Insurance Claims: Privilege and Work Product Challenges After TransCanada and Cedell

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Summary

I. Overview of Attorney-Client Privilege and Work Product Doctrine in Coverage Disputes


IV. Protecting the Privilege

V. Additional Discovery Issues In Coverage Litigation: Representative Cases
The Basics: Attorney Client Privilege and Work Product Doctrine
The attorney-client privilege shields from discovery a communication between *client and counsel* that:

(1) was intended to be and was in fact kept *confidential*; and

(2) was made for the purpose of obtaining or providing *legal advice*.

“*[T]he mere presence of a lawyer’s name at the top or bottom of a document is not the bell that causes the dog Privilege to salivate.”*  
Attorney-Client Privilege

Choice of law analysis often focuses on the state with the “most significant relationship with the communication.” Restatement (Second) of Conflict of Laws § 139..

Privilege is substantive, not procedural. Controlled by state law in federal diversity cases. See FRE 501.
Attorney-Client Privilege: Key Issues In Coverage Litigation

Attorney-client relationship?

Is attorney providing legal advice or business advice?

Waiver?

Privilege must always be evaluated and defended on a document-by-document basis. General rules provide an analytical framework, but not necessarily the answer.
Number of Attorneys In Coverage Dispute Can Complicate Privilege Determination

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<td>Communications between adjuster and insurer’s in-house counsel.</td>
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<td>Communications among co-insurers.</td>
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<td>Communications between insurer and reinsurer.</td>
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<td>Communications involving insurance broker.</td>
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Attorney-Client Privilege: Who Is Defense Counsel’s Client?

Relationship between insurer, insured and defense counsel can present complex privilege issues.

“Perhaps this Court’s patience, after thirty-six years on the federal bench, is wearing thin or, perhaps, this case is a perfect illustration of the flaws . . . in the current state of the legal practice as to insurance coverage disputes and the determination of questions of attorney-client privilege or work-product immunity in these ‘unique tripartite relationships’ . . . .” Maplewood Partners, L.P. v. Indian Harbor Ins. Co., 295 F.R.D. 550, 632 n. 322 (S.D. Fla. 2013).
The attorney work-product doctrine generally shields from discovery documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative.

The determination of whether a document has been prepared “in anticipation of litigation” turns on two issues:

(1) whether the document was prepared “because of” a party's subjective anticipation of litigation rather than an ordinary business purpose; and

(2) whether that subjective anticipation was objectively reasonable.
Work-Product Doctrine

Unlike the attorney-client privilege, which is derived from substantive law, the work product doctrine is based on the procedural law of the court in which the lawsuit is pending.

Federal work product doctrine encompasses all work performed by an attorney or his agent in anticipation of litigation. F.R.C.P. 26(b)(3)

In some states, work product protection is narrower. For example, in Illinois, only “opinion work-product”--matter which discloses the theories, mental impressions or litigation plans of a party's attorney--is protected from discovery. (See Ill. Sup. Ct. R. 201(b)(2))
Work-Product Doctrine: Key Issues In Coverage Litigation

Was material in insurer claim file prepared in anticipation of litigation?

Material prepared as part of ordinary business not work product.

When Does Insurance Business End?

Requires fact-specific analysis, but many courts hold that ordinary insurance business ends and litigation may be anticipated after insurer informs policyholder that claim isn’t covered.
Putting the Issues In Context
Why Do Policyholders Seek Production of Insurance Claim Files?

Insurer's claims file is usually considered to be the "crown jewel" of discovery by the policyholder, particularly in bad faith cases.
Why Do Insurers Typically Resist Production of Insurance Claim Files?

Insurer's claims file is usually considered to be the "crown jewel" of discovery by the policyholder, particularly in bad faith cases.
Why Insurers and Their Attorneys Must Consider Privilege Issues at Beginning of Claim Investigation: Case Study

Insured requests coverage for settlement of underlying class action alleging claims of negligence and fraud.

