THE ATTORNEY'S ROLE DURING THE ADJUSTMENT OF AN INSURANCE CLAIM*

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Introduction

It is not uncommon in the first or third-party context for an insurer to retain counsel early in the claims process to assist in the investigation of the claim. The attorney's role can include gathering documents, conducting an investigation, conducting examinations under oath, and issuing coverage opinions. The attorney may also actively communicate with the insured and the insured's counsel to collect information. However, whether the attorney is serving as legal counsel or as a claims adjuster is often blurred. As a result, questions often arise as to whether the documents created by the attorney are protected by the work-product of the attorney-client privilege.

Work Product Immunity

The concept of work-product immunity arises from Federal Rule of Civil Procedure 26(b)(3), which limits the discovery of documents prepared in anticipation of litigation. Protection for work product is not absolute, but is more accurately described as a "limited immunity" rather than

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a privilege. *Carver v. Allstate Insurance Co.,* 94 F.R.D. 131, 133 (S.D. Geo. 1982). The party resisting disclosure has the burden of establishing the documents' eligibility for protection. *Binks Manufacturing Co. v. National Presto Industries, Inc.,* 709 F.2d 1109, 1120 (7th Cir. 1983).

The work product doctrine is intended to prevent unwarranted inquiries into the files and mental impressions of an attorney (and others) when litigation is anticipated or underway. There are two kinds of work product: (1) ordinary work product; and (2) opinion work product. Ordinary work product includes raw factual information. It is generally not discoverable unless the party seeking discovery has a substantial need for the materials and the party cannot obtain the information elsewhere. Opinion work product includes an attorney's mental impressions, conclusions, opinions, and legal theories, and is entitled to substantially greater protection than ordinary work product. More than substantial need and undue hardship are generally required. *In re Murphy,* 560 F.2d 326, 336 (8th Cir. 1977). Illegality, criminal conduct, and fraud may qualify. *See also Moe v. System Transport, Inc.,* 270 F.R.D. 613, 622 (D. Mont. 2010) ("a party seeking such materials must show that the mental impressions are directly at issue … and the need for the material is compelling.") However, "the insured's right to discover the opinions and mental impressions of the insurer's claims adjusters does not mean that she is entitled to obtain the confidential observations, mental impressions of legal theories of the insurer's attorney." *Spargo v. State Farm Fire & Cas. Co.,* 2017 U.S. Dist. Lexis 96823.

When determining whether work-product immunity applies, many courts apply a two-prong approach. The first is what is typically referred to as the "causation" requirement. This is the basic requirement that the document in question be produced *because of* the anticipation of litigation, i.e., prepared for trial. *Harper v. Auto-Owners Ins. Co.,* 138 F.R.D. 655, 659 (S.D. Ind. 1991). The second requirement is what is typically referred to as "reasonableness" and is applied to the party's anticipation of litigation. In other words, it is more of a subjective test since litigation can essentially be anticipated at any time.

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Numerous courts throughout the country have addressed the issue of when the "anticipation of litigations arises", but in general most courts agree that a party must show more than a "remote prospect," or a "likely chance" of litigation. *Mission National Ins. Co. v. Lilly,* 112 F.R.D. 160, 163 (D. Minn. 1986). Rather, a party must demonstrate that "at the very least some articulable claim, likely to lead to litigation" has arisen. *Binks,* 709 F.2d at 1119.

Moreover, it is typically not enough that the documents merely be produced because of the justifiable anticipation of litigation, but the material must have been produced *because of* that prospect of litigation and for no other purpose. *Harper,* 138 F.R.D. at 660. Documents which are created in the ordinary course of business, are not privileged. *St. Paul Reinsurance Co. Ltd. v. Commercial Financial Corp.,* 197 F.R.D. 620, 636 (N.D. Iowa 2000).

In the insurance context, however, determining the scope of work-product immunity is more challenging because it is the very nature of an insurer's business to investigate and evaluate the claim. The question therefore becomes, when an attorney is retained to conduct an investigation and advise on a coverage position, is that the ordinary business of an insurer, or is it work product? As with most any issue in the law, whether it will be protected by work-product privilege will depend on the specific facts of the case.

