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"Nobody Better Lay a Finger on My Claim File: How Insurers May Preserve Attorney-Client Privilege While Working with Insurance Coverage Counsel"

The attorney-client privilege is one of the oldest and most fundamental evidentiary privileges in American law. Generally speaking, the privilege protects from disclosure or discovery any communications between a client and her legal counsel containing information given for the purpose of obtaining legal representation or providing legal advice. Some courts, however, are increasingly unlikely to allow an insurance company to assert its attorney-client privilege over communications with its coverage counsel in certain situations. In both first-party and third-party claims, a few states have held that no privilege exists when coverage counsel performs tasks traditionally performed by the insurer's claims professionals. Similarly, at least one state has refused to apply the privilege in a liability case when coverage counsel engages in conduct arguably better left to the insured's defense counsel. Some policyholders argue that an insurer's failure to separate or bifurcate its claims file into separate liability defense and coverage files may waive any privilege the insurer may have with its coverage counsel. And finally, some states recognize that an insurer may implicitly waive its privilege in coverage or bad faith litigation if the insurer puts its coverage counsel's advice at issue. This presentation and paper will discuss these issues at length.

1. The dangers of coverage counsel serving as a claim's professional in first- and third-party claims.

The frequency with which some courts are refusing to apply the attorney-client privilege to communications between an insurance company and its coverage counsel when that lawyer performs a function on a claim or lawsuit that the court deems more akin to that of a claim professional than of an attorney is increasing. This trend is developing in both first- and third-party claims as policyholder counsel push the issue throughout discovery.

The Washington Supreme Court's decision in *Cedell v. Farmers Ins. Co. of Washington*, 295 P.3d 239 (Wash. 2013), is often cited as the leading case in support of this trend in the first-party context. The case involved a fire damage claim to the insured Bruce Cedell's home. The insurer retained outside counsel to assist with the claim. Here is the court's description of counsel's activities:

> Farmers hired an attorney, Hall, to advise it on legal issue of coverage…. However, Farmers hired Hall to do more than give legal opinions. The record suggests that Hall assisted in the investigation. Hall took sworn statements from Cedell and a witness and corresponded with Cedell. Hall assisted in adjusting the claim by negotiating with Cedell. Seven months after the fire, Hall wrote to Cedell offering a "one time offer" of $30,000, which was open for only 10 days, and threatened denial of coverage if the offer was not accepted. It was Hall who was negotiating with Cedell on behalf of Farmers, and it was Hall who did not return his calls when Cedell was attempting to respond to the offer. While Hall may have advised Farmers as to the law and strategy, he also performed the functions of investigating, evaluating, negotiating, and processing the claim. These functions and prompt and responsive communications with the insured are among the activities to which an insurer owes a quasi-fiduciary duty to Cedell.

The Washington Supreme Court noted that courts there "start from the presumption that there is no attorney-client privilege relevant between the insured and the insurer in the claims adjusting process, and that the attorney-client and work product privileges are generally not relevant." It continued: "However, the insurer may overcome the presumption of discoverability 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 the law" (emphasis added). Upon such a showing, the insurer may be entitled to an in-camera review of the materials at issue. The Supreme Court remanded the matter to the trial court for further review of the materials at issue under this standard.

While the holding in *Cedell* may be limited to Washington due to that state's presumption against application of the attorney-client privilege in the first-party context, it does introduce the notion that an attorney's role in "adjusting the claim" may affect an insurer's privilege over communications with that attorney. A federal district court in Washington extended this doctrine to the third-party context. In *Canyon Estates Condo. Ass'n v. Atain Specialty Ins. Co.*, Case No. 2:18-cv-1761-RAJ (W.D. Wash. Jan. 22, 2020), the court held that an insurer's outside coverage counsel's "authoring of draft letters signed by [the insurer] and sent to the [insured] related to coverage and claims processing" qualified as "quasi-fiduciary activities" of the insurance company. The court held without limitation that "assisting an adjustor in writing a denial letter is not a privileged task." It further held that "where the insurer's attorney is involved in both quasi-fiduciary and coverage or liability capacities, waiver of the attorney-client privilege is likely since counsel's legal analysis and recommendations to the insurer regarding liability generally or coverage in particular will very likely implicate the work performed and information obtained in his or her quasi-fiduciary capacity." For these reasons, the district court did not apply the privilege to communications between the insurer and its outside counsel.