Insurer retains law firm to evaluate whether underlying settlement is covered. After extensive investigation, firm recommends that insurer should deny coverage based on fraud exclusion.

In subsequent coverage litigation, insured seeks production of all of the law firm’s research files, internal communications and memoranda, and communications with insurer.

Why Insurers and Their Attorneys Must Consider Privilege Issues at Beginning of Claim Investigation: Case Study

Insurer withholds attorney files based on the attorney work-product doctrine.

Court: Insurer must produce all documents created by its attorney before insurer notified the insured that it was denying coverage.

Why? Because “[d]ocuments 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.”

Why Insurers and Their Attorneys Must Consider Privilege Issues at Beginning of Claim Investigation: Case Study

Attorney files contained a detailed memorandum indicating that there was only weak factual and legal support for denial of coverage based on fraud exclusion, and internal attorney emails showed that the firm focused on trying to find ways to deny coverage.

Insurer’s coverage counsel is deposed. Expert opines that outside counsel was acting as an adjuster and conducted a biased investigation, which was bad faith. Case settles before trial.

TransCanada and Cedell
This case concerned first-party coverage for property damage and business interruption expenses arising from the breakdown of a steam turbine power generator.

Several insurers retained coverage counsel, who investigated the claim and provided advice as to whether the insurers should pay or deny the claim. This was done by a single firm for certain market insurers, who each held a percentage of risk, but were third-parties to one-another.

In coverage litigation that followed, the policyholders sought to discover documents created by the attorneys. The party claiming the privilege bore the burden of proof in establishing the documents were protected.

The court found that the insurers had not met their burden of demonstrating privilege as to the majority of the documents, finding that the insurers’ counsel were primarily engaged in claims handling, an ordinary business activity. These documents were not work product and trial preparation materials or attorney client communications.

For work product and trial preparation materials, the trial court had stated that an insurer cannot claim protection until it makes a firm decision to deny coverage.

For attorney-client privilege, there is no tie to contemplation of litigation. The document must be a confidential communication between and attorney and client, made in the context of legal advice.
There is no privilege for documents created in the ordinary course of business. Insurance companies investigate claims and decide whether to accept or deny coverage as part of their regular business activities. There is no privilege for attorneys performing such work.

Determining whether documents fall within the limited attorney-client privilege is a factual determination and requires in camera review of the documents.
TransCanada

Common interest privilege is not a separate privilege, but an exception to the usual rule that disclosure to a third-party waives protection.

The trial court held that, in New York, any common interest privilege is limited to where parties reasonably anticipated litigation and – for insurers – it held this meant after a denial of coverage.

Here, the trial court held that, where market insurers shared documents from counsel prior to the determination to deny coverage, there was no common interest privilege and the attorney-client protection was waived. No joint defense or similar agreement was provided to explain terms and conditions of joint representation.
TransCanada

The original decision of the intermediate appellate court affirming the trial court was issued on February 25, 2014.

After the insurers moved for reconsideration, the intermediate appellate court issued a new opinion dated July 31, 2014.
TransCanada

The difference between the two Appellate Division decisions is relatively minor:

The second opinion adds a discussion of the trial court’s *in camera* review and a statement that “claims handling” is an ordinary business activity for an insurance company.

Importantly, the second opinion does not reach the common interest exception to the attorney-client privilege (or the determination that it only can attach after a denial of coverage) because the court determined that the privilege did not attach in the first instance.
Postscript: The insurers in *TransCanada* are in the process of seeking further appellate review.
In this case, a policyholder’s house burned down, and he sought first-party coverage under his homeowner’s policy. The policyholder’s girlfriend was at the home at the time of the fire, but he was not. The fire department concluded that the fire was “likely” accidental and the insurer’s fire investigator found no evidence of arson and agreed a candle was a possible or even probable cause of the fire.

One of the insurer’s adjusters, as well as one of its independent estimators, provided an estimate of the damage to the house and property.

