

**A COVERAGE ATTORNEY MAY BE LIABLE TO  
UNSATISFIED JUDGMENT CREDITOR OF PLAINTIFFS IN  
AN UNDERLYING ACTION IF HE MISREPRESENTS  
COVERAGE TO DEFEAT RIGHT TO FAIR PAYMENT**

The insured’s policy limits and coverage are critical factors to be considered in the negotiation and settlement process. Along with the assets of the insured, coverage and policy limits are critical to a party being able to make an informed decision about the amount to accept in resolution of a claim. The policy limits and assets of an insured are not just taken into account by plaintiffs; often, the decision on how to negotiate and settle a cross-complaint is equally dependent on those factors. A defendant obtaining a defense verdict on the underlying action may also achieve victory on his cross-complaint. Should the plaintiff not satisfy the entire judgment, the prevailing party is considered an intended third-party beneficiary of the insurance contract between the plaintiff and his insurer, thereby allowing a direct right of action against the plaintiff’s insurer. What happens when the judgment creditor is deceived by an attorney representing the insurer?

In *Shafer v. Berger, Kahn, Shafton, Boss, Figler, Simon & Gladstone*, the Second District Court of Appeals in Los Angeles County was presented the question of whether an attorney, who was retained by an insurance company to provide coverage advice in a lawsuit against its insured, may be held liable to the plaintiff for making a fraudulent statement about coverage. Because fraud and deceit undermine the administration of justice, the Court of Appeals answered the question in the affirmative.

At least three separate lawsuits were spawned by a claim for construction defects, fraud, and intentional infliction of emotional distress brought by homeowners John and June Shafer in the early 1990’s. They contracted with Tri-County Builders (“Tri-County”), a general contractor/partnership run by Jay De May (“De May”) and Perry Hanstad (“Hanstead”), for remodeling and an addition to their home. Any disputes under the contract

were to be resolved by binding arbitration conducted by the American Arbitration Association (“AAA”).

The Shafers demanded arbitration against Tri-County, DeMay and Hanstad for breach of contract, negligence, fraud and intentional infliction of emotional distress, and also sought an award of punitive damages. DeMay tendered his defense to Truck Insurance Exchange (“Truck”). Truck initially agreed to defend Tri-County, DeMay and Hanstad subject to a rather onerous reservation of rights, advising its insureds there was no coverage for punitive damages or willful acts. DeMay requested Truck to pay for *cumis*, or independent counsel of his own choosing, as he was concerned Truck would retain a defense attorney who would have a conflict of interest. Truck sought advice on coverage issues from Lance LaBelle of Berger, Kahn, et al. (“La Belle”). LaBelle and a Truck employee decided to send a modified reservation of rights letter to DeMay, and made arrangements for DeMay’s defense to be handled by a Los Angeles insurance defense firm. DeMay was given the option of retaining counsel at his own expense. The superceding reservation of rights letter extended coverage to willful acts.

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On July 26, 1993, the AAA arbitration panel unanimously found in favor of the Shafers, awarding them \$153,732.00 in general damages, \$85,166.00 in attorneys' fees and costs, \$40,513.00 in pre-award interest, \$31,891.31 to cover AAA fees and arbitrator's compensation, and \$25,000.00 in punitive damages against DeMay, totaling \$336,302.31. The arbitration award excoriated DeMay, pointing out he never intended to honor the contract and he never intended to complete the project for the agreed upon price and within the time originally contracted for. The Los Angeles Superior Court confirmed the arbitration award on October 20, 1993, entering judgment in the Shafers' favor and against Tri-County, DeMay and Hanstad in the amount of \$311,302.31, plus \$25,000.00 in punitive damages against DeMay.

