Jeffrey I. Ehrlich
THE EHRLICH LAW FIRM

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Buying immunity

THE LID IS OFF THE POLICY! CAN INSURERS IMMUNIZE THEMSELVES FROM THEIR BAD-FAITH FAILURE TO SETTLE BY BUYING THE BAD-FAITH CLAIM FROM THEIR OWN POLICYHOLDER?

A big part of the job of being an appellate lawyer is reading cases. And part of the reason I like my job is that cases always tell a story. Sometimes, the story that I find most interesting is not the one told in the case, but the one I imagine underlies it. The new decision in *Potter v. Alliance United Ins. Co.* (2019) __ Cal.App.5th __, 2019 WL 3296949, is one of those cases.

Imagine that you are handling a substantial personal-injury action against a defendant who had minimal auto-insurance coverage. You make a policy-limits demand at the appropriate time for the insurer's $15,000 policy limit in the proper way; you give the insurer plenty of information about the scope of the damages and plenty of time to respond, and the insurer fails to respond. You have opened the policy!

You try the case against the defendant and get a $900,000 verdict! But the trial court grants a new trial. You try the case a second time, and this time the award is $975,000. With costs and pre-judgment interest, the total judgment is $1.5 million. You then approach the defendant seeking an assignment of his bad-faith claim against the insurer in exchange for a covenant not to execute, only to learn that in the period between the two trials, the defendant's insurance company entered into an agreement with the defendant, in which the insurer paid the defendant $75,000 in exchange for a release of his bad-faith claim and an agreement not to assign any claim to your client. What would you do?

I'm not sure what I would have done. But I do know that when this happened to Christopher Potter, his lawyers were savvy enough to file a lawsuit against the insurance company under the

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Uniform Voidable Transactions Act (UVTA), Civ. Code sections 3439, et seq. (If the name of that statute doesn't ring a bill, you might recognize it under its prior name, the Uniform Fraudulent Transfers Act, which was amended and got its new name in 2015.) The trial court sustained a demurrer to the claim without leave to amend, and the Court of Appeal (Second District, Division 5) reversed, finding that Potter had stated a viable claim against the insurer, Alliance United, under the UVTA.

Overview of the UVTA

The *Potter* opinion includes an overview of the UVTA, explaining that it is "the most recent iteration of creditor protection statutes that trace their origin to the reign of Queen Elizabeth I." A fraudulent transfer under the UVTA "'is a transfer by the debtor of property to a third person undertaken with the intent to prevent a creditor from reaching that interest to satisfy its claim." (*Kirkeby v. Superior Court* (2004) 33 Cal.4th 642, 648.) Under the UVTA, a transfer can be invalid either because of actual fraud or constructive fraud.

Actual fraud under the UVTA is shown when a transfer is made, or an obligation is incurred, "[w]ith actual intent to hinder, delay, or defraud any creditor of the debtor." (§ 3439.04, subd. (a)(1).) Such a transfer is voidable as to a creditor of the debtor, "whether the creditor's claim arose before or after the transfer was made or the obligation was incurred."(§ 3439.04, subd. (a).) It is not voidable, however, "against a person that took in good faith and for a reasonably equivalent value given the debtor or against any subsequent transferee or obligee." (§ 3439.08, subd. (a).) Constructive fraud under the UVTA can be shown in either of two ways.

First, a transfer is constructively fraudulent where a debtor makes a transfer or incurs an obligation "[w]ithout receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor either: (A) [w]as engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction[; or] (B) [i]ntended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due." (§ 3439.04, subd. (a)(2).) As with actual fraud, this form of transfer is voidable as to a creditor no matter whether the creditor's claim arose before or after the transfer. (§ 3439.04, subd. (a).)

Second, a transfer is constructively fraudulent when a debtor makes a transfer or incurs an obligation "without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation." (§ 3439.05, subd. (a).) This form of transfer is voidable as to a creditor whose claim arose before the transfer was made. (§ 3439.05, subd. (a).)

UVTA filing deadlines

The UVTA has filing deadlines that are stricter than ordinary statute of limitations because they affirmatively state that a cause of action under the statute is "extinguished" if the claim is not brought within the specified deadlines. In cases of actual fraud, the claim must be brought within "four years after the transfer was made or the obligation was incurred or, if later, not later than one year after the transfer or obligation was or could reasonably have been discovered by the claimant." (§ 3439.09, subd. (a).) The statute requires that a cause of action under section 3439.04, subdivision (a)(2) (constructive fraud – assets too small or debts too large) or section 3439.05 (constructive fraud – insolvency) must be filed "not later than four years after the transfer was made or the obligation was incurred."

