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TORT TRIAL & INSURANCE PRACTICE

# NAVIGATING THE DISCOVERY MAZE IN INSURANCE BAD FAITH LITIGATION

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An insurer has a duty to deal with its insured in good faith. In addition to this generic duty of good faith, many states impose specific statutory requirements for claims handling. Depending on state law, an insurer's breach of its common law duty to act in good faith and/or a violation of statutory claims handling requirements may render the insurer liable for penalties or punitive damages in addition to the imposition of liability for coverage owed under the policy. An insurer that wrongly denies defense coverage may also be estopped from asserting defenses to indemnification coverage.

While the stakes in bad faith litigation are high, proving bad faith is challenging. Absent a clear violation of a concrete state law requirement, an insured must demonstrate that the insurer unreasonably denied or delayed in paying a claim for which it was liable. Merely showing that the insurer mistakenly denied coverage or underestimated the insured's exposure to liability and damages in the underlying case usually does not suffice.

Given the obstacles to establishing bad faith claims handling or settlement conduct by an insurer, the claims file is the prize that offers the insured the best evidence of the decisions made by the insurer during the claims handling process and the information available to the insurer when it made its decisions. The path to the prize is neither clear nor straight. The prize is located at the far side of a maze of discovery rules and defenses, and many paths are dead ends. This article addresses the hurdles to discovering the claims file, and identifies some strategies to overcome these impediments.

## What Is Bad Faith?

Most insurers look for ways to pay covered claims—not ways to deny them. Further, the essence of bad faith is not mere denial, which may be well justified or at least subject to principled argument, but rather, unreasonableness.

Bad faith claims may arise in the context of either first-party or third-party insurance. Bad faith can take innumerable forms, but two of the most common scenarios occur when:

- An insurer refuses to pay or fails to promptly pay a covered claim without reasonable basis; or

- An insurer defends its insured against a third-party claim, but fails to settle the claim within policy limits when it had the opportunity to do so and the insured's liability (including damages exposure) was reasonably clear.

In both examples, the insured must prove either that the insurer's stated reason for its actions was a pretext for some other unsound motive or that the insurer's stated reason for its actions lacked a reasonable basis. Rarely, if ever, will an insurer who has committed bad faith directly admit either of these propositions.

## What Does a Claims File Contain?

In the seminal and often-quoted case of ***Brown v. Superior Ct.***, 670 P.2d 725, 734 (Ariz. 1983), the Arizona Supreme Court described the importance of the claims file in bad faith litigation:

> [B]ad-faith actions against an insurer, like actions by client against attorney, patient against doctor, can only be proved by showing exactly how the company processed the claim, how thoroughly it was considered, and why the company took the action it did. The claims file is a unique, contemporaneously prepared history of the company's handling of the claim; in an action such as this the need for the information in the file is not only substantial, but overwhelming. The "substantial equivalent" of this material cannot be obtained through other means of discovery. The claims file "diary" is not only likely to lead to evidence, but to the very important evidence on the issue of whether [the insurer] acted reasonably.

With the advent of e-mail and scanning, the size of the average claim file has undoubtedly ballooned since the Arizona Supreme Court wrote these words in 1983. Further, if common wisdom is correct, the convenience and immediacy of e-mail today promotes more frank, and less carefully considered expression than the handwritten or typed notes, memos, and letters of earlier years. More than ever, today's claims file is essential evidence in a bad faith case.

Items typically found in a claims file include the following.

- **Claims notes, logs, or diaries**—a contemporaneous record of all significant events in the handling of a file. These are likely to be kept electronically and may contain entries not only by the handling adjuster, but by supervisors, office managers, and even company officers. Entries regarding telephone communications here may help to pinpoint the dates and content of conversations. Settlement negotiations are also documented here.
- **Bills and estimates**—should be included as documentation of the amount of the loss. Attorney fee bills may also be included, revealing important information about counsel hired to defend the insured and/or coverage counsel.
- **Documentation of investigation of the claim**—may include such things as photographs, statements, reports from outside adjusters (or attorneys acting as adjusters), and expert reports. Documents may demonstrate an inadequate investigation. Or they may show an adequate investigation, but no reasonable basis for the insurer's decisions.
- **Internal correspondence**—usually by e-mail, this correspondence may contain disagreements among an insurer's personnel about handling and coverage, thereby giving unique insight into the reasoning of the insurer.
- **Correspondence with counsel**—correspondence with counsel hired to defend the insured or with coverage counsel likely contain information about key issues affecting the insurer's decisions.
- **Correspondence between insurer and reinsurers**—reports to reinsurers may be the most candid assessment of the case and the insurer's plans for handling. Questions by reinsurers directed to the insurer may highlight problems that the insurer itself has refrained from committing to writing.
- **Reserve and reserve change information**—a dollar and cents self-evaluation of the insurer's exposure at the beginning of the

case, that may change at key intervals as the insurer's view of the case changes.

