# LEGAL, TACTICAL, AND PRACTICAL GUIDE FOR LITIGATING YOUR BAD FAITH CASE

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Issues involving the role played by counsel in insurance matters arise in the context of first and third party bad faith litigation. A third party bad faith case involves a claim of bad faith based on the insurer's handling of claims against the insured under a liability policy. A first party bad faith case involves the insurer's handling of an insured's own claim for policy benefits.

When an insured presents a claim for bad faith the focus of the litigation is on the nature of the insurer's claim handling conduct. It is thus expected that where claims of bad faith are at issue in insurance litigation, the insureds have a pressing need for the information contained in their carrier's claims and investigation files. Reavis v. Metropolitan Prop. And Liab. Ins. Co. 117 F.R.D. 160, 164-5( S.D. Cal 1987); Silva v. Fire Ins. Exch. 112 F.R.D. 699 (D. Mont. 1986); Mission National Insurance Company v. Lilly 112 F.R.D. 160 (D. Minn. 1986); Western Nat'l Bank of Denver v. Employer's Ins. Of Wausau, 109 F.R.D. 55, 57 (D. Colo 1985)[Fed. R. Civ. P. 26 (b)93) was not intended to protect from general discovery materials prepared in the ordinary course of business (which) included investigations a person who was an attorney but acting in the capacity of an investigator and adjuster for the insured]; Marshall v. Nationwide Mut. Ins. Co., 1994 U.S. Dist. LEXIS 7834 (E. D. Pa. 1994) ; One of the first items of discovery that a claimant's advocate seeks is the production of the claim file created and maintained by the defendant insurance company. At the same time, the insurance company will arduously resist producing the claims file, fingerprinted with telling information as to who made the claims handling decisions, and why.

When the issue is whether an insurer has violated the covenant of good faith and fair dealing, the interaction of the attorney defending the claim and the insurance company may come into issue. There is a split of consensus on whether the entire claim file is fair game, or whether the insurance can prevent the disclosure of the communications with counsel, both in house and retained. The defenses often raised are "work product" and "attorney-client".

The concept of work product originated with Hickman v. Taylor, 329 U.S. 495 (1947) and was essentially codified by Rule 26 (b)(3) of the Federal Rules of Civil Procedure. The original idea was to protect the lawyer's work so that he could feel secure that he could work "within a certain degree of privacy" within the adversarial legal system. A party opposed the release of documents under Federal Rule 26 (b)(3) must demonstrate that the requested documents were obtained or created in anticipation of litigation and not in the regular course of business. Schmidt, Long & Assoc., Inc. v. Aetna U.S. Healthcare, Inc. 2001 U.S. Dist. LEXIS 7145 (E. D. Pa. May 31, 2001).

The mere existence of an attorney client relationship does not raise a presumption of confidentiality. P. & B. Marina, L.P. v. Logrande, 136 F.R. D. 50 (E.D. N.Y. 1991) aff'd, 983 F.2d 1047 (2d Cir. 1992). The attorney-client privilege applies only if:

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 and (b) in connection with the communication is acting as a lawyer;
3) the communication relates to a fact of which the attorney was informed (a)by the client and (b) without the presence of strangers (c) for a legal service; and
4) the privilege is claimed and not waived.

