EMERGING TRENDS IN ETHICS

Locking Others Out of Your Confidential Communications with Coverage Counsel

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This topical paper discuses recent court decisions eroding the attorney–client privilege and work-product protections for claims files and other communications in bad-faith litigation. It offers a host of practice pointers for insurers and their counsel to "help them protect their coverage file from discovery."

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Locking Others Out of Your Confidential Communications with Coverage Counsel

By Dan D. Kohane, Sean Griffin, and John R. Ewell[1]

Today the insurance industry faces a disturbing and growing threat as courts across the country crack open insurers' claims files, allowing policyholders and third-parties to gain access to insurers' confidential communications with coverage counsel. In the name of public policy, these courts are singling out insurance companies and stripping away their right to attorney–client privilege and work product[2] protection. These recent court decisions have made protecting an insurer's claims file and its communications with coverage counsel from discovery more challenging, and are forming an alarming trend.

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[2] This term of art refers to mental impressions, opinions, conclusions and legal theories of an

An insurance company should have the right to seek confidential legal advice. Like other organizations and individuals, an insurance company must consult lawyers for advice about legal issues affecting its business. An insurance company needs to be able to get an honest and candid evaluation of certain claims, including the worst case scenario, and it can only get this advice if it is assured that the communication will remain confidential and shielded from plaintiffs' counsel.[3]

Yet in recent years, courts across the country have crafted an exception to the attorney–client privilege and the work product doctrine, holding that these protections do not apply in insurance cases alleging bad faith. These courts consider bad faith insurance cases to be "unworthy" of these protections as a matter of public policy.

As disturbing as this is, a more significant problem faces claims professionals. Insurers are finding their right to confidential legal advice challenged, as some courts also restrict an insurer's work product protection even in the absence of bad faith. Accordingly, insurers who seek the advice and assistance of coverage counsel in reviewing first- and third-party coverage issues face the possibility that what it had assumed was confidential legal advice will become fodder for discovery by the policyholder and third parties.

Today, insurance companies cannot assume that their communications with their attorneys will remain confidential. Therefore, insurance companies need to adopt new strategies to lock down their claims files and lock others out of their communications with coverage counsel.

I. STRIPPING AWAY AN INSURER'S RIGHT TO ATTORNEY–CLIENT PRIVILEGE AND WORK PROTECTION IN THE NAME OF PUBLIC POLICY

A. Washington Law

A recent Washington Supreme Court case exemplifies this disturbing trend. *Cedell v. Farmers Ins. Co. of Washington*, 295 P.3d 239 (Wash. 2013) involved a house fire started when Mr. Cedell's girlfriend, Ms. Ackley, was home

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attorney. Some cases use this term incorrectly, to refer to what is really material prepared for litigation. Under both federal and New York law, attorney work product is not discoverable.

[3] *See Aetna Cas. & Sur. Co. v. Superior Ct.*, 153 Cal. App. 3d 467, 474 (Cal. Ct. App. 1984).

with the couple's young child. Farmers Insurance questioned the cause of the fire and investigated. Ms. Ackley admitted that she and others at the house "might have consumed" methamphetamine on the day of the fire. Mr. Cedell himself swore under oath that he had not consumed meth and did not know that Ms. Ackley had. The fire department investigated and concluded that the fire was likely accidental.

Farmers hired an attorney to assist in making a coverage determination. The coverage attorney examined Mr. Cedell and Ms. Ackley under oath and sent a letter to Mr. Cedell stating that Farmers might deny coverage. The letter extended to Mr. Cedell a one-time offer of $30,000, good for ten days. Mr. Cedell tried to contact Farmers regarding the offer, but no one from Farmers returned his calls.

Cedell sued Farmers alleging bad faith and requested the entire claim file. When the insurer resisted, Cedell moved to compel disclosure. Farmers opposed the motion, making the standard and generally accepted argument that the attorney-client privilege protected the communications. However, the trial court granted Mr. Cedell's motion to compel Farmers to produce the entire claim file. The Washington Supreme Court granted review. The Washington Supreme Court began its analysis noting that "unique considerations arise" in the context of insurance bad- faith claims. The court said "[t]he insured needs access to the insurer's file maintained for the insured in order to discover facts to support a claim of bad faith." *Id.* at 244–45. Furthermore, allowing a blanket privilege because lawyers were involved "would unreasonably obstruct discovery of meritorious claims and conceal unwarranted practices." *Id.* at 245.