## The Outliers—All or Nothing

A few cases take an all-or-nothing approach to discovery of claims files. For example, a number of Florida state courts take the approach that until the insured establishes coverage, a bad faith claim cannot proceed. Thus, the insurer's claims file is not discoverable so long as coverage is unresolved.[1] Indeed, before the Florida Supreme Court's 2005 decision in ***Allstate Indem. Co. v. Ruiz*****,** 899 So. 2d 1121 (Fla. 2005), Florida courts refused to permit discovery of claims files in first-party bad faith actions at any time. In ***Ruiz*****,** however, the Florida Supreme Court abolished the distinction between discovery in first-party and third-party bad faith actions, allowing claims file discovery in each.[2] Nonetheless, Florida appellate courts have maintained that unless and until an insured establishes coverage, there can be no discovery of the claims file.

Conversely, in ***Grewell v. State Farm Mut. Auto. Ins. Co.*****,** 102 S.W.3d 33 (Mo. 2003), the Missouri Supreme Court held that the claims file belongs to the insured. The court analogized the relationship of insurer-insured to the attorney-client relationship. Just as a client's file belongs to the client, not the attorney, a claims file belongs to the insured, and the insured must be given free and open access to the claims file.[3]

Most courts, however, draw no such bright lines and apply more flexible reasoning.

## Obstacle One: The Work Product Doctrine

The work product doctrine (in both federal and state courts) protects materials prepared in anticipation of litigation by or for a party or a party's representative. The doctrine is not a privilege, but rather a limited immunity that does not completely bar discovery. The insured may overcome work product protection by demonstrating a substantial need for, and an inability to obtain the substantial equivalent of, the withheld information by other means. Predictably, the issues that generate the most controversy in the application of the doctrine are (1) whether the insurer can demonstrate that the materials were prepared in "anticipation of litigation," and (2) if so, whether the insured can demonstrate "substantial need" sufficient to overcome work product protection. Approaches to these issues vary widely by jurisdiction.

### Anticipation of Litigation

To qualify for work product protection, documents must not only have been created at a time when litigation was justifiably anticipated, but the documents must also have been created for the purpose of litigation and not for some ordinary business purpose. In the context of insurance, this distinction is more difficult to apply, because it is the business and duty of an insurer to investigate claims by and against its insured. The insurer must investigate to process claims and arrive at claims decisions, regardless of the prospect of litigation.

#### *When Is Litigation Anticipated?*

Most courts today reject the view that the insurer's actions taken after a claim is made by or against its insured are always in anticipation of litigation.[4] The fact that an event has occurred which may require the insurer to make payments under its policy does not automatically transform its activities into preparation for litigation. The inchoate possibility of litigation does not invoke work product protection. Some of the factors that should be examined include the nature of the event that prompted the preparation, and, of course, the timing of the preparation.

One juncture that many courts consider critical is the date when the insurer denied the claim (in cases where bad faith turns on denial). In ***Harper v. Auto-Owners Ins. Co.*****,** 138 F.R.D. 655 (S.D. Ind. 1991), a thoughtful decision from the Southern District of Indiana, the magistrate judge proposed a rebuttable presumption that before a claims decision is made, litigation is not anticipated, and similarly after a claims decision is made, litigation is anticipated. The magistrate reasoned that insurers must necessarily collect and create materials to reach a claims

decision, regardless of whether they contemplate litigation.

> To overcome these presumptions, 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, and not to arrive at a (or buttress a tentative) claim decision.

*Id.* at 663–64.[5]

In ***Country Life Ins. Co. v. St. Paul Surplus Lines Ins. Co.***, No. 03–1224, 2005 WL 3690565, *1 (C.D. Ill. Jan. 31, 2005), a case from the Central District of Illinois, the magistrate judge applied this presumption strictly, holding that the work product doctrine did not protect documents prepared before the insurer actually notified the insured of the claims denial. The magistrate explained:

> January 5, 2003, is the crucial date, for until then, the insured did not know for certain what the insurer would finally decide about coverage. *The insurer has absolute control over when that final decision will be conveyed to the insured, so an internal decision, not conveyed to the insured, to deny coverage has no bearing on this question*. Documents created before the insured is notified simply reflect the business that insurance companies do, namely investigating facts and determining whether those facts fall within policy coverage. Until the decision to deny coverage is made and that decision is communicated to the insured, documents and communications are not protected by work product privilege.

*Id.* at *7 (emphasis added).

The magistrate stated that in a bad faith action, the insured is entitled to discover what the insurer knew at the time the claim was denied.

### *What Was the Document's Purpose?*

While the date of a final claims decision is often important, if a document was created in the ordinary course of business, and not for purposes of litigation, the document is not work product, even if it was created after litigation began. In ***HSS Ent., LCC v. Amco Ins. Co.***, No. 06–01485, 2008 WL 163669, *1 (W.D. Wash. Jan. 14, 2008), the magistrate in the Western District of Washington noted that the insurer's duty to investigate claims does not end even when litigation commences. The magistrate refused to impose an arbitrary cut-off date of suit-filing for anticipation of litigation, explaining that such a rule would permit the insurer to artificially insulate its claims file from discovery:

> If the Court were to sustain the defendant's position emphasizing the filing date of the lawsuit, the work product protection would be automatically available at the whim of the insurer, regardless of whether the materials were prepared in the ordinary course of business. Insurers could insulate all claims investigation materials produced after the filing date by merely inserting an arbitrary suit limitation clause into its policy, and forcing its insured to sue for coverage before the claim is fully adjusted. The Court cannot accept this approach.