The Mississippi Supreme Court recently adopted a similar analysis in *Travelers Prop. Cas. Co. of Am. v. 100 Renaissance, LLC*, 308 So. 3d 847 (Miss. 2020). The Supreme Court in that case affirmed a ruling that required the insurer to produce written communications between its in-house counsel and its claims handler where counsel had prepared a denial letter for the adjuster's signature in an uninsured motorist claim. Although the letter was signed by the adjuster, the court commented that "it clearly was prepared by someone other than" the

adjuster. As a result, the court concluded that in-house counsel "did not act as legal counsel and give advice to [the adjuster] to include in the denial letter. Instead, the denial letter contained [in-house counsel's] reasons to deny the claim."

The Mississippi Supreme Court reasoned that the adjuster's "signature was simply an effort to hide the fact that [in-house counsel], not [the adjuster], had the personal knowledge of Travelers' reasons to deny the claim and to use the attorney-client privilege as a sword to prevent [the insured] from discovering the reasons from the person who had personal knowledge of the basis to deny the claim." The adjuster's deposition testimony was likely the catalyst for the court's reasoning in this case:

> Based on [the adjuster's] testimony, [the insured] argues that Travelers' counsel actually made the decision to deny the claim and, as a result, that he must testify. [The adjuster's] deposition testimony offered no information or explanation as to why the claim was denied. She failed to explain Travelers' decision, its rationale, or how the claim would not be covered under the Mississippi UM statute. Her testimony also demonstrated a lack of knowledge of Mississippi UM law. She could not explain the origin or intended purpose of her citation of a nonexistent Mississippi statute in the denial letter. She also repeatedly testified that she was unable to answer coverage questions because she was not an attorney.

Importantly, because the adjuster seemed unable to explain the substance of her denial letter, the *100 Renaissance* decision may be limited to its facts.

2. The dangers of outside coverage counsel acting like the insured's liability defense counsel.

An insurer's attorney-client privilege over communications with its outside coverage counsel also may be threatened when coverage counsel engages in activities in a liability case that arguably would be better left to the insured's defense counsel. A recent example of the dangers associated with undefined roles of counsel is the Missouri case of *State ex rel. Kilroy Was Here, LLC v. Moriarty*, 633 S.W.3d 406 (Mo. App. E.D. 2021). The case arose out of an incident when a large tent that installed for the insured's patrons near Busch Stadium in downtown St. Louis came unmoored during a storm killing one and seriously injuring seven others.

the insured demanded that insurer settle the claims for the policy limits and argued that the insurer's refusal to do so would be bad faith causing the carrier to hire bad faith coverage counsel to monitor the case. The Missouri appellate court, however, indicated that coverage counsel's activities may have extended beyond that role:

> On the record before us summarized above, [bad faith counsel] appears to have imbedded himself as [the insured's defense lawyer's] co-counsel in Kilroy's defense to the underlying lawsuit. [Bad faith counsel] extended settlement offers, attended motion hearings, provided legal research and local rule information to lead counsel, participated in witness preparation, reviewed motions prior to filing, negotiated settlement with

> opposing counsel, and reviewed jury instructions. The record supports that while [he] was retained as bad faith counsel for [the insurer] Starr, he also acted with Starr's knowledge and favor in Kilroy's legal defense.

Because the insurer's bad faith counsel "was participating as de facto co-counsel of [the insured] Kilroy," the court held that "Kilroy should be entitled to the file generated in that connection because the client's files belong to the client, not to the attorney representing the client." The Missouri appellate court commented that the insured "should be entitled to know what [counsel] did on Kilroy's behalf and why."

3. The insurer's failure to maintain the claims file in a way so as to preserve privilege.

No reported decision appears to expressly require a liability insurer to bifurcate a claim into liability and coverage files once an insurance coverage issue arises. One of the few appellate opinions to squarely address whether a liability insurer should bifurcate its file in this situation is *State Farm Fire & Casualty Co. v. Superior Court*, 216 Cal.App.3d 1222, 265 Cal.Rptr. 372 (Cal. App. Ct. 1989). The underlying lawsuit at issue in *State Farm* concerned the insureds' alleged failure to disclose foundation defects in the sale of their home. The insureds' homeowner's carrier chose to defend under reservation of rights and provided the insureds with independent counsel. The liability carrier did not bifurcate the file and, instead, had a single adjuster handle both defense and coverage. That adjuster supposedly informed the insureds that "not one penny would be offered in settlement, that State Farm was only obligated to provide ... a 'defense,' because, in his opinion, there was no coverage under the policy." The insureds later filed suit against their insurer and alleged that the carrier defended them in bad faith.