United States v. United Shoe Machinery Corp., 89 F. Supp. 357, 358 (D. Mass. 1950). The party asserting the attorney-client privilege has the burden of establishing all of the elements of the privilege. United States v. Martin, 278 F.3d 988, 999-1000 (9th Cir. 2002) Client communications with both in-house and outside counsel are protectable by the privilege. See Robertson v. Allstate Ins. Co., 1999 U.S. Dist. LEXIS 2991, *3 (E. D. Pa March 10, 1999) The proponent of the privilege does not meet its burden if its fails to provide the court with sufficient facts to allow the court to state with reasonable certainty that the privilege applies. F. T. C. v. TRW, Inc. 628 F. 2d 207, 213 (D.C.Cir. 1980) The attorney-client privilege, which is strictly construed because it impedes the full and free discovery of the truth, does not make all communications with a lawyer privileged. Martin, 278 F.3d at 999. In the corporate setting, the attorney-client privilege generally applies to "to communications between corporate employees and counsel, made at the direction of corporate superiors in order to secure legal advice." United States v. Chen, 99 F. 3d 1495, 1502 (9th, Cir. 1996), cert. denied, 520 U.S. 383, 390-94, 101 S. Ct. 677, 683-85 (1981) The privilege is applicable when (1) the communication was made for the purpose of securing legal advice, (2) the employee making the communication did so at the direction of a corporate superior, (3) the superior made the request so that the corporation could secure legal advice, (4) the subject matter of the communication is within the scope of the employee's corporate duties, and (5) the communication is not disseminated beyond those persons, who, because of the corporate structure, need to know its contents. Diversified Industries, Inc. v. Merdedith, 572 F. 2d 596, 611 (8th Cir. 1978 ) (en banc); 3 Jack B. Weinstein & Margaret A. Berger, Weinstein's Federal Evidence, SS 503.22[4][b] at 503-86. (2nd Ed.)

Where a document was prepared for a client for the simultaneous review of legal and non legal personnel, it is not privileged legal advice because that was not the document's primary purpose. To be privileged, a client's communication must be made primarily to obtain legal services, with an expectation of confidentiality. Only the communication itself is privileged. Simon v. G.D. Searle Corp. 816 F. 2d 397 (8th Cir. 1987) cert. denied, 484 U.S. 917, 108 S. Ct. 268 (1987) (underlying facts of aggregate amounts allocated to certain risks were discoverable)

When a corporation seeks to protect communications made by an attorney who serves the corporation in a legal and business capacity, the "corporation must clearly demonstrate that the advice to be protected was given 'in a professional legal capacity'" Avianca, Inc. v. Corriea, 705 F. Supp. 666, 676 (D.D.C. 1989) This showing is "necessary to prevent corporations from shielding their business transactions from discovery simply by funneling their communications through a licensed attorney." Id. at 676. The attorney-client privilege extends only to communications of the client for the purpose of obtaining legal advice. The privilege does not protect communications as to business and management advice, even from an attorney. U.S. vs. IBM, 71 F.R.D. 376, 378 (S.D.N.Y. 1976). See also Fine v. Facet Associate Products Co. 133 F.R.D. 439 (S.D.N.Y. 1990); Teltron , Inc, v. Alexander, 132 F.R.D. 394 , 396 ("when a corporation seeks to protect communications made by an attorney who serves the corporation in a legal and business capacity, the corporation must clearly demonstrate that the advice to be protected was given in a professional legal capacity") The communications must have as a primary purpose the securing or providing of legal services. Thus, documents that are reports of "general corporate business decisions as opposed to legal advice based upon confidential information" are not privileged. Barr Marine Products Co., Inc. v. Borg-Warner Corp. 84 F.R.D. 631 (E.D. Pa. 1979), citing Congoleum Industries, Inc. v. G.A.F. Corp.49 F.R.D. 82 (E.D. Pa. 1969) Aff'd without op., 478 F.2d 1398 (3rd Cir. 1973) Communications to in-house counsel is protected only if made to them in their professional capacity as lawyers. United Jersey Bank v. Wolosoff, 196 N.J.Super at 563, (App. Div. ) To prevent corporate attorneys from abusing the privilege by using it as a shield to thwart discovery, the "claimant must deomonstrate that the communication would not have been made but for the client's need for legal advice or services." First Chicago International v. United Exchange Company, Ltd., 125 F.R.D. 55, 57, (S.D.N.Y. 1989)