Therefore, the court created a procedure for determining the scope of attorney-client privilege protection for bad-faith claims that began with the presumption that insurance companies could claim ***no*** attorney-client privilege or work product protection for first-party bad-faith claims that do not involve uninsured motorist claims. The insurance company could overcome this adverse presumption by showing that its attorney was providing legal advice rather than investigating the claim, but the insurance company's argument would be subject to strict evaluation by the trial court.[4] The following procedure for determining the scope of discovery in bad faith claims:

1) For first-party bad-faith claims that do not involve uninsured motorist claims, there is a

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[4] *See also Stewart Tit. Guar. Co. v. Credit Suisse, Cayman Is. Branch*, 1:11-CV-227-BLW, 2013 WL 1385264, *4 (D. Idaho Apr. 3, 2013) (adopting *Cedell* as "well-reasoned").

presumption of no attorney–client privilege or work product protection. As a matter of law, "attorney–client and work product privileges are generally not relevant." *Id.* at 246.

2) The insurer can overcome this presumption "by showing its attorney was not engaged in the quasi-fiduciary tasks of investigating and evaluating or processing the claim, but instead in providing the insurer with counsel as to its own potential liability; for example, whether or not coverage exists under law." *Id.*

3) If the insurer overcomes the presumption, it is entitled to an *in camera* review of the documents and "redaction of communications from counsel that reflected the mental impressions of the attorney to the insurance company, unless those mental impressions are directly at issue in its quasi-fiduciary responsibilities to its insured." *Id.*

4) At that point, the insured may assert any exceptions to the privilege it claims should apply, such as the civil fraud exception. If the civil fraud exception is asserted, the court will conduct a second *in camera* review to determine if there is "a showing that a reasonable person would have a reasonable belief that an act of bad faith tantamount to civil fraud has occurred." *Id.* at 246–47.

In other words, the Supreme Court of Washington held that there is a presumption of no attorney–client privilege in bad faith cases. Where an attorney is engaged in the tasks of "investigating and evaluating or processing the claim" during the claims adjustment process, the presumption against the attorney–client privilege applies and the insurer may not raise the shield of privilege. *Id.* at 246. However, where an attorney instead engages in core attorney–client communications with the insurer, such as "providing the insurer with counsel as to its own potential liability," there is no presumption against the attorney–client

privilege. *Id.* Although *Cedell* was decided in a "bad faith" milieu, the language used suggested a broader context.

Based on *Cedell*, when an attorney takes on the role as a claims handler, courts are suggesting that he or she has a quasi-fiduciary duty to act in good faith towards the insured. Therefore, the attorney retained to provide coverage advice must take care not to commingle the claim investigation with the provision of coverage advice. *Cedell* drew a distinct line between acting as coverage counsel and acting as a claims handler, stating that while the attorney "may have advised [the insured] as to the law and strategy, he also performed the functions of investigating, evaluating, negotiating, and processing the claim." *Cedell*, 295 P.3d at 247. Therefore, the *Cedell* court advised, "[w]here an attorney is acting in more than one role, insurers may wish to set up and maintain separate files so as not to co-mingle different functions." *Id.* at 246 n.5.

Even in the State of Washington, the courts are divided on how to apply this presumption against the insurer in bad faith insurance cases, and *Cedell* is not applied consistently. In Washington federal courts, each court may decide whether to review the insurance company's confidential documents before deciding whether to order the company to produce them to plaintiffs.

B. Illinois Law

Illinois law restricts an insurer's right to attorney–client privilege as a matter of public policy. Illinois has adopted the common interest exception to attorney–client privilege. Under the common interest exception, "when an attorney acts for two different parties who each have a common interest, communications by either party to the attorney are not necessarily privileged in a subsequent controversy between the two parties."[5] In *Illinois Emcasco Ins. Co. v. Nationwide Mutual Ins. Co.*, communications between an insurer and its coverage counsel were subject to an *in camera* review to determine if the communications were made for the common benefit of the insurer and its insured. 913 N.E.2d 1102, 1108–09 (Ill. App. Ct. 2009). The court held that Illinois law "provides for the trial court to conduct an *in camera* inspection to resolve disputes over which communications are privileged." *Id.* In other words, if the insurer and insured shared a common interest in the underlying litigation, then the insured is entitled to an *in camera* inspection of the claim file in the declaratory judgment action.