The California appellate court recognized that while a liability adjuster can become the agent of the insured in some situations ("most usually...when no issue as to coverage arises"), "[t]his does not constitute the adjuster the insured's agent for all purposes." Where coverage is in dispute, the court commented that it is "obvious that the adjuster's loyalties are divided and the insured and his counsel cannot reasonably expect that he represents only the interest of the insured." Rather than require bifurcation of the claims file, however, the appellate court held that the interests of the insured would be "adequately protected" by independent defense counsel. Indeed, the court explained that "it is to remedy this problem that the concept of the *Cumis* [independent] counsel has been created." The court concluded, "In these days of ever-increasing costs in the processing of insurance settlements, we conclude it would be unwise to impose yet another layer of administration."

It should be noted that the *State Farm* opinion made clear that the insureds did not allege that defense counsel provided confidential information to the carrier relative to coverage or that the adjuster tried to have defense counsel do so. The appellate court emphasized that it was defense counsel's "obligation to guard against improvident revelations to the insurance company."

Most other reported decisions also do not require bifurcation. *See Trotter v. American Modern Select Insurance Company*, 220 F.Supp.3d 1266 (W.D. Okla. 2016); *State Farm Fire &*

Cas. Co. v. King Sports, Inc., 827 F.Supp.2d 1364 (N.D. Ga. 2011); *United Services Auto. Ass'n v. Bult*, 183 S.W.3d 181 (Ky. Ct. App. 2003).

On the other hand, the *Safeco Ins. Co. of America v. Butler* opinion out of the state of Washington is often cited for the proposition that a liability insurer's failure to bifurcate or split a claim into defense and coverage files can be evidence of bad faith. 118 Wash.2d 383, 823 P.2d 499 (1992); *see also Cincinnati Specialty Underwriters Insurance Company v. Milionis Construction, Inc.*, No. 2:17-CV-00341-SMJ, 2018 WL 6069002 (E.D. Wash. Nov. 20, 2018). Unlike many other states, Washington imposes an "enhanced obligation of fairness" upon insurance companies that goes "beyond that of the standard contractual duty of good faith."

In *Butler*, the insured alleged that the liability carrier committed at least eight acts of bad faith:

(1) Safeco decided to defend under a reservation of rights over two months prior to notifying the Butlers of its intent to do so;
(2) Safeco delayed the Butlers' attorney's investigation;
(3) Safeco used that delay to enhance its position on the coverage issue;
(4) Safeco did not conduct a timely and thorough investigation;
(5) Due to Safeco's delay evidence was lost that would have been useful to the Butlers in the coverage suit;
(6) Safeco attempted to use the Butlers' attorney to obtain statements for use in the coverage action;
(7) At the regional level, Safeco commingled information from the tort defense and coverage action files; and
(8) Safeco exhibited greater concern for its financial risk than for the Butlers' interests.

The insurance company's supposed bad faith in failing to bifurcate the file was only one of eight alleged acts (and ranked only seventh on the list). Rather than commenting in any way on whether the failure to bifurcate could be evidence of bad faith, the Washington Supreme Court simply concluded the insured had presented sufficient evidence to create a question of fact as to the carrier's alleged bad faith. While insurers should note the *Butler* decision, its impact outside of the state of Washington on the bifurcation issue may be limited.

Indeed, at least one federal district court in Washington has questioned whether the *Butler* decision holds much precedence on this issue even within Washington. *See American Capital Homes, Inc. v. Greenwich Ins. Co.*, No. C09-622-JCC, 2010 WL 3430495 (W.D. Wash. Aug. 30, 2010) ("The *Safeco* court never returned to the Butler's contention to affirm that any such duty to avoid commingling existed. Plaintiffs' authority is rooted in the summary of a party's arguments, not a judicial holding.")