The Shafers' attorney wrote to La Belle in December, 1993 requesting Truck to satisfy the entire judgment against its insureds. The Shafers expected Truck to pay the entire judgment. La Belle sent the Shafers' attorney a letter and enclosed a check for \$120,000.00 in March, 1994. La Belle stated in his letter that Truck was making a good faith payment at the time, but raised certain coverage issues with respect to the findings of intentional misconduct and fraud. La Belle and the Shafers' attorneys exchanged a series of letters from March to July, 1994 where the Shafers sought additional payment and Truck refused. La Belle's May 6, 1994, letter raised the intentional acts of DeMay and pointed to policy language which did not provide coverage for those acts. At that time, Truck and DeMay entered into a settlement agreement whereby Truck paid DeMay \$35,000.00 as part of a mutual release of all claims, and DeMay moved to the Canadian-Wisconsin border to avoid enforcement of the Shafers' judgment. Hanstad avoided the judgment by discharging his debt in bankruptcy. Two Truck employees passed an internal memo dated November 30, 1994, where they noted the Shafers would have a hard time collecting because they made assertions in the bankruptcy court that Hanstad's actions were fraudulent, and thus not covered. Still left open was the Shafer's right to pursue Truck for the remainder of the judgment.

Hanstad sued Truck for bad faith in 1996, represented by the Shafers' counsel. Hanstad's attorney learned for the first time in December, 1998 that Truck had agreed to indemnify the contractors for willful acts, and this knowledge was confirmed when La Belle was deposed in early 1999. Hanstad ultimately prevailed against Truck for insurance bad faith.

## NEW AT W & Z

Jill D. Brachman: Jill graduated from Emory University School of Law in 1998; licensed and practiced in New York from 1998-2002. Most recently Ms. Brachman worked at Lewis, Brisbois, Bisgaard & Smith in Los Angeles.

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The Shafers sued Truck, La Belle and the Berger Kahn firm, alleging breach of contract, bad faith, and fraud. The Shafers amended their complaint, adding a cause of action against La Belle and Truck for conspiracy. La Belle demurred, and the trial court, on December 26, 2000, ordered the lawsuit dismissed. The Shafers appealed.

The Court of Appeals agreed with the Shafers that the trial court erred in dismissing their causes of action for fraud and conspiracy. The court found that Insurance

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**BIKE RIDE RELEASE HELD NOT TO BAR CLAIM  
AGAINST 10-K PARTICIPANT, BUT PRIMARY  
ASSUMPTION OF THE RISK ALSO APPLIES TO NON-  
COMPETITIVE ACTIVITIES, EVEN WHERE THERE IS AN  
ALLEGED VIOLATION OF STATUTE**

The doctrine of primary assumption of risk operates as a complete bar to a plaintiff's claims where it can be shown that the plaintiff was involved in a sporting activity where participation alone involves some degree of risk inherent in the activity. Prior to the decision of the Second Appellate District in *Christian Moser v. Joanne Ratinoff*, most appellate opinions have addressed application of that doctrine in competitive sporting activities. However *Moser v. Ratinoff* clearly extends the doctrine to the non-competitive arena as well. The court further held that even where the plaintiff alleges that the defendant has violated a statute (and thus raises negligence per se), the doctrine will still stand as a complete bar for plaintiff's claims.

Christian Moser was engaged in a non-competitive bicycle ride through approximately 200 miles of public highways. The ride involved approximately 600 participants. During the course of the ride, another participant, Joanne Ratinoff, collided with Mr. Moser and caused him to crash. He sued Ms. Ratinoff alleging general negligence.

Ms. Ratinoff ultimately filed a motion for summary judgment. The initial grounds were the fact that Mr. Moser had signed a release prior to the event whereby he released all of the event organizers, sponsors and promoters from liability. While the court did not find that release to be effective as against Ms. Ratinoff, the court emphasized the fact that the release contained language acknowledging that bicycle riding poses the potential for death, serious injury and property loss. Some risks of bicycle riding include, but are not limited, to those caused by the actions of third parties, including other participants.

The court ruled that releases are only binding between the actual parties to the release agreement. However, the court held that this non-competitive bicycling event fell within the protection of the primary assumption of the risk doctrine. A sport is defined as something done for enjoyment or a thrill which required physical exertion, as well as the elements of skill and a challenge containing a potential risk of injury. While a defendant has a duty not to increase the inherent risks of a particular activity, the collision between Ratinoff and Moser was not found to be something outside the realm of an inherent risk in the activity of bicycling. Increasing the inherent risk would involve doing something that was totally outside the range of ordinary activity not involved in the sport in general. Given the fact that Mr. Moser acknowledged, in the release, that bicycle riding involved risks including the actions of other participants, the court held that the collision was not a result of any increase in the risk level by the activities of Ms. Ratinoff.