*Id.* at *5.

Adjusting claims is indisputably the ordinary business of insurers and is not normally performed in anticipation of litigation.[6] Routine claims-processing material, including attempts to settle a claim through ordinary channels, is not immunized from discovery.[7] To determine whether a document is a work product, courts must examine each individual document and decide whether the document was created to prepare for litigation or simply to evaluate the claim.[8]

### Substantial Need

Many courts recognize that in the context of bad faith insurance claims, insureds may have a substantial—even overwhelming—need for work product in the claims file, because it may be the only material available to prove why the insurer acted as it did.[9] A series of cases out of Montana has developed this theme.

In ***Holmgren v. State Farm Mut. Auto. Ins. Co.***, 976 F.2d 573 (9th Cir. 1992) **[see summary at (5) 140–11*],** a case involving an allegation of bad faith settlement practices, the Ninth Circuit Court of Appeals held that a plaintiff may be able to establish a compelling need for evidence in the insurer's

claim file regarding the insurer's opinion of the viability and value of the claim.

In ***Palmer by Diacon v. Farmers Ins. Exch.***, 861 P.2d 895 (Mont. 1993), a case where an insurer denied a claim, the Montana Supreme Court pointed out that the insurer's mental impressions and opinions were directly at issue, and therefore:

> [i]t is difficult to envision a circumstance in which the compelling need requirement would not be met when the mental impressions of a party are directly at issue in the case.

*Id.* at 911.

In ***Dion v. Nationwide Mut. Ins. Co.***, 185 F.R.D. 288 (D. Mont. 1998), a magistrate judge in the District of Montana, held that, because the claims processing of an insurer is almost entirely an internal operation, a claim for an insurer's violation of the Montana Unfair Trade Practices Act necessarily created a compelling need to discover the full context in which the insurer handled the underlying claim.

While none of these cases purported to establish that substantial need always exists in bad faith cases, as a series they demonstrate a strong inclination in favor of the insured's "substantial need." However, not all courts reach the same conclusion.

In ***Dixie Mill Supply Co. v. Continental Cas. Co.***, 168 F.R.D. 554 (E.D. La. 1996), a magistrate judge in the Eastern District of Louisiana explicitly rejected the notion that all bad faith cases implicate the insurer's state of mind, resulting in a compelling need for work product documents. The magistrate stated that a mere assertion that an insured cannot otherwise prove bad faith does not automatically permit an insured "to rummage through the insurers' claims file." *Id.* at 559 (brackets omitted). An insured, according to this magistrate judge, can prove bad faith through depositions and objective facts.

## Obstacle Two: Attorney-Client Privilege

The claims file may contain communications between the insurer and various attorneys. The insurer may have retained counsel to conduct an investigation, to defend the insured, or to give it advice about coverage issues. In diversity cases, whether these communications are privileged depends on the applicable state's law regarding the attorney-client privilege.[10] Courts take distinct positions on the sanctity of the privilege. These positions range from asserting that the privilege is deserving of the utmost protection,[11] to asserting that the privilege impedes full and free discovery of the truth and should be narrowly construed.[12] Although the attorney-client privilege is less malleable than the work product doctrine, in bad faith actions, attorney-client communications in a claims file may be discoverable, depending on the circumstances.

### Attorney as Adjuster

Not every communication between an attorney and client is privileged. Although states vary in their description of the elements of the attorney-client privilege, if the attorney is not acting in the role of legal counsel with respect to a particular document, the attorney-client privilege never attaches to the communication.

In ***Mission Nat'l Ins. Co. v. Lilly***, 112 F.R.D. 160 (D. Minn. 1986), a fire destroyed the insured's restaurant. The insurer suspected arson and hired a law firm to conduct the investigation. The insurer asserted that it retained the law firm as a matter of course to investigate all claims exceeding $25,000 and within a specified geographic area. The insurer filed a declaratory judgment action, seeking a declaration of no coverage and the insured counterclaimed for bad faith. The insured then sought discovery of the claims file, including documents generated by the law firm that had conducted the claims investigation. The insurer resisted on grounds of attorney-client privilege and work product.

The district judge noted that the insurer's practice of using attorneys to fulfill the ordinary business function of claims investigation caused the problem. While the attorneys initially acted as fact investigators, at some point, they began to concurrently prepare a legal stance in anticipation of trial. Even though the date on which the insurer first contemplated litigation was undisputed, some degree of pure claims investigation continued past that date. The district judge concluded that:

> It would not be fair to allow the insurer's decision in this regard to create a blanket obstruc-

> tion to discovery of its claims investigation. To the extent that Cozen & O'Connor 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 plaintiff, outside the scope of the asserted privileges. This approach results in the majority of the file being discoverable.