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[5] *Waste Mgt., Inc. v. Int'l Surplus Lines Ins. Co.*, 579 N.E.2d 322, 328 (Ill. 1991).

C. New York Law

New York courts have stretched this reasoning to a near breaking point, going as far as restricting an insurer's work product protection regardless of whether bad faith is alleged. In *Bombard v. Amica Mut. Ins. Co.*, 11 A.D.3d 647, 648 (2d Dep't 2004), the court noted that the party asserting material was prepared in anticipation of litigation, and thus entitled to the statutory privilege, "bears the burden of demonstrating that the material it seeks to withhold is immune from discovery . . . by identifying the particular material with respect to which the privilege is asserted and establishing with specificity that the material was prepared exclusively in anticipation of litigation . . ." The appellate court held that the insurer's conclusory assertions failed to satisfy this burden. *Id.* Thus, the court held that reports prepared by attorneys before the decision is made to pay or reject a claim are not privileged and must be produced to plaintiff's attorneys.

In *Lalka v. ACA Ins. Co.*, 128 A.D.3d 1508 (4th Dep't 2015), the plaintiff commenced an action to recover supplementary underinsured motorist coverage (underinsured motorist benefits) pursuant to an automobile liability insurance policy issued by an insurer. The plaintiff moved for an order compelling the insurer to disclose its entire claim file. Citing *Bombard*, *supra*, the court held that:

> It is well settled that '[t]he payment or rejection of claims is a part of the regular business of an insurance company. **Consequently, reports which aid it in the process of deciding which of the two indicated actions to pursue are made in the regular course of its business**'
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> *Id.* at 1508–09 (emphasis added).

Moreover, the court held that:

> Reports prepared by . . . attorneys before the decision is made to pay or reject a claim are thus not privileged and are discoverable . . . even when those reports are 'mixed/multi-purpose' reports, motivated in part by the potential for litigation with the insured . . . Here, the documents submitted to the court for *in camera* review constitute multi-purpose reports **motivated in part by the potential**

> **for litigation with plaintiff, but also prepared in the regular course of defendant's business in deciding whether to pay or reject plaintiff's claim, and thus plaintiff is entitled to disclosure of those documents."**
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> *Id.* at 1509 (emphasis added).

Accordingly, the court ordered that the insurer turn over the communications between itself and its coverage counsel, even in the absence of any claim of bad faith, simply because, at the time the communications were made, the insurer had not yet made a decision on whether or not the claim was covered. *Id.*

Under this rule, the insurer would need to deny coverage, then seek a coverage opinion for the protection afforded to material prepared for litigation to apply. Thus, the insurer faces a Hobson's choice: either blindly deny a claim and then seek confidential legal advice or seek legal advice knowing that its communications will be discoverable. Since coverage opinions are not protected unless made after coverage is denied, the conditional immunity offered to material prepared for litigation provides seemingly no protection. Even so, the rationale that the report is not privileged because it has been prepared in the ordinary course of business should apply to material prepared for litigation only; it should not apply to attorney–client privilege.

II. A Better Rule

A. Attorney–Client Privilege

Rather than stripping away insurers' right to attorney-client privilege, courts should apply the privilege to all businesses and individuals equally. In 2014, for example, the West Virginia Supreme Court of Appeals held that coverage opinions are protected by attorney–client privilege in bad-faith cases.[6] In reaching this conclusion, the court reasoned that "an insurance company's retention of legal counsel to interpret the policy, investigate the details surrounding the damage, and to determine whether the insurance company is bound for all or some of the damage, is a *classic example* of a client seeking legal advice from an attorney." Courts in California, Hawaii, South Dakota, and Indiana

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[6] *State ex rel. Montpelier U.S. Ins. Co. v. Bloom*, 757 S.E.2d 788, 794–95 (W. Va. 2014).

have ruled similarly.[7] By preventing a mere allegation of bad faith from eviscerating the attorney-client privilege, these courts preserve the attorney-client privilege in the context of insurance litigation.

This position would restore fairness to the litigation process. After all, a policyholder can take a copy of the insurance policy and meet with a lawyer for legal advice, and those communications are protected from discovery. An insurer should have the same right to seek and secure confidential legal advice. When an insurer consults an attorney, it is seeking confidential and privileged legal advice just like any other business or individual. It makes no sense that some jurisdictions single out insurance companies to strip them "as a matter of public policy" of protections normally surrounding the receipt of legal advice.