Some courts have adopted a rebuttable presumption based on whether a document was prepared before or after the insurer has made its claims decision. For example, in *Harper,* the court declared:

> It is presumed that a document or thing prepared before a final decision was reached on an insured's claim and which constitutes part of the factual inquiry into or evaluation of a claim, was prepared in the ordinary and routine course of an insurer's business and is not work product.

Harper, 138 F.R.D. at 662-663. Conversely, documents created after a denial is issued are presumed to be work product. *Id.* In order to rebutt this presumption, the insurer must demonstrate "by specific evidentiary proof of objective facts" that "a reasonable anticipation of litigation existed when the document was produced, and that the document was prepared and used solely to prepare for that litigation." *Id.* at 663-664. This presumption was adopted by the court in *Pete Rinadli's Fast Foods v. Great Am. Ins. Co.,* 123 F.R.D. 198, 202 (M.D.N.C. 1988) as follows:

> Because an insurance company has a duty in the ordinary course of business to investigate and evaluate claims made by its insureds, the claims files containing such documents usually cannot be entitled to work product protection. Normally, only after the insurance company makes a decision with respect to the claim, will it be possible for there to arise a reasonable threat of litigation so that information gathered thereafter might be said to be acquired in antici-

> pation of litigation. This is not to say that the threat of litigation may never arise at an earlier time. However, if the insurer argues it acted in anticipation of litigation before it formally denied the claim, it bears the burden of persuasion by presenting specific evidentiary proof of objective facts demonstrating a resolve to litigate.

But other courts have rejected the *Harper* presumption as too mechanical. For example, in *Anastasi v. Fidelity National Title Insurance Co.*, 137 Haw. 104, 114 (2016), the Hawaii Supreme Court declared:

> the Harper presumption does not fit squarely with the [work-product] privilege as laid out in HRCP Rule 26, because it focuses not on whether material was prepared in anticipation of litigation or for trial, but on whether material was prepared before or after a formal determination has been made on a claim. Nowhere in the rule is there reference to when a document is prepared. Instead, the rule clearly focuses on the purpose of the prepared material and not on when it is prepared.

Whether or not the *Harper* presumption is adopted, what remains clear is that the determination of whether application of the work-product immunity applies depends on the facts of the particular case. One such context where it often arises is a claim of arson. In *Harper,* the defendant took the position that it reasonably anticipated litigation on the date of the fire and that all documents were protected as work product. The court concluded that a finding that the fire was "arson" was not enough, in and of itself, to anticipate litigation. The court also concluded that Auto-Owners investigation into the fire was not undertaken and used solely to prepare for litigation, but rather that it was under a duty to conduct an investigation as part of its regular business. Ultimately, the court in *Harper* concluded that the documents prepared prior to the date the insurer denied the claim were not protected and those prepared after the denial were presumed to have been produced in reasonable anticipation of litigation.

However, often times a question can arise if a document has a "dual-purpose". For instance, what happens if a document is created to both evaluate a claim and prepare for litigation? The most common approach will be to determine if the "primary motivating purpose" behind the creation of the document was to aid in preparation for litigation. *Stout v. Illinois Farmers Ins. Co.,* 150 F.R.D. 594, 601 (S.D. Ind. 1993). The court in *Stout* concisely articulated the rule as follows:

> If a document or thing would have been created for non-litigation uses regardless of its intended use in litigation preparation, it should not be accorded work product protection. Because the document would have been created for non-litigation reasons anyway, disclosure of the information therein would not disadvantage its creator, or advantage his op-

ponent, by revealing the creator's legal strategy or tactics; thus, the document's release in discovery would not contravene the policies support the work product rule.

Thus, there is no hard and fast rule to determine the point in time in which a document is created which will protect it under the work-product privilege. Rather, courts will typically look at cases on a case-by-case basis to determine factors which include the nature of the document and the purpose of the creation of the document. However, in the insurance context, it is more likely that documents created before the denial of the claim will qualify as documents created in the ordinary course of business and cannot be protected from disclosure as work-product.