*Id.* at 163.[13]

In ***Insurance Co. of Pa. v. City of San Diego*****,** No. 02–0693, 2007 WL 935712, *1 (S.D. Cal. Feb. 27, 2007), the City of San Diego accused its insurer of bad faith refusal to defend it in underlying tort litigation. The City contended that this bad faith manifested not only by denial of the duty to defend, but also by unreasonable failure to pay an appropriate rate for counsel, denial of expenses, and untimely and delayed payments. The magistrate judge granted the City discovery of most claims file materials, including the insurer's counsel's review and payment of invoices tendered by litigation counsel for the City. The magistrate observed that the law firm hired by the insurer acted in the dual role of claims handler and legal adviser. Tasks such as investigating and analyzing claims, and determining whether payment should be made, did not have to be performed by someone licensed to practice law. Therefore, as to those materials, the attorney-client privilege never arose.

Insurers who routinely hire attorneys to conduct claims investigations can alleviate the problem that occurred in ***Mission Nat'l*** by using two, separate firms—one to conduct factual investigation and one to litigate coverage questions. In ***HSS Ent.*****,** the magistrate judge enforced the attorney-client privilege as to communications between the insurer and its coverage counsel, but found the privilege inapplicable to the separate law firm hired by the insurer to investigate and adjust the claim. The magistrate observed that, "[t]he line between what constitutes claim handling and the rendition of legal advice is often more cloudy than crystalline." *Id.* The magistrate found that, as a matter of public policy, insurance companies cannot insulate the factual findings of a claims investigation by the involvement of an attorney who performs, or helps perform, that work.

## Common Interest

When the insurer hires an attorney to defend its insured, and a bad faith claim later ensues, the insurer is not entitled to assert the attorney-client privilege as to communications between itself and that attorney. This is because the insured is also deemed to be the attorney's client. While different states formulate the elements of the attorney-client privilege differently, in most states, the attorney hired by the insurer to defend the insured owes a paramount duty to the insured. To the extent that the interests of the insured and the insurer collide with respect to the assertion of the attorney-client privilege for communications with counsel retained for the insured, the insured prevails. The same principle also applies to the work product of the attorney retained for the insured.[14]

This principle, referred to as the common interest doctrine, was applied by the Illinois appellate court in ***Western States Ins. Co. v. O'Hara,*** 828 N.E.2d 842 (Ill. App. 2005) **[see summary at (17) 140–2*]**, *appeal denied,* 839 N.E.2d 1038 (Ill. 2005). ***O'Hara*** involved a serious automobile accident in which several people sustained severe injuries allegedly as a result of the negligence of the insured, O'Hara. O'Hara's insurer hired one attorney, Heck, to defend O'Hara in the criminal proceedings against her, and hired another attorney, Duffy, to pursue settlement with the injured parties. Duffy settled the most serious case, a paraplegic, for the policy limits of $500,000. Other injured parties then sued O'Hara, and the insurer brought a declaratory judgment requesting a declaration that it had no further duty to defend O'Hara. O'Hara then counterclaimed for bad faith.

The insurer urged that its communications with Duffy were protected by the attorney-client privilege and the work product doctrine. The insurer argued that the common interest doctrine did not apply, because O'Hara was separately represented by Heck.

The appellate court rejected these arguments, noting that Heck represented O'Hara on the criminal matters, and even if Heck had been consulted regarding the settlement with the injured paraplegic, the insurer could not insulate Duffy's communications regarding that settlement by simply hiring

separate counsel. The appellate court explained that even though Duffy was hired by the insurer, and even though he did not technically represent the O'Haras:

> [Duffy] was sought to give advice on settling this claim—a claim in which the O'Haras, as the insureds, had an interest…. [B]oth the insured and the insurer do not have to be privy to or involved in the communications with counsel for counsel to be acting in the interests of both.

*Id.* at 848.

Under the common interest doctrine as espoused in ***Western States*****,** an insurer may not claim privilege concerning documents created at a time when its attorney was acting in the common interests of both the insurer and the insured, regardless of the fact that the attorney was not actually appointed as counsel for the insured and did not directly communicate with the insured.

On the other hand, if the interests of the insurer and the insured are adversarial, the insured is not necessarily entitled to discover communications between the insurer and its attorney, even though the communications may have taken place at a time when the insured had no inkling that it would later file a bad faith action. Thus, several cases have held that the attorney representing the insurer in an uninsured motorist claim does not represent the interests of the insured; their positions are deemed adversarial, and the attorney's communications with the insurer are protected by the attorney-client privilege.[15]

## Advice of Counsel Defense

If an insurer affirmatively asserts as a defense that it was in good faith because it relied on the advice of counsel, the insurer waives attorney-client privilege concerning those communications. Some courts interpret this waiver narrowly, noting that waiver is not effected merely because the advice of counsel is relevant or might have influenced a client's state of mind. The Third Circuit Court of Appeals adopted this position in ***Rhone-Poulenc Rorer Inc. v. Home Indem. Co.*****,** 32 F.3d 851 (3d Cir. 1994), explaining its rationale as follows:

> [I]n leaving to the client the decision whether or not to waive the privilege by putting the attorney's advice in issue, we provide certainty that the client's confidential communications will not be disclosed unless the client takes an affirmative step to waive the privilege, and we provide predictability for the client concerning the circumstances by which the client will waive that privilege.

