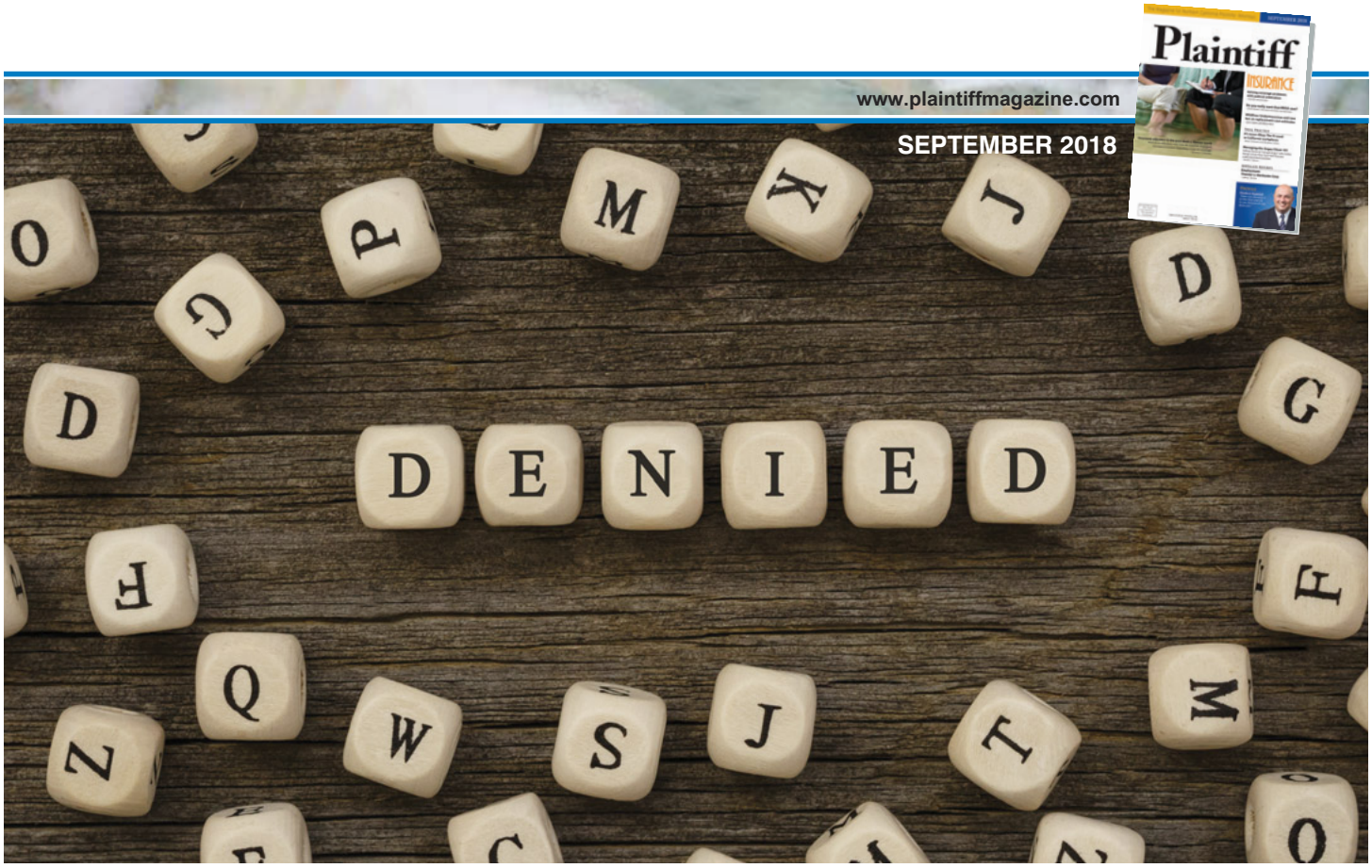

Solving coverage problems with judicial arbitration

Even a low arbitration award may help with coverage issues and lead to a bad-faith claim

By Demián Oksenendler

Judicial arbitration. Most of us have been there. Sometimes it feels fruitless. I've been sent against my will. The order arrives and it feels like I've been pre-judged. Like the court is sending a message that my case is worth a lot less than I thought. It jams up my schedule: I have to get through a lot more discovery a lot faster than planned. Within just a few months of the first case management conference, I have to complete written discovery, depose the defendant, an eye-witness or two, and maybe even a defense doctor.

Then the day arrives. I put on a good case. About a week later, sometimes longer, I receive the arbitrator's award. It's usually well-reasoned. Arbitrators always seem to spend more time than their $150 stipends (Code Civ. Proc., § 1141.18) would justify. Maybe this time the amount of the award is lower than I hoped for, but it's a number my client and I can live with. So, I cross my fingers and wait. Sure enough, the day before the arbitrator's award becomes final, I get that envelope from defense counsel's office: Arbitration award rejected. I pick up the phone and call defense counsel. "It was a fair award," I say, "you rejected it to keep a judgment off your client's credit report, right?" Defense counsel growls: "Either you give me a discount off of that award, or get ready for trial."