In *Potter*, the agreement between the insured (Tovar) and his insurer, Alliance, was made during the pendency of Potter's action against Tovar, which ultimately confirmed Potter was a creditor of Tovar. In *Cortez v. Vogt* (1997) 52 Cal.App.4th 917, 929, the court held that the Act's filing deadlines run from the time the underlying judgment becomes final. Hence, under *Cortez*, which the *Potter* court followed, the UVTA filing deadlines did not begin to run until the judgment was entered in Potter's case against Tovar.

Alliance's defenses

Alliance's demurrer did not challenge the sufficiency of Potter's allegations of either actual or constructive fraud. Instead, its demurrer attacked the sufficiency of the foundational allegations that establish certain predicates for a UVTA violation, namely whether Potter sufficiently alleged (1) an asset was transferred, (2) Potter was injured by the transfer, and (3) any suffered injury entitled Potter to sue Alliance. On appeal, Alliance continued to press these points and additionally argued the complaint failed to sufficiently allege that Potter had a "claim" against Tovar or that Tovar was insolvent at the pertinent time. The court considered each argument and found it lacking.

Is a bad-faith action for failure to settle an "asset" under the UVTA?

The UVTA defines an asset as the "property of a debtor," excluding property "to the extent it is encumbered by a valid lien[,]" and "to the extent it is generally exempt under nonbankruptcy law." (§ 3439.01, subd. (a).) As noted by the Legislative Committee Comments, the definition of asset "requires a determination that the property is subject to enforcement of a money judgment. Under Section 704.210 of the Code of Civil Procedure, property that is not subject to enforcement of a money judgment is exempt." (Legis. Com. com., 12A pt. 2 West's Ann. Civ. Code (2016 ed.) foll. § 3439.01, p. 253.)

"Except as otherwise provided by law, all property of the judgment debtor is subject to enforcement of a money judgment." (Code Civ. Proc., § 695.010, subd. (a).) "'Property' includes real and personal property and any interest therein." (Code Civ. Proc., § 680.310.)

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"'Personal property' includes both tangible and intangible personal property." (Code Civ. Proc., § 680.290.)

A cause of action to recover money damages is known as a "chose in action," which is considered a form of personal property. (*Vick v. DaCorsi* (2003) 110 Cal.App.4th 206, 212, fn. 35; see also Code Civ. Proc. § 17, subd. (b)(8)(A) [defining "personal property" to include "things in action"].) From just these basic definitional principles, Tovar's right to bring a bad-faith cause of action would constitute personal property subject to the enforcement of a money judgment.

But the Code of Civil Procedure does include an exception – "Except as otherwise provided by statute, property of the judgment debtor that is not assignable or transferable is not subject to enforcement of a money judgment." (Code Civ. Proc., § 695.030, subd. (a).) Hence, if Tovar's bad-faith cause of action was not assignable, the UVTA would not apply. To determine whether the claim was assignable, the Court looked to the nature of the cause of action.

The case law provides that a policyholder may assign a cause of action for bad faith failure to settle in exchange for the plaintiff's covenant not to execute an excess judgment against the insured's personal assets. (*Hamilton v. Maryland Cas. Co.* (2002) 27 Cal.4th 718, 732.) The assignment becomes operative after the excess judgment has been rendered. (*Ibid.*)

Tovar's bad-faith cause of action was assignable when Tovar entered into the release with Alliance, even though Tovar could not yet have sued Alliance for bad faith, because no excess judgment had been entered against him. Because it was assignable and was not otherwise exempted, his potential cause of action is property subject to a money judgment and therefore an asset under the UVTA.

Alliance cited Civil Code section 1045, which says, "[a] mere possibility, not coupled with an interest, cannot be transferred," to argue that the unaccrued cause of action could not have been assigned. The Court rejected this contention. "Although common law and statutory rules against assignment of expectations ... prevent the transferee from immediately asserting his claim, the attempted transfer of a future right arising out of the breach of the insurer's duty to settle in good faith operates as an 'equitable assignment or contract to assign, which becomes operative as soon as the right comes into existence.' [Citation.]" (*Schlauch v. Hartford Accident & Indem. Co.* (1983) 146 Cal.App.3d 926, 931, fn. 3.) The *Potter* court noted that "California courts have long enforced assignments of contingent expectancies '[d]espite ... section 1045.'" (*Id.*, citing *Bank of California v. Connolly* (1973) 36 Cal.App.3d 350, 366-367 and *Dougherty v. California Kettleman Oil Royalties, Inc.* (1937) 9 Cal.2d 58, 89.)