*Id.* at 863.[16]

Similarly, if an insurer calls its attorney as a witness, the privilege is waived as to its communications with that witness, even though the insurer does not affirmatively plead the advice-of-counsel defense.[17]

Other courts have taken a broader view, holding that even where an insurer states it will not rely on an advice-of-counsel defense, such a defense may be implicit due to positions taken by the insurer in the litigation, and, accordingly, the attorney-client privilege may be waived.

In ***Tackett v. State Farm Fire and Cas. Ins. Co.*****,** 653 A.2d 254 (Del. 1995), the Delaware Supreme Court ruled that the insurer implicitly waived the attorney-client privilege when it asserted that its delay in paying an uninsured motorist claim was "routine handling" caused by the insured's failure to supply information necessary to the evaluation of the claim. In fact, the claims file revealed that the insurer's attorney had earlier assessed the insured's claim at policy limits. Once the insurer asserted the routine claims-handling defense, it could not shield its counsel's opinion from discovery.

The Arizona Supreme Court addressed the implied advice-of-counsel waiver extensively in ***State Farm Mut. Auto. Ins. Co. v. Lee*****,** 13 P.3d 1169 (Ariz. 2000). ***Lee*** was a bad faith class action in which policyholders of State Farm sought discovery of files and other documents relating to State Farm's rejection of their underinsured and uninsured motorist claims. Between 1988 and 1995, State Farm took the position that insureds who had more than one State Farm policy covering their several cars could not stack the policies in a single loss. In 1995, the Arizona Supreme Court, in ***State Farm Mut. Ins. Co. v. Lindsey,*** 897 P.2d 631, 634 (Ariz. 1995), decided that State Farm's policies did not comply with statutory requirements for prohibiting stacking. In ***Lee*****,** State Farm asserted that, until the Arizona Supreme Court decided ***Lindsey*****,** it acted reasonably in denying stacking claims.

The Arizona Supreme Court held that even though State Farm did not directly assert an advice-of-counsel defense, it did so implicitly when it argued that its claims managers held a subjective good-faith belief that their decision to deny stacking was reasonable under what they knew about the state of the law as it then existed. While the claims managers made the ultimate decision to deny coverage, what the claims managers actually knew and reasonably believed was dependent in large part on counsel's advice regarding the validity of stacking claims. The court described its rule as this:

> We conclude that … in cases such as this in which the litigant claiming the privilege relies on and advances as a claim or defense a subjective and allegedly reasonable evaluation of the law—but an evaluation that necessarily incorporates what the litigant learned from its lawyer—the communication is discoverable and admissible.

***Lee*,** 13 P.3d at 1175.

The Arizona Supreme Court rejected ***Rhone-Poulenc's*** approach, which would have protected State Farm's communications with counsel so long as State Farm did not affirmatively assert its reliance on its counsel's advice as a defense. State Farm's assertion that its actions were reasonable, because of what it knew about the applicable law, was the functional equivalent of an express advice-of-counsel defense. To find waiver only upon an express assertion of the defense would allow the privilege holder to control waiver through artful pleadings, and, "[m]ost sophisticated litigants will know better than to dig that hole for themselves." *Id.* at 1181.

### Crime-Fraud Exception

The attorney-client privilege does not protect attorney-client communications in furtherance of a fraud or crime. Some courts have held that it is inappropriate to extend the crime-fraud exception to the arena of insurance bad faith litigation.[18]

The Connecticut Supreme Court took the opposite view in ***Hutchinson v. Farm Family Cas. Ins. Co.,*** 867 A.2d 1 (Conn. 2005). Connecticut extends the crime-fraud exception to cases of civil fraud if the party seeking disclosure can establish that (1) there is probable cause to believe that the client intended to perpetrate a fraud, and (2) the communications between client and attorney were made in furtherance of the fraud. The Connecticut Supreme Court in ***Hutchinson*** concluded that just as there was no justification for the attorney-client privilege when a communication is made for the purpose of committing fraud, there is no justification for the privilege "when a communication was made for the purpose of evading a legal or contractual obligation to an insured without reasonable justification." *Id.* at 6–7. However, the court found the crime-fraud exception inapplicable because the plaintiffs alleged that the insurer failed to follow the advice of its attorneys, not that the insurer had any purpose in communicating with its attorneys other than to obtain complete and accurate legal advice. *Id.* at 11.

## One Step Further: The Ohio Rule

In ***Boone v. Vanliner Ins. Co*.,** 744 N.E.2d 154 (Ohio 2001), *cert. denied*, 534 U.S. 1014 (2001), the Ohio Supreme Court advanced discovery of attorney-client communications in bad faith cases one step further. ***Boone*** held that when an insured alleges bad faith denial of coverage, the insured is entitled to discover claims file materials containing attorney-client communications related to the issue of coverage that were created before the coverage denial. The court reasoned that, "claims file materials that show an insurer's lack of good faith in denying coverage are unworthy of protection." *Id.* at 158.