Just like that, what looked like a way of getting the case resolved relatively early and bringing my client some closure has turned into a barrier. The arbitration award has become a ceiling on what the defense will pay. It feels like I'm back at square one.

Experiences like these made me want to stay away from judicial arbitration. But recently, my attitude has shifted. Why the change of heart? I learned that judicial arbitration can solve my coverage problems.

Judicial arbitration basics

There have been plenty of articles written about the benefits of judicial arbitration generally, and about the basic rules. But for context and ease of reference, I cover the relevant ones here. Generally, cases that the court feels will be worth $50,000 or less are automatically referred to judicial arbitration. (Code Civ. Proc., § 1141.11.) However, any case,

regardless of the amount in controversy, can go to judicial arbitration if the parties stipulate. (Code Civ. Proc., § 1141.12(a); Cal. Rules of Court, rule 3.811(a)(4).) In the context we care about here, a stipulation or involuntary judicial assignment is important. If the plaintiff is the only one asking for judicial arbitration, the award is capped at $50,000. (Code Civ. Proc., § 1141.12(b); (Cal. Rules of Court, rule 3.811(a)(5).)

Once assigned to judicial arbitration, the race is on. Judicial arbitrations are supposed to be completed within 90 days of assignment of an arbitrator. (Cal. Rules of Court, rule 3.817.) Parties can conduct discovery pursuant to the Discovery Act. (Cal. Rules of Court, rule 3.822.) The cutoff is 15 days before the hearing. (Cal. Rules of Court, rule 3.822.) After arbitration (assuming a party rejects the award), the only discovery allowed is expert discovery. (Code Civ. Proc., § 1141.24.)

At the hearing, evidentiary rules are relaxed. For example, a party may submit written witness statements and expert reports, as long as those are shared with the opposing party 20 days in advance. (Cal. Rules of Court, rule 3.823(b).) Similarly, medical records and bills are per se admissible. Indeed, even police reports are admissible in judicial arbitration. (*Ibid*.) Interestingly, however, no record of the proceedings is allowed, other than the arbitrator's own notes – stenographers are prohibited. (Cal. Rules of Court, rule 3.824(b).)

Once arbitration is complete, the arbitrator files a written award with the superior court where the action is pending. (Code Civ. Proc., § 1141.23; (Cal. Rules of Court, rule 3.825.) Any party may reject a judicial arbitration award by requesting a trial de novo within 60 days of issuance. (Code Civ. Proc., § 1141.20; (Cal. Rules of Court, rule 3.826(a).) Rejecting an arbitrator's award is easy. The judicial council created a one-page, preprinted form for this purpose (ADR-102). The filing is free. (Cal. Gov. Code, § 70617(b)(4).) If no one requests a trial de novo before the deadline, the arbitrator's award automatically becomes a nonappealable judgment. (Code Civ. Proc. 1141.23; (Cal. Rules of Court, rule 3.827(a).)

How does this solve my coverage problems?

Judicial arbitration can solve coverage problems because of the way its procedural rules – especially the right to reject the award – dovetail with the rules governing insurance coverage.

The type of coverage dispute where I have found judicial arbitration to be most helpful is in matters where an insurer has refused to defend. Most of us are familiar with the principle that the duty to defend is broader than the duty to indemnify. Nothing more than "a bare 'potential' or 'possibility' of coverage" is required to trigger the duty to defend. (*Montrose Chem. Corp. v. Superior Court* (1993) 6 Cal.4th 287, 300.) The duty arises as soon as facts known or inferable from the complaint or learned from other sources suggest a potential of coverage. (*GGIS Ins. Services v. Superior Court* (2008) 168 Cal.App.4th 1493, 1506.) The only way an insurer can avoid defending is if "the third party complaint *can by no conceivable theory raise a single issue which could bring it within the policy coverage*." (*Ibid.* (emphasis in original).) Indeed, "the duty may exist even where coverage is in doubt and ultimately does not develop." (*Montrose, supra,* at 295.) Once the duty to defend arises, the only way for an insurer to extinguish it is to "negate[] all facts suggesting potential coverage." (*GGIS, supra,* at 1506 (quoting *Scottsdale Ins. Co. v. MV Transp.* (2005) 36 Cal.4th 643, 655).)

After looking at the complaint, and investigating the facts, "any doubt as to whether the facts establish the existence of the defense duty must be resolved in the insured's favor." (*Montrose, supra,* at 299-300 (citations omitted).) "As many cases have held, '[i]f coverage depends on an unresolved dispute over a factual question, the very existence of that dispute would establish a possibility of coverage and thus a duty to defend.' (Citations omitted)." (*North Counties Eng'g, Inc. v. State Farm* (2014) 224 Cal.App.4th 902, 922.) When there is an exclusion at issue, the insurer has to go even further; it must provide "conclusive evidence demonstrating the exclusion applies . . . [it] has the burden of proving, through conclusive evidence, that the exclusion applies in all possible worlds." (*Atl. Mut. Ins. Co. v. J. Lamb, Inc.* (2002) 100 Cal.App.4th 1017, 1039.)

