Andrew B. Downs
San Francisco,
Shareholder

Direct Dial: 415.352.2716
Fax: 415.352.2701
Email Attorney

A Deal Is Not A Deal: California Court Uses Uniform Voidable Transactions Act to Invalidate Policyholder Release of Bad Faith Claim

By Andrew B. Downs

In a case that ought to remind us that there are few limits to the creativity of the policyholder bar, and that if a course of action seems too cute, it probably is, the California District Court of Appeal used the Uniform Voidable Transactions Act to invalidate a policyholder's release of extracontractual claims.

Potter v. Alliance United Insurance Company began with a motor vehicle accident. The automobile liability policy for the at fault driver had a limit of liability of $15,000. The insurer failed to respond to a policy limits demand from the claimant. Eventually, the claimant's suit against the policyholder went to trial, resulting in a verdict of just over $900,000. After the trial court granted a new trial, vacating the verdict, the claimant appealed. While the appeal was pending the insurer agreed to settle the policyholder's bad faith failure to settle claim for $75,000 and the policyholder gave the insurer a complete release. After the case was retried, leading to judgment in excess of $1.5 million against the insolvent policyholder, the claimant sued the insurer seeking to set aside the bad faith release so he could execute upon the policyholder's bad faith failure to settle cause of action.

On appeal from a judgment following the sustaining of a demurrer the Court of Appeal agreed the claimant stated a valid claim under the Uniform Voidable Transactions Act and could seek to have the bad faith release voided.

The Uniform Voidable Transactions Act, formerly called the Uniform Fraudulent Transfers Act is codified at California Civil Code § 3439 *et seq*. Similar versions of the act as construed in this case have been adopted in most other states. It treats as fraudulent "a transfer by a 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*, 33 Cal.4th 642, 648 (2004). In *Potter*,the Court of Appeal held the policyholder's bad faith claim was an asset subject to the act, that the transfer was made for the insurer's benefit, and that a claim had been stated under the Uniform Voidable Transactions Act.

The insurer's strategy here was somewhat unusual. While the appellate court didn't comment on the disparity between the $75,000 paid and the original verdict or the eventual seven digit excess judgment, it would not be surprising if that disparity had an effect on the court's perception of the case. The court did comment in a footnote that the fact that $75,000 was paid while the original appeal was pending indicated the bad faith claim "had significant monetary value when the Release was executed."

Going forward, it is important to keep in mind that a bad faith release that doesn't include the claimant, and which seems too good to be true for the insurer (at least when viewed from hindsight) may not be enforceable if the consideration paid and release given appear to have been intended to foreclose the claimant from obtaining an assignment of the policyholder's excess judgment bad faith claim.