In ***Garg v. State Auto. Mut. Ins. Co.*,** 800 N.E. 2d 757 (Ohio App. 2003), *appeal not allowed*, 805 N.E. 2d 540 (Ohio 2004), the Ohio appellate court reviewed the language of ***Boone*** and held that ***Boone*** extended not only to attorney-client communications, but also to work product. Furthermore, ***Garg*** concluded that the ***Boone*** exception was not limited to materials relating to coverage alone, but rather extended to *all* documents created before coverage denial "that may cast light on whether the insurer acted in bad faith in handling an insured's claim." *Id.* at 763.

It appears that no other state has yet been willing to go as far as ***Boone*. *Boone*** has been rejected by courts in New Jersey[19] and Connecticut.[20] No

doubt other jurisdictions will weigh in on ***Boone*** in the future.

## Special Issues: Reserves and Reinsurance

Claims files will likely contain information concerning reserves and reinsurance. Insurers often object to discovery of these materials on a variety of grounds, including work product, proprietary information, and relevance.

The reserve amount is the insurer's best estimate of the value of the claim when the reserve is set. Many courts allow discovery into reserve information in bad faith litigation concerning an insurer's alleged failure to settle when liability and damages were reasonably clear.[21] Evidence that an insurer set reserves well above the amounts offered in settlement can prove very helpful to the insured in these disputes. In bad faith litigation concerning an insurer's denial of coverage, discovery into reserve information can more readily be challenged on relevance grounds.[22]

As for reinsurance, its existence, as well as communications between an insurer and its reinsurers, may be helpful to an insured seeking to establish a bad faith claim. Many courts hold that reinsurance agreements are discoverable, particularly in federal court where Federal Rule of Civil Procedure 26(a)(1)(A)(iv) (2008) requires the production of "any insurance agreement under which an insurance business may be liable to satisfy all or part of a possible judgment in the action or to indemnify or reimburse for payments made to satisfy the judgment."[23]

Whether communications between an insurer and its reinsurers are discoverable is determined on a case-by-case basis. In ***Allendale Mut. Ins. Co. v. Bull Data Sys., Inc.,*** 152 F.R.D. 132 (N.D. Ill. 1993), the magistrate judge in the Northern District of Illinois, concluded that communications between an insurer and its reinsurer were not protected by the work product privilege.[24] After reviewing the documents, the magistrate determined that the documents were nothing more than business documents:

> None of the documents were prepared by lawyers or by agents on behalf of lawyers. While this in itself is not fatal to a claim of protection, *see,* ***United Coal Cos. v. Powell Const. Co.,*** 839 F.2d 958 (3d Cir. 1988), we find it significant that the vast majority of the documents are simply the private musings of non-lawyer employees of a non-party, which on their face do not appear to be related to preparation for litigation other than in an incidental manner. In other words, these documents are mere insurance business material.

***Allendale Mut. Ins. Co.,*** 152 F.R.D. at 136–37. These documents, then, were merely communications in the ordinary course of business intended by the insurer to keep the reinsurer apprised of the status of the underlying claims.

The court in ***Medmarc Cas. Ins. Co. v. Arrow Int'l, Inc.,*** No. 01–2394, 2002 WL 1870452, *3–4 (E.D. Pa. July 29, 2002), posited the following rule of thumb for determining relevance:

> Whether communications between cedents and their reinsurers are discoverable appears to be dependent on the nature of the issues to which they are alleged to be relevant…. [C]ourts appear reluctant to permit discovery of communications between cedents and their reinsurers for the purpose of establishing the proper interpretation of an unambiguous insurance policy, but are more willing to permit discovery for other purposes, such as defending against an insurer's effort to rescind a policy; to deny claims for late notice; to reconstruct a lost policy; or as extrinsic evidence of an ambiguous policy provision.

*Id.*

In addition to the list provided in ***Medmarc,*** correspondence with reinsurers may contain other information relevant to bad faith, such as a more candid evaluation of the value of the case and problems faced by the insurer in the claim.

## Conclusion

An insured pursuing a bad faith claim will invariably request the claims file in discovery. The insurer will likely resist claims file discovery, particularly of materials that reflect the insurer's mental impressions and materials arguably protected by the attorney-client privilege. Routine objections of this nature, which might otherwise be well taken in other contexts, may be overcome in bad faith actions,

depending on the facts of the case and the inclination of the courts in the venue where the case is pending.

An insured who finds his path through the maze blocked may find another route to reach the prize of the claims file. And the insurer who sees the insured charging toward the treasure chest may be able to erect yet another barricade. The guideposts provided here should assist the parties in determining whether there is a way out of their particular discovery maze.