In the insurance claims handling context, in –house and outside counsel often perform ordinary business functions of the insurer. To the extent an attorney acts as a claims adjuster, claims process supervisor, or claims investigation monitor, the attorney-client privilege does not apply. See, e.g. Harper v. Auto-Owners Ins. Co. 138 F.R.D. 655 (SD.D. Ind. 1991) There, documents prepared by outside counsel hired to monitor progress of the case and to conduct examination under oath of insured were not privileged; the court found the counsel acted in claims investigation function as a legal advisor) In Merrin Jewelry Co. v. St Paul Fire and Marine Insurance Company, 49 F.R.D. 54 (S.D.N.Y. 1970), the attorney's notes and report of his taking a statement under oath of the president and accountant were not privileged, but for his provision of advice. The court adopted plaintiffs' argument that the documents should not be protected because at the time of the oral examination of the witnesses, the attorney was conducting loss claim investigation which could have been conducted by any person, not necessarily by an attorney. Id. at **7.

Here are the various scenarios where the privilege may be invoked:

I. In a **first party claim** where the insured claims his claim was not settled within the coverage afforded by the policy which personally exposed him, the claimant usually wants to review the file maintained by the counsel retained by the insurance company to represent him. The attorney of record is assigned by the insurance company and his actions are entirely controlled by the insurance company, although he was technically answerable to the insured himself.

In Dombach v. Allstate Insurance Company, for instance, the court refused to recognize an exception to the protection afforded by the attorney client privilege although the claim focused on Allstate's delay and eventual under-evaluation of a claim for injuries caused by an automobile accident. The court refused to permit the plaintiff's counsel access to the communications originating from the attorney defending its insured. 1998 U.S. Dist. LEXIS 13241 (E.D Pa. Aug. 27, 1998) Other Pennsylvania courts have followed the lead of Dombach. See also Robertson v. Allstate Ins. Co., 1999 U.S. Dist LEXIS 2991 (E.D. Pa 3.10.99) ('simple assertion of bad faith does not entitle the insured to circumvent the attorney client privilege"); Quaciari v. Allstate Ins. Com, 1997 U.S. Dist. LEXIS 13834 (E.D. Pa. Sept. 5. 1997) (finding that attorney client privilege applied to communications between insurer and in house counsel concerning claim that later becomes basis for bad faith suit). But see Yohe v. Mutual Life Insurance Co. 7 Pa. D & C. 4th 300, 303-304 (York Cty, 1990); Little v. Allstate Insurance Co., 16 Pa. D. & C. 3d 110, 112 (Allegheny Cty, 1980) and Reusswig v. Erie Insurance 49 Pa. D & C. 4th, 338 (Monroe Cty 2000) [suits over the previous bad faith handling of litigation eradicates attorney-client protections found in the initial claim.}

II. What if the insurance company retains counsel soon after the accident to provide counsel as to the investigation and assessment of the loss and coverage issues? Often, after a first party loss occurs, the insurance company will assign an employee to investigate the loss. They may also assign outside counsel to monitor the case. If the insurance company directs the attorney to interact with the investigator, is their collective thoughts and impressions discoverable? Or does the attorney-client privilege cloak these interactions in secrecy? The party asserting that communications are protected by the attorney-client privilege has the initial burden of demonstrating that the privilege is properly invoked. George v. Wausau Ins. Co. 2000 U.S. Dist. LEXIS 16813 (E.D. Pa. Nov. 21, 2000)

If the attorney was actively involved in directing and controlling the claims adjustment and claims investigation process, are these interactions discoverable? The cases say that if the attorney was directing, coordinating, controlling and dictating the nature, scope, direction and timing of the investigation of this claim, and its disposition, it is not protected. (**use Bagel research here)** The attorney- client privilege does not protect from discovery documents generated and communications made between an attorney and client where the attorney is acting as an insurance claims adjuster or investigator capacity.