III. Practical Pointers

We offer the following eight practical pointers for insurers and their counsel to lock down their claims file and protect their confidential communications with coverage counsel.

A. Know the Law in Your Jurisdiction

Because an insurer's right to attorney–client privilege varies from state to state, the first step in protecting your coverage communications from disclosure is knowing the applicable law in your jurisdiction. Where an insurer is not in the same state as its attorney, the laws may conflict, and the attorney must research which jurisdictions may apply to the communications. All privileged communications should be tailored to the law of any applicable jurisdictions to minimize the risk of discovery.

B. Keep the Number of Protected Documents to a Minimum

To optimally protect attorney–client privilege, the insurer and its attorney should try to keep the number of privileged communications to a minimum. Often, it is best for the insurer and its attorney to discuss the issue over the phone

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[7] *Aetna Cas. & Sur. Co. v. Superior Ct.*, 153 Cal. App. 3d 467, 474 (Cal. Ct. App. 1984) (holding that coverage counsel is performing a legal service when they are given an insurance policy, a legal document, and are asked to interpret the policy and investigate the claim to determine whether the insurer is legally bound to provide coverage); *Anastasi v. Fid. Nat. Tit. Ins. Co.*, 341 P.3d 1200, 1221 (Haw. Ct. App. 2014) (same) *aff. in part, vacated in part by* 137 Hawai'i 104 (2016); *Bertelsen v. Allstate Ins. Co.*, 796 N.W.2d 685, 701 (S.D. 2011) (same); *Hartford Fin. Services Group, Inc. v. Lake County Park & Recreation Bd.*, 717 N.E.2d 1232, 1236 (Ind. Ct. App. 1999) (same).

and make an informed decision before memorializing the communication in a letter or email. This is especially important to remember in the age of e-discovery as courts require the production of emails, texts, and other electronic documents. Although an email may take only seconds to write, it lasts forever, and each email created increases the risk of disclosure of privileged communications. The more privileged documents created, the greater the chance of disclosure of privileged communications.

C. Clearly Document When Litigation is Anticipated

Work product protection is triggered when the party reasonably anticipates litigation. Within the context of insurance coverage, the point when litigation is reasonably anticipated varies from jurisdiction to jurisdiction. When an insurer anticipates litigation, it is necessary to clearly document when and why the insurer first anticipated litigation. In this manner, the insurer can prove that litigation was anticipated from a distinct point in time and offer a good argument that work product protection should apply from that day forward.

However, in some jurisdictions, the date when the insurer reasonably anticipates litigation is irrelevant. As detailed above, in New York, the entire claims file is discoverable as a matter of law until the insurer makes a decision to pay or reject the claim. An insurer in a jurisdiction that follows such rule must weigh the benefits and risks of seeking a coverage opinion before making a decision to pay or reject a claim.

D. In Federal Court, Emphasize Work Product Doctrine

While the attorney–client privilege is a matter of substantive state law, the work product doctrine is a matter of federal procedural law. If federal law can apply, the work product protection offers distinct, and often stronger, protection than the attorney-client privilege.

The insurer resisting discovery of the claims file in federal court should argue that, even if the court determines that some of the documents in the claims file must be disclosed, the Federal Rules still *mandate* that the mental impressions, conclusions, opinions, and legal theories of the insurer be redacted or in some other way protected against disclosure. The attorney may be able to gain back some or all of the protection that is not available through the attorney-client privilege.

E. Keep a Detailed and Accurate Privilege Log

Where an insurance company withholds documents and asserts such documents are protected, the privilege log must be detailed and accurate. A vague

privilege log runs the risk of causing unnecessary delay or provoking a blanket disclosure order.

The privilege log should indicate whether the documents were authored or received by the coverage attorney. The privilege log should also identify:

- the type of document (*i.e.*, email, handwritten notes, letter, memorandum, or report), the number of pages, the author and recipient(s);
- the date (if any);
- a general description of the subject matter; and
- the type of privilege asserted (*i.e.* attorney–client privilege, work-product doctrine, or both).