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## Endnotes

[1]*See*, *e.g.:*

- ***State Farm Mut. Auto. Ins. Co. v. O'Hearn,*** 975 So. 2d 633 (Fla. Dist. Ct. App. 2008)
- ***GEICO Gen. Ins. Co. v. Hoy,*** 927 So. 2d 122 (Fla. Dist. Ct. App. 2006)
- ***Hartford Ins. Co. v. Mainstream Const. Group, Inc.,*** 864 So. 2d 1270 (Fla. Dist. Ct. App. 2004)
- ***Old Republic Nat'l Title Ins. Co. v. Home Am. Credit, Inc.,*** 844 So. 2d 818 (Fla. Dist. Ct. App. 2003)

*But see,* ***St. Joe Co. v. Liberty Mut. Ins. Co.,*** No. 05–01266, 2006 WL 3391208, *1 (M.D. Fla. Nov. 22, 2006) (reaching a different result as a federal court sitting in Florida applying the Federal Rules of Civil Procedure).

[2]***Ruiz*** specifically discussed the claims file in relation to the work product doctrine. ***Ruiz's*** applicability in case of attorney-client privilege claims is disputed. *Compare* ***XL Specialty Ins. Co. v. Aircraft Holdings, LLC,*** 929 So. 2d 578 (Fla. Dist. Ct. App. 2006), *rev. granted*, 935 So. 2d 1219 (Fla. 2006), *rev. dismissed* 993 So. 2d 510 (Fla. 2008) (holding that ***Ruiz*** applies only to work product, not the attorney-client privilege) *with* ***Adega v. State Farm Fire & Cas. Ins. Co.,*** No. 07–20696, 2008 WL 1009719, *1 (S.D. Fla. Apr. 9, 2008) (noting that ***Ruiz*** applies to both work product and attorney-client privilege).

[3]*See also* ***McConnell v. Farmers Ins. Co., Inc.,*** No. 07–4180, 2008 WL 510392, *1 (W.D. Mo. Feb. 25, 2008) (stating that under Missouri law, the claims file belongs to the insured up to the time when the insurer denies the claim). *But see* ***Medical Protective Co. v. Bubenik,*** No. 06–1639, 2007 WL 3026939, *1 (E.D. Mo. Oct. 15, 2007) (eroding ***Grewell*** and protecting from discovery legal advice sought by the insurer regarding the noncooperation of the insured, stating that it was not part of the claims file).

[4]***Brown v. Superior Ct.,*** 670 P.2d 725, 731–32 (Ariz. 1983).

[5]*See also:*

- ***St. Joe Co. v. Liberty Mut. Ins. Co.,*** No. 05–01266, 2006 WL 3391208, *1 (M.D. Fla. Nov. 22, 2006)
- ***Connecticut Indem. Co. v. Carrier Haulers, Inc.,*** 197 F.R.D. 564 (W.D.N.C. 2000)
- ***Pete Rinaldi's Fast Foods, Inc. v. Great Am. Ins. Cos.,*** 123 F.R.D. 198, 202 (M.D.N.C. 1988)

[6]***Conn. Indem. Co.,*** 197 F.R.D. at 571.

[7]***Schmidt v. California State Auto. Ass'n,*** 127 F.R.D. 182, 184 (D. Nev. 1989). *See also:*

- ***Mendez v. Unitrin Direct Prop. & Cas. Ins. Co.,*** No. 06–563, 2006 WL 4449538, *2 (M.D. Fla. Dec. 8, 2006) (refusing to grant work product protection to documents that, "merely document[ed] the progress of the underlying claim through the litigation process and note[d] the expenses incurred as a result. That information goes to the heart of the issue in this case, i.e., whether the insurer acted in good faith while handling the underlying claim. Thus, the documents are highly relevant to the subject matter of the present action and subject to discovery….")
- ***Residential Constructors, LLC v. Ace Prop. & Cas. Ins. Co.,*** No. 05–01318, 2006 WL 3149362, *10 (D. Nev. Nov. 1, 2006) ("Discovery of opinion work product is permitted in insurance 'bad faith' claims because the mental impressions of the insurer's representatives

in handling the claim and making coverage decisions are directly at issue and the insured's need for the material is compelling.")

- ***Prisco Serena Sturm Architects, Ltd. v. Liberty Mut. Ins. Co.,*** No. 94–5716, 1996 WL 89225, *1 (N.D. Ill. Feb. 27, 1996) ("[B]ecause the insurance company has a duty in the ordinary course of business to investigate and evaluate claims made by its insureds, the claims file containing such documents cannot be entitled to full work product protection. This is especially true where the good faith of the company is directly at issue.").

[8]***Harper v. Auto-Owners Ins. Co.,*** 138 F.R.D. 655, 670 (S.D. Ind. 1991). *See also* ***Schmidt*****,** 127 F.R.D. at 184 ("The boundary between claims adjusting materials prepared in the ordinary course of processing claims and work-product prepared in anticipation of litigation evades precise demarcation. Occasionally, courts must draw these lines through *in camera* inspections.").

[9]***Brown v. Superior Ct.,*** 670 P. 2d 725, 734 (Ariz. 1983).