*Cedell v. Farmers Ins. Co. of Wash.*, 295 P.3d 239 (Wash. 2013)
The insurer also hired an attorney to assist in making a coverage determination. The attorney conducted an examination under oath of the policyholder and his girlfriend.

Roughly eight months after the fire, the attorney sent the policyholder a letter:
(1) stating that the insurer may deny coverage based on a delay in reporting and based on the girlfriend’s inconsistent statements about the fire; and
(2) extending a one-time offer to settle for approximately 1/3 of the estimated loss, which would be held open for ten days.
Cedell v. Farmers Ins.

The policyholder unsuccessfully attempted to contact the attorney during the 10-day period.

Claiming that Farmers ignored his repeated calls, and that he was forced to retain counsel to elicit any action on the claim, the policyholder sued the insurer, alleging that it acted in bad faith.

In discovery, the parties disputed whether and the extent to which materials in the claim file relating to the attorney’s investigation and advice would be discoverable.
When an insured asserts bad faith against his insurer, unique considerations arise. “A first party bad faith claim arises from the fact that the insurer has a quasi-fiduciary duty to act in good faith toward its insured.”

“Implicit in an insurance company’s handling of [a] claim is litigation or the threat of litigation that involves the advice of counsel. To permit a blanket privilege in insurance bad faith claims because of the participation of lawyers hired or employed by insurers would unreasonably obstruct discovery of meritorious claims and conceal unwarranted practices.”
“We 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.”

“[T]he insurer may overcome the 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 the law.”
“Upon such a showing, the insurance company is entitled to an *in camera* review of the claims file, and to the 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.”

“If the trial judge finds the attorney-client privilege applies, then the court should next address any claims the insured may have to pierce the attorney-client privilege.”
In particular, in the bad faith context, the insured may assert the civil fraud exception. If the civil fraud exception is asserted, then upon a showing of a reasonable belief that an act of bad faith tantamount to a civil fraud has occurred, the court will conduct an *in camera* review.

In the *in camera* review, upon the finding that there is a factual foundation to permit the claim of bad faith to proceed, the attorney client privilege will be waived by the civil fraud exception.

Note: There is an exception for first-party UIM claims, where there is no presumption of no privilege because the insurer is entitled to stand in the shoes of the tortfeasor to defend, and is entitled to counsel’s advice with respect to such defenses.
Cedell v. Farmers Ins.

As applied to the facts here, the court ruled that the insurer hired the attorney “to do more than give legal opinions.”

“While [the attorney] may have advised [the insurer] 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 which an insurer owes a quasi-fiduciary duty to [the insured].”

And, to the extent attorney-client privilege applied to some documents where the attorney was not acting as a quasi-fiduciary, it was unclear whether the trial court followed the steps outlined, so the matter was remanded for further proceedings consistent with the Washington high court ruling.
Post-Cedell

Has been applied to third party bad faith claims.


“Several district courts ... have interpreted *Cedell* as broadening the scope of discoverable information in insurance disputes.”


At least one court outside of Washington has applied *Cedell*.

But *Cedell* does not apply to the work product doctrine, which is a matter of federal law.

And, *Cedell’s* mandate for an *in camera* review of attorney-client has been viewed as “procedural.” Thus, the determination about whether to conduct an *in camera* review rests “in the sound discretion of the court.”

TransCanada and Cedell - Outliers?


The Court considered whether attorney-client privilege prevented disclosure of: (1) a commercial liability coverage opinion letter provided to Montpelier prior to the claim by the Corricks; (2) coverage opinion letters provided to Montpelier finding coverage for an alleged claim; and (3) copies of any seminar or training materials prepared for any insurer or industry group related to coverage interpretation or extra-contractual liability.
“[A]n 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.”

The insured contended that, because the insurers disclosed the recommendation of the coverage opinion letters to the insureds, the attorney-client privilege was lost as to the actual coverage opinion letters. The court found no case that held that the attorney-client privilege does not apply to a coverage opinion letter when an insurer communicates the gist of the recommendation contained in the letter to the insured.

