

PROFESSIONAL LIABILITY UPDATE

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Issue No. 151

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ATTORNEY LIABILITY TO THIRD PARTIES

California Law

by William L. Jacobson

The Second District, Division One, holds that an attorney retained to provide coverage advice can be liable to a claimant for making a fraudulent statement about coverage.

Shafer v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladston 03 C.D.O.S. 2402

John and Jane Shafer filed an arbitration demand against their remodeling contractors, Tri-County Builders, Jay DeMay, and Perry Hanstad (“Tri-County”). Tri-County tendered defense of the action to their insurer, Truck Insurance Exchange. Truck initially agreed to defend subject to a reservation of rights as to intentional acts and punitive damage allegations.

After Tri-County asked for independent *Cumis* counsel Truck retained Lance LeBelle of Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone (“Berger”) to advise it on coverage issues. To avoid the need for independent counsel, Truck authorized Berger to withdraw the reservation of rights for intentional and willful acts, but not as to punitive damages. The arbitration resulted in a \$336,302.31 award against Tri-County, including \$153,732 in general compensatory damages and \$25,000 in punitive damages. The award found Tri-County had committed fraud.

The Shafer’s attorney sent Berger a demand for payment of the award. In response, Berger tendered a check that excluded the punitive sum and most of the compensatory award. The accompanying letter stated that Truck reserved its rights under California law that precludes indemnity of fraud damages. Subsequent correspondence also asserted California’s statutory preclusion of indemnity for losses caused by willful acts. Meanwhile, the Shafers blocked Hanstad’s attempt to discharge the judgment in bankruptcy, asserting that the judgment was based on fraudulent conduct. The Shafer’s counsel then successfully represented Hanstad in a bad faith action against Truck.

After the Shafers learned that the insurer had effectively agreed to indemnify their insureds’ willful acts, they sued Truck and Berger. The Shafers alleged that Berger falsely told them Truck had not agreed to provide indemnity for willful acts. The trial court sustained Berger’s demurrer to Shafer’s conspiracy and

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fraud claims and dismissed the complaint. The Court of Appeal reversed.

Drawing heavily on the Restatement Third of Law Governing Lawyers and *Cicone v. URS Corp.* (1986) 183 Cal.App.3d 194, the court stated that attorneys, even when acting for their clients, can be personally liable for fraudulent conduct toward third parties. While attorneys generally have no affirmative duty of disclosure to non-clients, the court stressed their duty not to make fraudulent statements even when negotiating at arm's length.

The Court concluded that Berger's alleged misrepresentation about the insurance coverage was a false statement of fact, rather than a nonactionable legal opinion. Significantly, the Court also said the Shafers pleaded reasonable reliance on the alleged misrepresentation because, in part, there was no opposing party relationship between the Shafers and Berger. The judgment enforcement procedures of Insurance Code § 11580 entitled the Shafers to be treated as insureds.

The Court also found that the litigation privilege (Civ. Code, § 47 (b)) did not apply. Application of the privilege would be inconsistent with the purpose of Insurance Code § 11580 because the Shafers stood in the insureds' shoes. The court cited cases that described a judgment creditor as a third party beneficiary of the insurance contract under § 11580. In the court's view, none of the purposes served by the litigation privilege would be frustrated by limiting its application in this setting. The court

also asserted its decision was not contrary to *Home Ins. Co. v. Zurich Ins. Co.* (2002) 96 Cal.App.4th 17 (P.L. Update No. 121), which held a misrepresentation of policy limits was privileged, because that case did not consider Insurance Code § 11580.

The court held inapplicable the protections of Civil Code § 1714.10, which requires a prima facie showing before a suit can allege a conspiracy between attorney and client. The court concluded the exception under subdivision (c)(1) applied, because the attorney "had an independent legal duty to the plaintiff" Here again the court relied on its conclusion that Berger owed the Shafers a duty to provide truthful insurance coverage information.

Comment: The apparent conflict between the court's opinion and the holding in *Home Ins. Co. v. Zurich Ins. Co.* (2002) 96 Cal.App.4th 17, together with the expansion of insurance counsel's duties to judgment creditors under Insurance Code § 11580, may make this case a candidate for review by the California Supreme Court.

The full text of the court's opinion is available on-line:

<http://www.courtinfo.ca.gov/opinions/documents/B151730.PDF>