In the context of bad faith insurance litigation, there is often a "substantial need" for discovery of the claim file. *See In re Lake Lotawana Cmty. Improvement Dist.,* 563 B.R. 909, 916 (W.D. Mo. 2016). *See also Lloyd's Acceptance Corp. v. Affiliated FM Ins. Co.,* 2012 WL 1389708, at *5 (E.D. Mo. April 23, 2012). Notably, the mere allegation of bad faith is insufficient to overcome the work product immunity. Typically, the insured must demonstrate some likelihood or probability that the documents sought may contain evidence of bad faith. *Logan v. Commerical Union Ins. Co.,* 96 F.3d 971, 977 (7th Cir. 1996). But this is not a high hurdle, as the insured need only show the possibility, not a certainty, that the claim documents contain evidence of bad faith. *Id.*

Additionally, experts' knowledge may, or may not, qualify for protection from disclosure under the work product doctrine. An expert must be retained or a document prepared because litigation was reasonably anticipated, and a court will consider the totality of circumstances. There must be "objective facts establishing an identifiable resolve to litigate prior to investigative efforts before the work product doctrine becomes applicable." *Binks. Mfg. v. Nat'l Presto Indus., Inc.,* 709 F.2d 1109, 1119 (7th Cir. 1983).

Lastly, it is important to note that work product protection is procedural; whereas the attorney client privilege is a matter of substantive law. As such, the application of attorney client privilege may differ among states. And while federal courts will apply the applicable state's law on privilege when a matter is pending in federal court based diversity jurisdiction, federal courts will apply their own law on work product immunity.

Attorney-Client Privilege

Under Federal Rule of Civil Procedure 26 and similar state equivalent rules, privileged material is not (generally) discoverable. What constitutes a privileged communication between client and attorney is a matter of state law, but generally speaking, a party asserting the attorney-client privilege must show:

> (1) The asserted holder of the privilege is or sought to become a client; (2) the

> person to whom the communication was made (a) is a member of the bar of a court, or his subordinate and (b) in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers (c) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client. *Diversified Ind. Inc. v. Meredith,* 572 F.2d 596, 601-602 (8th Cir. 1977).

Once again, the question of whether the attorney-client privilege applies is complicated in the insurance context. The Florida Court of Appeals in *Bankers Ins. Co. v. Florida Dept. of Ins. and Treasury,* 755 So.2d 729 (Fla. Dist. Ct. App. 2000) held that an insurer's communications with an attorney, who was hired as an investigator for an insurance company were not privileged because the attorney functioned as a mere "conduit." The attorney-client privilege only attaches when an attorney performs acts for an insurer in his/her professional capacity and in anticipation of litigation. *Milinazzo v. State Farm Ins. Co.,* 247 F.R.D. 691, 697 (S.D. Fla. 2007). Thus, often times the question of when the attorney-client privilege attaches goes back to the issue of when anticipation was reasonably anticipated. *1550 Brickell Ass'n v. QBE Ins. Co.,* 253 F.R.D. 697, 699-700 (S.D. Fla. 2008).

In *Harper,* the court noted that Auto-Owners hired outside counsel five days after the fire to monitor the progress of the claim, ensure compliance with arson reporting requirements, and conduct examinations under oath per the policy. As such, the court noted that to the extent that counsel acted as a claims adjuster, claims process supervisor, or claim investigation monitor, and not as legal advisor, the attorney-client privilege would not apply. *Harper,* 138 F.R.D. at 671 *citing Mission National,* 112 F.R.D. at 163. Additionally, if a document was pre-existing or otherwise not produced for the purpose of obtaining or communicating legal advice, it does not become privileged merely because it was passed on, or through, an attorney in the course of repetition. *Stout,* 150 F.R.D. at 610.

Therefore, in order to determine whether the attorney-client privilege attaches, the question really focuses on the purpose of the retention and legal services rendered. Thus, generally speaking in the insurance context, for the attorney-client privilege to apply, the attorney must be acting in his professional capacity as an attorney, and not performing an insurer's "quasi fiduciary" responsibilities to investigate a claim or loss. So, for example, answering a client's question regarding the law governing insurance claims and the application of policy terms to a given loss or claim will qualify as acting within one's professional capacity as an attorney. But gathering facts

from a third party regarding the loss is within the purview of a claim investigation.

The attorney client privilege is waived when the client voluntarily reveals an attorney client communication to a person outside the scope of the attorney client relationship. Further, as a general rule, a party impliedly waives the privilege when it expressly relies on the advice of counsel as a defense to a claim against it. *Chevron Corp. v. Pennzoil Co.,* 974 F.2d 1156, 1162 (9th Cir. 1992).