While little caselaw requires a liability carrier to bifurcate its claims file, insureds are increasingly arguing that a liability insurer's failure to do so allows the insured to access the carrier's communications with its coverage counsel. For example, in *State ex rel. Shelter Mutual Insurance Company v. Wagner*, 575 S.W.3d 476 (Mo. App. W.D. 2018), a Missouri appellate court considered whether communications between a liability carrier and its coverage counsel

regarding whether to accept a plaintiff's settlement demand were protected by the attorney-client privilege. The insured argued that he was entitled to the communications under *Grewell v. State Farm Mut. Auto. Ins. Co.*, 102 S.W.3d 33 (Mo. banc 2003), a case that had recognized "an insured's right of access to his or her liability insurance claims file." The insurance company in *Wagner* notably did not bifurcate its file between coverage and liability defense, but rather, commingled the privileged communications in a single file.

The Missouri appellate court held, however, that *Grewell* did not apply because that case did not involve a claim of an insurer's attorney-client privilege. The appellate court in *Wagner* clarified that *Grewell* "holds that an insured is entitled to his or her claims file but does not hold that the entitlement to the file extends to documents protected by privilege." The court in *Wagner* accordingly held that *Grewell* did not require disclosure of the communications at issue.

A California appellate court rejected a very similar argument in the aforementioned *State Farm* decision. *See* 216 Cal.App.3d at 1228 ("The principle espoused by Durants would require that counsel representing an insurance company make sure, before discussing coverage concerns, that the individual in the company with whom he was talking was not also involved otherwise in the investigation of the claim. We believe such a requirement would be unreasonable and impractical. We find that the communications between coverage counsel [and the adjuster] are privileged...and are not discoverable.")

Although Missouri and California appellate courts have held that an insurer's commingling of defense information and attorney-client privileged coverage communications in the same claims file did not waive the carrier's privilege, the fact that they were commingled gave rise, in part, to the insureds' argument that they should have access to these communications. Bifurcation of the claim into separate defense and coverage files and storing privileged coverage communications in the coverage file only, provides a liability with a stronger position in arguing the applicability of the privilege to the communications sought by the insured.

4. The risk of an insurer's implied waiver of privilege in insurance coverage or bad faith litigation.

When an insurer is accused of bad faith for an improper settlement or coverage decision, it has the option to invoke an advice-of-counsel defense. If the insurer relied in good faith on counsel's input, this may help to portray the insurer as reasonable. A drawback to the advice of counsel defense is that it places the attorney's advice at issue, thereby waiving attorney-client privilege with respect to the subject matter of the advice. *See*, *Static Control Components, Inc. v. Lexmark Int'l., Inc.*, 250 F.R.D. 575, 580 (D. Colo. 2007) (citing *In re EchoStar Commc'ns. Corp.*, 448 F.3d 1294, 1302-1305 (Fed. Cir. 2006)). "This [waiver] rule allows the opposing party to probe fully all advice received by the alleged [wrongdoer] and which played any part in its belief concerning [the alleged conduct]." *Id.* Some courts allow counsel to protect their legal work and mental impressions (work product) that have not been shared with the client. *Id.; Nicholas v. Bituminous Cas. Corp.*, 235 F.R.D. 325, 333 (N.D. W. Va. 2006) ("[a]sserting the advice of counsel defense does not waive information protected by the work-product

doctrine unless counsel communicated the information to the defendant."); *see*, *Cordis Corp. v. SciMed Life Sys., Inc*., 980 F. Supp. 1030 (D. Minn. 1997), *see also Thorn EMI N. Am., Inc., v. Micron Tech., Inc*., 837 F. Supp. 616, 620 (D. Del. 1993).

While this aspect of the waiver rule may seem to be straightforward – privilege being waived when an insurer invokes the advice of counsel defense – courts in many jurisdictions have expanded the rule to include the concept of implied waiver. According to some courts, an implied waiver can occur whenever an insurer broadly asserts its good faith in handling a claim. The assertion of good faith, in turn, arguably places at issue all information known to the insurer, including legal advice. Courts have adopted a variety of approaches to the notion of implied waiver in these circumstances.