Certain insurance firms have suffered the consequences of injecting themselves too deeply in the business decision making process of insurance claims. Understandably, Cozen's current counsel hold the following view:

> "There is no question that the attorney client privilege and work produce doctrine are sound principles that protect the disclosure of confidential or protected material. Undeterred, however, policyholders have attempted to circumvent the reach of these principles by advocating the creation of exceptions to the well established principles afforded litigants." *Traditional Rights in Modern Day Litigation: Upholding the Attorney-Client Privilege and Work Product Doctrine in Actions Brought Under Pennsylvania's Bad Faith Statute*, 73 PA Bar Assn. Quarterly, 47 April 2002, By Michael A. Hamilton, Esq. And Sara Anderson, Frey, Esq., of Cozen and O'Connor.

Mission v. Nat'l Ins. Co. Lilly 112 F.R.D. 160, 163 ( D. Minn 1986) Here, Cozen and O'Connor were hired early in the claim. They provided essentially investigative functions and later, after included in their reports, an assessment of the legal stance the company should take if litigation followed. The court characterized Cozen's task as fulfilling an ordinary business function of claims investigation which later merged into its legal function.To the extent the insurers outside counsel, acted as claims adjusters, then, their work product, communications to client and impressions about the facts will be treated herein as the ordinary business of the plaintiff, outside the scope of the asserted privilege. Thus, in that setting the majority of the entire claims file was discoverable.

Merrin Jewelery Co. v. St Paul Fire and Marine Ins. Com. 49 F.R.D. 54, 57 ( S.D.N.Y. 1970) the report of insurer's attorney that consisted of oral examination of insured and other aspects of claims investigation that non lawyer could perform was not protected by privilege.

Work Product:

Several courts have held that bad faith allegations warrant disclosure of work product documents. In Birth Center V. St. Paul Companies, 727 . 2d 1144 (Pa. Super, 1999) because the legal opinion of the attorney was relevant in the action, the letters of that attorney as well as memoranda and notes of the claims supervisor were discoverable. When suit is brought against an insurance carrier for unreasonable refusal to settle, resulting in a judgment against the insured in an amount in excess of the insurance coverage, an attorney's conclusions or opinions as to the value or merits of a claim should be discoverable. In Birth Center, following a trial of the underlying case, the carrier paid the plaintiff the entire jury verdict although it was in excess of the coverage. The court declared that 1)counsel's letters analyzing the law of bad faith in lieu of the verdict entered against Birth Center in the liability case and 2) notes of conversations between counsel and the liabilities claims supervisor records and 3)a typewritten note from St. Paul's liabilities claims supervisor setting forth counsel's comments and analysis

were no longer sacrosanct because St. Paul made them relevant to it state of mind at the time it paid the excess verdict. Birth Center 1999 P.A. Super 49, 727 A. 2d 1144 at 1166. See also Nedrow v. Pennsylvania National Mutual Casualty Insurance Co., 31 D. & C. 3d 456, 460 (Somerset Cty, 1981) (insurer's file from prior litigation is not exempt from discovery in a bad faith action where the legal opinion of an attorney as to the value or merit of a claim is a relevant issue); General Refractories Company vs. Firemans' Fund Insurance Company, 45 Pa. D & C. 4th 159, 169 ( Philadelphia Cty, 2000) See also Meuller v. Nationwide Mut. Ins. Co. 31, Pa. D & C. 4th 23 ( Allegheny Cty, 1996), (holding work product documents were relevant and discoverable in bad faith action because the actual rationale and motive of the insurer were in issue); Reussing v. Eric Insurance 49 Pa D & C 4th 338 (Monroe Cty, 2000) (ordering production of work product information because it was relevant and could shed light on whether insured's claim was denied without reasonable foundation); Marshall v. Nationwide Mut. Ins. Co. 1994 U.S. Dist. LEXIS 7834 (E.D. Pa. June 7, 1994) ( finding that work product protection should not be absolute in bad faith action where strategy, mental impressions and opinions of insurer are directly at issue).