*State of West Virginia ex rel. Montpelier US Ins. Co.*
TransCanada and Cedell - Outliers?

The policyholder also sought disclosure of all seminar or training materials the attorneys prepared for any insurer or industry group.

The court held: “We have reviewed all of the documents submitted under this discovery request. All of the documents reflect CRW’s legal opinion on specific topics. The documents explain legal concepts and procedures and specific policy issues. . . these documents are protected by the attorney-client privilege.”

Note: The West Virginia high court did not address the crime-fraud issue because it was not relied upon by the discovery commissioner or circuit court, nor was it presented below.

Finally, the court considered whether the attorney’s contract with Montpelier and its billing statements for the work on the coverage opinion letter were protected from disclosure by the work product doctrine.

The court said they were not. The retention agreement was a general agreement about how legal work would be assigned, how conflict of interests would be resolved, how billing would occur, counsel’s obligation to obtain professional liability insurance, how disputes between the parties would be resolved, and a few other miscellaneous matters.

The two billing statements were typical non-protected billing statements that provided very general descriptions of the work, the initials of the attorney, and the time it took to perform each task (the actual amount charged was ordered redacted).
Protecting the Privilege When Investigating an Insurance Claim:

Attorney Investigations and Coverage Analysis
# Investigations and Coverage Determination

- Evaluate governing law and, in litigation, the applicable forum (state vs. federal court)
- The less that counsel’s conduct is quasi-fiduciary, the more it is likely to be privileged.
- Consider “splitting the file.”
- Use separate communications about factual investigation versus legal advice.
- Specify basis for engagement of counsel in retention letter.
Investigations and Coverage Determination

- Label communications privileged, when appropriate.
- Be careful about what you put in writing.
- Consider use of written joint defense and non-waiver agreements.
- Particularly, in cases of *in camera* review, consider use of a discovery master.
- Evaluate possible bifurcation of bad faith claims.
Protecting the Privilege When Investigating Insurance Claims:

Sharing Defense-Related Information Between Insurer and Insured
Assume No Insurer-Insured Privilege

Although some courts discuss a de facto insurer-insured privilege, relationship between insurer and insured is not an independent source of privilege.

Correct analysis requires determination of whether insurer and insured are deemed to be co-clients of defense counsel and/or whether insurer and insured share a common legal interest.
Common Interest Between Insured and Insurer Following Coverage Denial?

No: *Petco Animal Supplies Stores, Inc. v. Ins. Co. of N. Am.*, 2011 U.S. Dist. LEXIS 70748 (D. Minn. June 10, 2011) (agreeing with trial court that “there could be no common interest in defeating or minimizing claims against the insured where the insurer has refused to cover the insured's claims . . . .”)

### Practical Guidance for Sharing Defense-Related Information Between Insurer and Insured

1. Avoid communicating sensitive and privileged material in writing.
2. Limit the dissemination of privileged communications only to persons directly involved with the claim.
3. Mark all privileged communications as an "attorney-client communication" and instruct all recipients to maintain the communication as confidential.
4. Avoid discussing coverage issues and liability issues in the same communications.
5. Use confidentiality agreements and common interest agreements.
6. Ask court for protective order in coverage litigation.
Additional Discovery Issues In Coverage Litigation: Representative Cases
# Are Insurer Reserves Attorney Work Product?

Often depends on how and when reserves are calculated

Privilege Waiver If Insurer Forwards Privileged Communication to Its Reinsurer?

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<th>Usually depends on common interest doctrine</th>
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Privilege Waiver If Insurer Asserts “Advice of Counsel” Defense to Bad Faith Claim?

Usually depends on jurisdiction’s “at issue” doctrine.

Privilege Waiver If Insured Forwards Privileged Information to Broker?

Often turns on issues of agency and whether the communication was in furtherance of a legal function

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