In *Cedell v. Farmers Ins. Co. of Washington,* 295 P.3d 239 (Wash. 2013), the Washington Supreme Court held that, in the context of a lawsuit alleging bad faith handling and processing of a "first party" claim (other than UIM):

1. There is a *presumption* of *no* attorney-client privilege; and

2. If the presumption is rebutted, the insured can attempt to "pierce" the privilege with the "civil fraud exception."

The *Cedell* case involved a first-party claim on a homeowner's policy for a house fire, and an allegation that the insurer had violated its duty of good faith claims handling of the fire-loss claim. The insurer retained counsel during the claims process, and that attorney examined witnesses under oath, directly interacted with the insured during the claims process, issued a coverage position letter on behalf of the insurer, and made a time-limited settlement offer to the insured.

Cedell was insured with Farmers for over 20 years. It appears that the insured reported the fire, which was caused by a candle, to Farmers within two days. The insured's girlfriend, who was not an insured, admitted that she and others in the house may have been using methamphetamines at the time. However, Cedell swore under oath that he had not consumed methamphetamines and did not know his girlfriend had. According to the opinion, Farmers delayed its coverage determination based upon inconsistencies in statements by the insured's girlfriend (apparently regarding the use of methamphetamines).

Although Washington courts have long held that normal claims handling functions cannot be shielded with attorney-client privilege by retaining an attorney to perform them, the *Cedell* court held there is a "presumption" of no attorney-client privilege whenever an insurer is sued for bad faith handling of a first-party claim (the court excepted UIM claims from this newly created presumption).

The court's rationale was as follows: (1) "To permit a blanket privilege in insurance bad faith claims because of the participation of lawyers hired or employed by insurers would unreasonably obstruct discovery of meritorious claims and conceal unwarranted practices." And, (2) "… bad faith claims by insureds against their own insurer are unique and founded upon two

important public policy pillars: that an insurance company has a quasi-fiduciary duty to its insured and that insurance contracts, policies, and procedures are highly regulated and of substantial public importance."

The *Cedell* presumption does not do anything more than implement the normal rule that a party claiming privilege has the burden of establishing the facts constituting the foundation for the privilege. The insurer may overcome the presumption upon a showing *in camera* that the attorney was providing legal counsel to the insurer (e.g., a coverage opinion) and was not engaged in the insurer's quasi-fiduciary functions, such as investigating and evaluating the claim. See, See Restatement (Third) of the Law Governing Lawyers §86(2) (2000).

If the presumption of no attorney-client privilege is rebutted, the insured may attempt to "pierce" the privilege. Historically, the attorney-client privilege has not protected communications wherein the attorney and client are discussing how to commit fraud. This is known as the "civil fraud exception" to attorney-client privilege. In *Cedell,* for "first-party" insurers, the Washington Supreme Court endorsed a two-step process to assess the civil fraud exception:

1. First, upon a showing that "a reasonable person would have a reasonable belief that an act of bad faith [tantamount to civil fraud] has occurred," the trial court will perform an *in camera* review of the claimed privileged materials.

2. Second, after *in camera* review and upon a finding that there is "a foundation to permit a claim of bad faith to proceed," the insurer's attorney-client privilege "shall be deemed to be waived."

Generally speaking, the insured is entitled to discover the claims file, but it will normally involve redactions of communications from counsel that reflected the mental impressions of the attorney to the insurer. The insured will be required to satisfy a much higher burden in order to discover such mental impressions.

Conclusion

Ultimately, the application of the work product doctrine and attorney client privilege are unique in the context of an attorney who represents an insurer and is working both as an attorney and claims adjuster. If you find yourself in such a position, or seeking to discover materials in analogous situation, here are some strategies to consider:

- Understand what constitutes a privileged communication between attorneys and their clients.

- Attorneys providing legal advice to insurance companies should be mindful when timekeeping.

- Attorneys should not perform 'claim' functions, even when litigating with the insured, if they wish to maintain the confidentiality of their work.

- 'Claim functions' should still be handled directly between insurer and insured, even where insurer has retained counsel in a matter, to preserve the privilege.

- Counsel should use appropriately descriptive language when providing advice to insurers regarding the handling of a claim.

- Challenge / determine the basis and scope of the bad faith claim early, before discovery becomes an issue.

- Challenge relevancy in discovery.

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