**II. Advice of Counsel Defense**

Advice of counsel is raised as a basis for waiving the attorney client privilege only "when the client asserts a claim or defense and attempts to prove that claim or defense by disclosing or describing an attorney-client communication". George v. Wausau Ins. Co. 2000 U.S. Dist. LEXIS 16813 (E.D. Pa. Nov. 21, 2000), *citing* Rohne-Poulenc Rorer Inc. v. Home Indemnity Co., 32 F. 3d 851, 853 (3d Cir. 1994) Courts rely on the language of the asserted affirmative defenses and the nature of the causes of action raised in the suit when determining waiver of the privilege. Id. The deliberate injection of the advise of counsel into a case waives the attorney client privilege as to the communications and documents relating to that advice. United States Fire Ins. Co. v. Asbestospray, Inc. 182 F. 3d 201, 212 (3d Cir. 1999) Advice of counsel is at issue only when a party attempts to prove its claim or defense by disclosing attorney-client communications. George v. Wausau Ins. Co. 2000 U.S. Dist. LEXIS 16813 (E.D. Pa. Nov. 21, 2000). Some courts hold that only when the insurer takes the affirmative step to place the advise of the attorney in issue, is the attorney client privilege waived. Robertson v. Allstate Ins. Co. 1999 U.S. Dist. LEXIS 2991 (E.D. Pa. Mar. 10, 1999) Others have found that the insurer's affirmative defense that it acted reasonably and in accordance with the laws of the Commonwealth of Pennsylvania made the advice of counsel issue relevant for purposes of discovery, reasoning that "the advice of counsel in a bad faith action… is interwoven into the substantive issues of fact and law. Jones v. Nationwide Insurance Company 2000 U.S. Dist. LEXIS 18823 (M. D. Pa. July 20, 2000) Hunt v. Blackburn, 128 U.S. 464 (1988),; Trans World Airlines, Inc. v. Hughes, 332 F. 2d 602 (2d Cir. 1964 ), cert. Dismissed, 380 U.S. 248 (1965); Kunglig Jarnvagssteyrelsen v. Dexter & Carpenter, Inc., 32 F. 2d 195 (2d Cir.) cert. Denied, 280 U.S. 579 (1929); Smith v. Alyeska Pipeline Service Co. 538 F. Supp. 977 (D. Del 198290; Barr Marine Products Co., Inc. V. Borg-Warner Corp. 84 F.R.D. 631 (E.D. Pa. 1979); Handgards, Inc. V. Johnson & Johnson, 413 F. Supp. 926 (N.D.Cal. 1976), Garfinkle v. Arcata Nat'l

Corp. 64 F.R.D. 688 (S.D.N.Y. 1974); Smith vs. Bentley, 9 F.R.D. 489 (S.D.N.Y. 1949) see also 8 Wigmore, Evidence SS 2327 (McNaughton rev. 1961) The rule has been applied specifically in a case where an insurer has defended a bad faith claim with the advice of counsel. See. Wender v. United Services Auto. Ass'n 434 A. 2d 1372 (D.C.App. 1981)

In Mueller v. Nationwide Mutual Insurance Co. 31 Pa. D & C. 4th 23, (Allegheny County, Pa 1996), plaintiff requested the court compel Nationwide to produce communications in which their counsel provided legal advice regarding the underlying claims. Specifically, plaintiffs asserted that by asserting in their answers that they acted in good faith, Nationwide waived the attorney-client privilege because they have now made relevant the communications between Nationwide and their attorneys. The communications would be relevant to the state of mind of the representatives of the insurance company when they made claims handling decisions and are thus a central issue in the case. This is referred to as the "at issue" exception to the attorney-client privilege. It is explained thus:

The "at issue" waiver has arisen in a bad faith claim of an insured against the insurance company in which the insurance company claims that it acted in good faith in the manner in which it handled the underlying claim. The insured usually contends that the insurance company waived the attorney client privilege by claiming that it acted in good faith in the manner in which it handled the underlying claim. It may be argued that the communications of the insurance company with its attorney are inextricably merged with the elements of plaintiff's case and defendant's affirmative defense, they inhere in the controversy itself, and to deny access to them would preclude the court from a fair and just determination of the issues. [1] see Wardleigh v. Second Judicial District Court of the State of Nevada, 891 p. 2d 1180, 1186 (Nev. 1995) [at issue waiver occurs only where the holder of the privilege pleads a claim or a defense in such a way that eventually he or she will be forced to draw upon the privileged communication at trial in order to prevail.] However, in Mueller v. Nationwide Mutual Insurance Co., supra, the court refused to adopt this exception because defendants had not contended that the advice of counsel influenced the manner in which they handled the plaintiff's claims. The court appeared concerned that lay people for insurance companies feel comfortable consulting with counsel for the insurance companies without the threat that the communications will be the subject of disclosure in later bad faith litigation. The court reasoned:

"We want insurance companies to involve attorneys in their decision-making where the claims may be complicated. If the law encourages an honest, careful, and prompt analysis of the claims of counsel for insurance companies, claims are more likely to be resolved in a manner envisioned by the laws governing insurance companies…'(cites omitted)"..These honest, open and candid exchanges are less likely to occur if the communications between counsel and the decision-makers of the insurance companies are discoverable in bad faith suits. Id. at **27-28.

[1] For the birth of the "at issue" argument, see Hearn v. Rhay 68 F.R.D. (E.D. Wash. 1975)

In McAndrew v. Donegal Mutual Insurance Co. 56 Pa. D & C. 4th 1 (Lackawanna Cty, Pa. 2002) Donegal refused to pay for certain bills incurred for treatment received following an accident. Counsel deposed the physician providing the services, and transmitted a deposition summary to the insurer, where he outlined his opinions as to whether payment for the treatment should be paid. Upon that basis, Donegal had declined to pay the medical bills. Court ordered production of records of a deposition taken by counsel, the report of counsel submitted to the insurance carrier upon which the company relied in denying benefits. held "where an insurer defends a bad faith claim by asserting that it relied on the advice of counsel in denying benefits, the insurer waives the attorney-client privilege with respect to counsel's recommendations concerning the underlying claim for benefits.

**III. Continuing Bad Faith During Litigation**

An insurer's duty of good faith and fair dealing does not end when the insured initiates litigation for a contractual dispute. O'Donnell v. Allstate Co. 1999, PA Super 1612, 734 A. 2d 901, 906-7 (Pa. Super. 1999); Ridgeway v. U.S. Life Credit Life Ins. Co. 2002 PA Super, 54, 793 A. 2d 972, 977 (Pa. Super. 2002) ["The scope of 42 Pa. C.S. SS 8371 has been extended to the investigatory practices of an insurer during litigation initiated by an insured to obtain the proceeds of his or her insurance policy."] Because the insurer's duty of good faith continues even after an insured files suit, [2] the insured in a bad faith action may be entitled to discovery of documents which were created after the filing of the complaint. Adams v. Allstate Ins. Co. 189 F.R.D. 331, 332 (E.D.Pa. 1999).

During litigation, an insurer's unreasonable defense may evidence bad faith. Ingalls v. Paul Revere Life Ins. Group, 561 N.W. 2d 273, 280 (N.D.1997) In fact, "an insurer's duty to promptly pay a legitimate claim does not end because a lawsuit has been filed against it for non payment. Put more bluntly, if you owe a debt the duty to pay does not end when you are sued for non-payment of it." Gregory v. The Continental Ins. Co. 575 So. 2d 534, 541, (Miss. 1990) Who may be liable for continuing bad faith during litigation? Is the bad faith committed by the insurance company or by the counsel, or a combination?

Insurers understand that they have a continuing obligation to investigate and evaluate its insured's claim for benefits even after the litigation was filed. Usually, they rely on their legal counsel to apprise them of any significant developments during the litigation that would support payment. McAndrew v. Donegal, supra, at *5.

[2] See generally, Windt, Insurance Claims and Disputes, 3d Edition, 9.28.