For example, some jurisdictions have adopted a nearly *per se* rule that an insurer loses its claim of privilege over certain key documents if it contests an allegation of bad faith. Courts in Ohio are a leading example of eliminating insurer's claims of privilege over certain key documents in bad faith cases. *See e.g.* Boone v. Vanliner Ins. Co., 91 Ohio St. 3d 209, 2001 Ohio 27, 744 N.E.2d 154, 158 (Ohio 2001) ("[I]n an action alleging bad faith denial of insurance coverage, the insured is entitled to discover claims file materials containing attorney-client communications related to the issue of coverage that were created prior to the denial of coverage."). The Ohio legislature, and some courts, have attempted to soften this rule in certain respects by bifurcating issues, requiring a prima facie showing of bad faith, and utilizing "in camera" review. Nonetheless, a number of Ohio courts continue to strictly enforce the concept requiring production of privileged materials without protections in bad faith cases.

On the other extreme, some jurisdictions continue to remain protective of the privilege and restrict the application of waiver to limited, if any, circumstances. These jurisdictions will only find an implied waiver if the insurer directly puts the attorney's advice at issue in the case. See *State ex rel. Shelter Mutual Insurance Company v. Wagner*, 575 S.W.3d 476 (Mo. App. E.D. 2018); *Leaphart v. Nat. Union Fire Ins. Co.*, 2017 Mont. Dist. LEXIS 16, *26 (Mont. 8th Dist., July 28, 2017) (emphasizing that waivers should be voluntary, knowing, and intentional); *2,022 Ranch, L.L.C. v. Superior Court,* 113 Cal. App.4th 1377, 1395, 7 Cal. Rptr. 3d 197 (2003) ("waiver can only be shown by 'demonstrating that the client has put the otherwise privileged communication directly at issue'"); *see also*, *Republic Ins. Co. v. Davis*, 856 S.W.2d 158, 163-164 (Tex. 1993) (finding no waiver; setting rules which requires "offensive use" of the material in seeking affirmative relief, with the confidential material going to "the very heart of the affirmative relief sought"). *But see In re Kubosh Bail Bonding,* 522 S.W.3d 75 (Tex. App. 1 Dist. 2017) (finding waiver of privilege where party attempted to use privileged emails for its own benefit "offensively").

Other jurisdictions approach the issue by attempting to balance the need for the discovery against the importance of maintaining the privilege under the circumstances. Court applying this balanced approach have tried to establish clear rules which: (a) require a plaintiff to establish a "prima facie" case of bad faith before discovery of privileged materials will be required; and/or (b) examine privileged materials in camera to determine if they provide any evidence of bad faith. *ContraVest Inc. v. Mt. Hawley Ins. Co.*, 2017 U.S. Dist. LEXIS 48638, *1-2, 2017 WL 1190880 (D. S.C., Mar 31, 2017).

For example, in *State Farm Mut. Auto. Ins. Co. v. Lee*, 199 Ariz. 52, 13 P.3d 1169 (2000), the insurer was deemed to have impliedly waived privilege where it argued that its

interpretation of its policies, statutes, and caselaw were reasonable. The insurer did not seek to expressly rely upon the advice of counsel in defending itself, but the court ruled that the insurer placed the advice that it had received from its counsel "at issue" by advancing that the insurer's conduct was "reasonable":

> We assume client and counsel will confer in every case, trading information for advice. This does not waive the privilege. We assume most if not all actions taken will be based on counsel's advice. This does not waive the privilege. Based on counsel's advice, the client will always have subjective evaluations of its claims and defenses. This does not waive the privilege. All of this occurred in the present case, and none of it, separately or together, created an implied waiver. But the present case has one more factor — State Farm claims its actions were the result of its reasonable and good-faith belief that its conduct was permitted by law and its subjective belief based on its claims agents' investigation into and evaluation of the law. It turns out that the investigation and evaluation included information and advice received from a number of lawyers. It is the last element, combined with the others, that impliedly waives the privilege. State Farm claims that its actions were prompted by what its employees knew and believed, not by what its lawyers told them. But a litigant cannot with one hand wield the sword — asserting as a defense that, as the law requires, it made a reasonable investigation into the state of the law and in good faith drew conclusions from that investigation — and with the other hand raise the shield — using the privilege to keep the jury from finding out what its employees actually did, learned in, and gained from that investigation.

The court thus found the privilege to be waived. *Id*; *see also Maplewood Partners, L.P. v. Indian Harbor Ins. Co*., 295 F.R.D. 550, 614-18 (S.D. Fla. 2013) (requiring production of privileged items on various grounds, including placing them at-issue).