The Court also rejected Alliance's argument that the Release was not a transfer of an asset because "transfer" under the UVTA has a broad meaning. (*Sturm v. Moyer* (2019) 32 Cal.App.5th 299, 308.) It includes "*every* mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money, *release*, lease, license, and creation of a lien or other encumbrance." (§ 3439.01, subd. (m), italics added.) Under the plain language of the UVTA, a release qualifies as a "transfer."

Did Potter have a "claim" against Tovar?

Alliance argued that Potter did not have a "claim" against Tovar, and thus was not a "creditor" when Tovar executed the Release, because Potter did not have a judgment against Tovar at the time. While Alliance is correct that a creditor under the UVTA is "a person that has a claim," the word "claim" is not as narrowly defined as Alliance claimed. With an exception not pertinent here, a claim is "a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." (§ 3439.01, subd. (b).)

The language of section 3439.01 demonstrates an individual need not have a judgment to have a claim, as does section 3439.04, which provides certain transfers are voidable as to a creditor "whether the creditor's claim arose before or after the transfer was made." (§ 3439.04, subd. (a).) Though Potter did not have a judgment against Tovar when the Release was executed, he had a claim against him. He and Tovar were thus, respectively, a creditor and debtor under the terms of the UVTA. (§ 3439.01, subds. (c), (e).)

Did Potter suffer an "injury"?

Alliance claimed that Potter suffered no "injury" as a result of the Release between it and Tovar. The Court held otherwise. It explained that Potter alleged that he had obtained a verdict in excess of $1.5 million and was damaged because he could not collect on it from either Tovar or Alliance. The Court already concluded that the bad-faith cause of action was a transferrable asset. Without the Release, Tovar could have assigned the cause of action to Potter. If Tovar had declined to do so in favor of pursing it himself, Potter could have placed a lien on the cause of action or potential proceeds of the lawsuit. (Code Civ. Proc., § 708.410, subd. (a).) The Release deprived Potter of those options. While it is unclear at this juncture what value Tovar's cause of action had or has, the allegation is sufficient to demonstrate injury for the purposes of a demurrer. (The Court noted in a footnote that, "It seems fair to assume, however, from the $75,000 AUIC paid Tovar in consideration for the Release, that the cause of action had significant monetary value when the Release was executed."

Did Potter have standing to sue Alliance?

The UVTA permits a creditor to recover against a transferee or a "person for whose benefit the transfer was made." (§ 3439.08, subd. (b)(1)(A).) Alliance argued that Potter could not state a cause of action against it for fraudulent conveyance because Alliance was not a debtor, a transferee, or a person for whose benefit a transfer was made. But

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the facts as alleged in the operative complaint forestall this conclusion. As alleged, the transfer in question was made for Alliance's benefit.

Was Potter required to show that the Release rendered Tovar insolvent?

Alliance argued that the Release did not render Tovar "insolvent" as defined by the UVTA. But only one of the three methods of proving a violation of the UVTA requires a plaintiff to prove insolvency (§ 3439.05), and the operative complaint pleads all three methods in the alternative. As a result, even if Alliance were correct, it failed to show that the complaint failed to state a cause of action for violation of the UVTA.

Conclusion – some good lawyering

Faced with a surprising and difficult situation, Potter's lawyers, who are listed in the opinion as Michael D. Compean and Frederick G. Hall of Black Compean & Hall, got creative and found an effective countermove to the insurer's attempt to make an end-run around California bad-faith law. Had they not succeeded, insurers could have relied on the tactic of buying their insured's bad-faith claim as a way to vitiate the duty to settle. Sometimes, the best stories are the ones that don't actually happen.

Jeffrey I. Ehrlich is the principal of the Ehrlich Law Firm*, in Claremont, California. He is a cum laude graduate of the Harvard Law School, a certified appellate specialist by the California Board of Legal Specialization, and a member of the CAALA Board of Governors. He is the editor-in-chief of* Advocate *magazine and a two-time recipient of the CAALA Appellate Attorney of the Year award.*