[10]*See:*

- ***Spiniello Cos. v. Hartford Fire Ins. Co.,*** No. 07–2689, 2008 WL 2775643, *1 (D.N.J. July 14, 2008)
- ***EPCO Carbondioxide Prods., Inc. v. St. Paul Travelers Ins. Co.,*** No. 06–01800, 2007 WL 4560363, *2 (W.D. La. Dec. 21, 2007)
- ***Country Life Ins. Co. v. St. Paul Surplus Lines Ins. Co.,*** No. 03–1224, 2005 WL 3690565, *4 (C.D. Ill. Jan. 31, 2005)
- ***Dion v. Nationwide Mut. Ins. Co.,*** 185 F.R.D. 288, 294 (D. Mont. 1998)
- ***Ferrara & DiMercurio, Inc. v. St. Paul Mercury Ins. Co.,*** 173 F.R.D. 7, 11 (D. Mass. 1997).

This contrasts with the work product doctrine which, in federal cases, is governed by Rule 26 of the Federal Rules of Civil Procedure. *See, e.g.*, ***Coregis Ins. Co. v. Law Offices of Carole F. Kafrissen, P.C.,*** 57 Fed. Appx. 58, 60 (3d Cir. 2003) (not selected for publication).

[11]***Dixie Mill,*** 168 F.R.D. at 557; ***Rhone-Poulenc Rorer Inc. v. Home Indem. Co.,*** 32 F.3d 851, 862 (3d Cir. 1994) (noting that the attorney-client privilege is "worthy of maximum legal protection").

[12]***Connecticut Indem. Co. v. Carrier Haulers, Inc.,*** 197 F.R.D. 564, 572 (W.D.N.C. 2000).

[13]*See also:*

- ***Country Life Ins. Co.,*** 2005 WL 3690565 at *4 ("In the insurance context, to the extent that an attorney acts as a claims adjuster, claims process supervisor, or claims investigation monitor, and not as a legal advisor, the attorney-client privilege does not apply.")
- ***Conn. Indem. Co.*****,** 197 F.R.D. at 572 (noting that where attorney acts as fact investigator, the key to application of attorney-client privilege is whether the investigation was clearly related to rendition of legal services)
- ***Bertalo's Rest. Inc. v. Exch. Ins. Co.,*** 658 N.Y.S.2d 656 (N.Y. App. Div. 1997) ("Merely because such an investigation was undertaken by attorneys will not cloak the reports and communications with privilege.").

[14]***Tudor Ins. Co. v. McKenna Assocs.,*** No. 01–00115, 2003 WL 21488058, *2 (S.D.N.Y. June 25, 2003).

[15]*See* ***Hutchinson v. Farm Family Cas. Ins. Co.,*** 867 A.2d 1, 10 (Conn. 2005); ***Palmer by Diacon v. Farmers Ins. Exch.,*** 861 P.2d 895, 905–06 (Mont. 1993).

[16]*See also* ***Palmer by Diacon,*** 861 P.2d at 907. *Cf.* ***Ex parte Meadowbrook Ins. Group, Inc.,*** 987 So. 2d 540 (Ala. 2007) (noting that insurer who refuses to commit to whether advice of counsel defense will be used waives privilege).

[17]***Dion v. Nationwide Mut. Ins. Co.,*** 185 F.R.D. 288 (D. Mont. 1998).

[18]***Ferrara & DiMercurio, Inc. v. St. Paul Mercury Ins. Co.,*** 173 F.R.D. 7, 12 (D. Mass. 1997).

[19]*See* ***Spiniello Cos. v. Hartford Fire Ins. Co.,*** No. 07–2689, 2008 WL 2775643, *6 (D.N.J. July 14, 2008).

[20]***Hutchinson v. Farm Family Cas. Ins. Co.,*** 867 A.2d 1, 8 n.5 (Conn. 2005).

[21]*See, e.g.*:

- ***Bishelli v. State Farm Mut. Auto. Ins. Co.,*** No. 07–00385, 2008 WL 280850, *1 (D. Colo. Jan. 31, 2008)
- ***U.S. Fire Ins. Co. v. Bunge N. Am., Inc.,*** 244 F.R.D. 638 (D. Kan. 2007)
- ***Swicegood v. Medical Protective Co.,*** No. 95–0335, 2004 WL 1698285, *1 (N.D. Tex. July 29, 2004)
- ***Silva v. Basin W., Inc.,*** 47 P.3d 1184 (Colo. 2002).

[22]***National Union Fire Ins. of Pittsburgh, Pa. v. Stauffer Chem. Co.,*** 558 A.2d 1091 (Del. Super. 1989) (court denies discovery into reserves on grounds that insurer's decision to set reserves did not constitute an admission regarding the availability of coverage).

[23]*See also* ***Bunge N. Am., Inc.*****,** 244 F.R.D. at 641–42 (noting that the Rule is absolute and does not require any showing of relevance, and requiring disclosure even though reinsurers were not parties to case); ***Country Life Ins. Co. v. St. Paul Surplus Lines Ins. Co.,*** No. 03–1224, 2005 WL 3690565, *10 (C.D. Ill. Jan. 31, 2005), and cases cited therein.

[24]*But see* ***Country Life Ins. Co.*****,** 2005 WL 3690565 at *10 (denying discovery on the grounds that it was irrelevant).