The privilege log should also be clear whether the document is protected by attorney–client privilege, work product, or both. Maintaining credibility with the court is essential, and therefore, attorney–client privilege should not be asserted when a document is only protected by work product doctrine. For this reason, the log should avoid employing ambiguous designations such as "attorney–client privilege and/or the work product doctrine" or "AC/WP." Moreover, insurers should not attempt to cast a blanket privilege over their claim investigation activities. If a document has actually been prepared for non-litigation purposes it must be produced, even where a document can be characterized as being helpful or important to the coverage litigation.

The privilege log must also be accurate because whether to conduct an *in camera* inspection, and what exactly that entails, is left to the trial court's discretion. Some judges will review and carefully scrutinize each individual document and determine whether the document is privileged. Other judges will determine whether the documents are privileged only by reviewing the privilege log. Accordingly, the privilege log should be sufficiently detailed to permit the court to determine whether all elements of the privilege are present for each document. If a privilege log is sufficiently detailed, it may provide enough information for the court to rule in favor of protection without an *in camera* review of the documents themselves.

If a privilege log is not sufficiently detailed, the court may be more likely to scrutinize each document, or worse, to grant a motion to compel without reviewing the documents. In some jurisdictions, the failure to timely produce or the production of an inadequate privilege log may constitute waiver of any asserted privileges.

F. Maintain Separate Files for Defense and Coverage Issues

When an attorney provides coverage advice to the insurer, there is no fiduciary duty to the insured. However, the cases described above suggest when that attorney investigates the facts of a claim, he or she owes a quasi-fiduciary duty to the insured. A smart lawyer will keep these two roles separate. When an attorney is fact gathering, most courts treat the lawyer as a claims adjuster and hold that there is no blanket attorney–client privilege. To receive the protection of attorney–client privilege, the insurer must show that the communication had been made for the purpose of obtaining or rendering legal advice. Therefore, to optimally protect privileged communications, the insurer should set up and maintain two separate files: one for coverage issues and one for the defense of the insured. In *Cedell*, the Supreme Court of Washington wisely cautioned that "[w]here an attorney is acting in more than one role, insurers ought to set up and maintain separate files – with different claims professionals – so as not to co-mingle different functions." *Cedell*, *supra*, 295 P.3d at 246 n.5. Admittedly, this is easier said than done. However, if an insurance company wants to protect its privileged communications from discovery, then such effort is necessary.

By keeping privileged communications separate from non-privileged communications, an insurance company and their attorney decreases the likelihood that the document will be subject to discovery. Although separate files may not protect all coverage communications from disclosure, it should help the court identify and protect "those that have no relevance" to the insured's bad faith claims.

G. Keep Facts and Legal Opinions Separate As Much As Possible

When writing a coverage opinion, the coverage attorney should keep facts and legal opinion separate as much as possible. When a coverage attorney mixes law and fact, often referred to by the courts as "mixed reports," the attorney risks the coverage opinion becoming discoverable. The court may require the insurer to produce a redacted form of the coverage opinion, particularly when the coverage opinion is heavily fact-specific. Although the legal analysis has been be redacted, the party seeking discovery typically can discern or at least get a good idea about the insurer's legal strategy.

A better approach to the coverage opinion is keeping facts and law separate as much as possible. The coverage lawyer should write separate reports concerning the factual investigation and the legal advice given. The first

document should objectively state the facts. Legal advice based on the fact gathering should be offered in a separate document marked "privileged and confidential." Thus, when the judge reviews the documents *in camera*, the judge could simply hand the page concerning the underlying facts to the plaintiff and hand the coverage opinion to the insurer as protected by attorney–client privilege. Obviously, it is often necessary to discuss the facts in providing a coverage opinion; therefore, where the attorney is providing a report combining factual investigations and legal advice, the attorney should cite to case law as relevant to establish that the report is legal strategy protected by attorney–client privilege.

IV. CONCLUSION

Based on the recent trend, insurance companies cannot assume that the legal advice they receive will remain confidential. In these jurisdictions – and possibly others – the advice and assistance of coverage counsel in reviewing first- and third-party coverage issues have become fodder for discovery by the policyholder and third parties.

As courts take it upon themselves to "regulate" the insurance industry by stripping away insurer's right to attorney-client privilege and work protection, insurers will need to adopt new strategies to lock down their claims file. These eight pointers should help to aid insurers and their counsel to lock policyholders and third-parties out of their confidential communications with coverage counsel.