Establishes the necessary doubt triggering duty to defend

Obviously, California law on duty to defend favors the insured. But how do these coverage concepts relate to judicial arbitration when the insurer has already refused to defend? They relate because a judicial arbitration can produce a ruling that triggers the duty to defend while there is still time to do so. A judicial arbitration can be the perfect setting to show that there is "doubt as to whether the facts establish a duty to defend." An arbitrator's award can show the carrier that "possible world" where an exclusion does not apply.

This does require at least a partially cooperative defendant. When an insurer refuses to defend, I recommend asking the defendant to stipulate to judicial arbitration. It is not typically a difficult sell. The in pro per defendant, rightly concerned about facing the litigation process alone will usually be glad to take advantage of the cost savings and relaxed evidentiary rules of arbitration. Be sure to pick an arbitrator whom you trust to render a fair decision. Even better if it is someone who understands coverage issues.

When the time comes for the arbitration, my suggestion is to put on a case on whatever the coverage problem may be. Ask the arbitrator to decide that issue in addition to liability and damages. This does not mean that you should give the arbitrator a copy of the insurance policy and ask for a coverage opinion. Instead, just go for the factual issue. For instance, if an insurer refuses to defend an auto accident case on the grounds that the driver was not a permissive user, you can ask the

arbitrator to decide the issue of permission. If an insurer is refusing to defend a dog bite case because the dog is an excluded breed, you can ask the arbitrator to decide the breed of the dog. If an insurer is refusing to defend on the grounds that the harm its insured caused did not occur by accident, you can ask the arbitrator to decide whether there was an accident.

For obvious reasons, the most likely arbitration outcome against a pro per defendant is a decision in your client's favor on liability and damages. Additionally, it is likely that the arbitrator's award will contain a paragraph or two deciding the factual issue related to coverage in your favor as well. There is no reason for the arbitrator to decide it against you. The pro per defendant is likely unprepared to address the issue, but more importantly, the defendant has no incentive to dispute it. The defendant wants there to be coverage at least as much as you do. It is possible, but unlikely, that the arbitrator could refuse to decide the extra factual issue. If it has been briefed and argued, there is no reason to leave it out. As far as the arbitrator is concerned, the coverage-related issue is dicta. If the parties want a ruling on it, why leave it out?

I have an arbitration award, now what?

Once you receive the arbitration award, someone (either you or the pro per defendant) has to send it to the insurer *before it becomes a judgment*. Timing is critical. Having refused to defend, the insurer will not have participated in the arbitration at all. It may not have even known an arbitration was going forward. It is essential that the insurer receive the arbitration award in time to do something about it. It will have two options at that point. The insurer can either de novo the award and start defending its insured, or it can do nothing. Either choice is a victory for your client.

If the insurer responds to the arbitration award by starting to defend (the least likely choice, in my experience), that means the defendant in the case has a source of funds to pay a settlement or judgment after trial. Even better, the insurer will be at a disadvantage. Discovery closed (except for experts) fifteen days before the arbitration. With likely no depositions or other discovery done by the pro per defendant, how can the insurer hope to win?

In my experience, the insurer's most likely course of action is that it will place a copy of the arbitration award in the claim file and do nothing, allowing it to become a judgment. That conduct will form the linchpin of a subsequent bad-faith case. The insurer will choose this course of conduct, thinking that the arbitrator's decision on the coverage-related facts is dicta and that it is not bound by those findings because it did not participate in the arbitration. It will be correct on those two points, but that line of thinking is only correct as far as it goes.

The new possibility of coverage

When an insurer ignores an arbitrator's award, what the carrier is missing in its analysis is that the award is more than just a decision about the merits of the case. The award is also a piece of new information that the insurer should be considering in the context of whether it has a duty to defend. When an insurer receives an arbitrator's award that reaches a different conclusion than the insurer did with regard to an issue central to coverage (e.g., whether there was an accident, whether there was permissive use, or the breed of a dog), it is confronted with a possibility of coverage. The arbitrator's award means that an independent factfinder can reach a different conclusion about the facts, i.e., there is a "conceivable theory" that brings the claims against the insured within coverage – there is a "possible world" where the exclusion does not apply. (See *Montrose, supra,* at 295; *J. Lamb, Inc., supra*, at 1039.)

Regardless of what might have come before, an arbitrator's award that conflicts with an insurer's coverage position creates a factual dispute over the issue upon which the insurer has relied to deny coverage. The existence of that dispute means there is a duty to defend. (See *North Counties Eng'g, supra* at 922.) If the insurer receives a copy of the arbitration award with enough time to act, then its conduct can be judged from that point forward. A failure to defend at that time will be wrongful. Problem solved.


Oksenendler

Demián Oksenendler is a shareholder at Mannion, Lowe & Oksenendler, P.C. in San Francisco. His represents policyholders against insurance companies of all kinds in both litigation and consulting matters. He is AV Rated, has been named to the Northern California Super Lawyers Rising Stars list every year since 2011, and is a member of the Board of Directors of the San Francisco Trial Lawyers Association.