occurrence" defense/limitations.

Attorney LaBelle's attempt to hide behind the litigation privilege (Civil Code §47) was also rejected. Shafer stood in the position of the insured under Insurance Code §11580, after he obtained his judgment and there was no litigation, when the request was made for satisfaction of the judgment:

> **Counsel retained by an insurer has an obligation to be truthful in describing insurance coverage to a third party beneficiary. The litigation privilege is not a license to deceive an injured party who steps into the shoes of the insured. (See pt. II.A.2. *ante*.) Section 11580 grants an injured party the right to file suit to recover under the insurance policy. Coverage counsel may not commit fraud in an attempt to defeat that right. And to the extent there is a conflict between an injured party's rights under section 11580 and coverage counsel's reliance on the litigation privilege (Civ. Code, §47, subd. (b)), the rights of the injured party prevail as they arise under the more specific of the two statutes. (See *Schoendorf v. U.D. Registry* (2002) 97 Cal.App.4th 227, 243.)**

The status of the claimant as a judgment holder and policy beneficiary cannot be overlooked. The duties and obligations become clearer and more important when insurance attorneys and insurers state their positions post judgment. It is clear that the claimant and the claimant's attorney should renew their demands for full payment after judgment and request a full explanation for any non-payment after the judgment is final. It is equally clear that the insurer's defense attorney cannot engage in misleading conduct that causes an insured or a judgment creditor injury.