The court then turned to the argument as to whether a violation of statute precludes application of the doctrine of the primary assumption of the risk. While the court was unable to find specific authority on the subject, it ultimately held that a majority of the current Supreme Court justices had expressed the view that a violation of a statute that does not specifically state that it intends to eliminate the assumption of the risk defense, does not displace the primary assumption of the risk doctrine. Accordingly, the Second Appellate District denied that argument by the plaintiff as well. Accordingly, primary assumption of risk applies to a non-competitive sporting event even where it is alleged that the defendant violated a statute and caused harm to the plaintiff.

- Thomas E. Martin

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Code §11580 makes a plaintiff judgment creditor an intended third-party beneficiary of the insurance policy against the insured's insurer, entitling the judgment creditor to a direct cause of action against the insurer. The judgment creditor can then proceed against the insurer up to the policy limits. The judgment creditor's claim is subject to the policy's term and limitations, including any reservation of rights. The court relied on principles of agency established more than a century ago in applying §11580. The agent represents the principal in dealings with third persons, and the agent or employee will always be liable for his own torts, whether his employer is liable or not. Even if the principal becomes liable for a tortious act, the agent is not exonerated from liability. The relationship of attorney and client is one of agent and principal. Just as with other types of agency relationships, the court pointed to nationwide rules governing attorneys and held that the law of misrepresentation applies to attorneys. The court observed that an attorney communicating on behalf of a client with a non-client cannot knowingly make a false statement of material fact to the non-client. The court noted that misrepresentation is not a part of proper legal assistance, although vigorous argument often is. Therefore, lawyers can be liable to non-clients for fraudulent misrepresentation, but cannot be liable for using legally innocuous hyperbole or proper argument in negotiations or in presenting an argument to a tribunal during litigation.

Where special circumstances require disclosure, an attorney must speak the whole truth and not conceal any facts which materially qualify those stated. There is a duty owed to others to refrain from intentionally tortious conduct, although duty is not an element of fraud in the traditional sense. Since 1895, when strict notions of privity ruled the day, the California Supreme Court recognized that an attorney could be liable for defrauding a third-party even without privity. An attorney is liable for negligence in the conduct of his professional duties to his client alone and not to third parties. However, an attorney who engages in fraud or collusion, or performs a malicious or tortious act which injures a third party is liable to that party, without reference to privity between the attorney and the wronged party. This liability extends to both transactional matters and litigated matters.

La Belle then argued that his statement about insurance coverage was a non-actionable legal opinion rather than a representation of fact. The appellate court disregarded La Belle's argument that he uttered a non-actionable opinion. Instead, it found that the amended complaint adequately

alleged that LaBelle misrepresented the scope of insurance coverage when he had a duty to refrain from making fraudulent statements. The court also observed La Belle's relationship vis-à-vis the Shafers was not that of an opposing participant or party, but rather that of a representative of the insurer which owed them the amount of the judgment consistent with coverage and policy limits. The court noted that La Belle was trying to have his cake and eat it too, for he advised Truck to provide coverage for willful acts so that Truck would not have to pay for *cumis*, subsequently, however, he represented to the Shafers that willful acts were not covered so that Truck would not have to pay the total amount due on the judgment.

La Belle was also found potentially liable under a conspiracy claim engaged in with Truck. By virtue of La Belle's status as an attorney, he had a duty to provide truthful information to the Shafers about Truck's insurance coverage. As a general rule, agents and employees of a corporation cannot conspire with their corporate principal while acting in their official capacities on behalf of the corporation for their individual advantage. On the other hand, there is an exception to this general rule for claims against an attorney conspiring with his or her client to cause injury by violating the attorney's duty to the plaintiff.

Several important lessons can be learned from this decision. First, an attorney representing an injured party must take all steps to ascertain the defendant's available insurance coverage and assets. Should a judgment be entered in favor of the attorney's client, the attorney representing the insurer of the judgment debtor must be very careful to make absolutely no misrepresentations of fact concerning coverage issues or policy limits. Nevertheless, the attorney representing the judgment creditor must take all reasonable steps to assure that he or she has received accurate information in order to make an informed decision on behalf of his or her client.

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