Attorney-Client Privilege and Work-Product Protection in Insurance Bad Faith Litigation

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Jay M. Feinman

INTRODUCTION

This article explores two issues that often arise in litigation over insurance claim practices, commonly referred to as bad faith litigation. In first-party bad faith litigation, the policyholder is entitled to receive in discovery a copy of the insurer's "claim file"—the record of the insurer's investigation and evaluation of the claim that underlies the dispute. Insurers often seek to protect elements of the claim file from disclosure under one or both of two theories: attorney-client privilege or work-product doctrine. Litigation collateral to the main issues in the case inevitably ensues about whether the protection claimed is applicable.

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The doctrines that control these disputes are not uniform among the jurisdictions, but the structure of the doctrinal analysis is widely accepted. For attorney-client privilege, two questions direct the inquiry. First, was the insurer a client seeking, and did the lawyer provide, legal assistance, which would be within the scope of the privilege, or was the attorney engaged in the ordinary investigation and evaluation of a claim, in which case the privilege does not attach? Second, even if that element of the standard is met, is there some exception to the privilege such that it does not apply? For work-product protection, the key issue is whether the documents at issue were prepared in the ordinary course of the insurer's business in processing the claim or in anticipation of litigation. Under both of these doctrines, there is no consensus on results but there is an accepted way of framing disputes.

In any endeavor, where one starts has much to do with where one ends up. This article starts from an understanding of the practices an insurer uses in processing a claim and its obligations to a policyholder in doing so, rather than starting from a formulation of the two doctrines. Starting there leads to different conclusions and supports a principle common to both doctrines: Neither attorney-client privilege nor work-product protection attaches to any communication made before the insurer has made a final determination on the claim and communicated that determination to the insured.

I. TRADITIONAL APPROACHES TO THESE ISSUES

The literature and case law on attorney-client privilege and the work-product doctrine in bad faith litigation are voluminous. This section summarizes the traditional approaches as background to reframing the analysis. The traditional approaches include both points of agreement and well-defined controversies.

A. *The Claim File*

The starting point for the analysis is to understand what material is discoverable in claim practices litigation before the application of limiting doctrines such as attorney-client privilege or work-product protection. The core of the answer is simple: The policyholder is entitled to discovery of the claim file.[1]

1. This is the core of the answer but not the entire answer. Policyholders often seek discovery of other types of material in claim practices litigation and often they are entitled to it. Claim files of other policyholders, the claims manual in its various physical and electronic iterations, incentive policies for claims personnel, and other evidence of institutional practices may be relevant to whether the insurer has acted in bad faith and therefore should be discoverable. These types of materials do not involve issues of attorney-client privilege or work-product protection, however, so they are not within the scope of this article. For those issues, see NEW APPLEMAN INSURANCE BAD FAITH LITIGATION § 16.02[3][c]–[e]; Doug-

When a policyholder reports a loss, the insurer's personnel receive the report, investigate the cause and extent of the loss, assess the amount of damage and the cost to repair, determine whether the cause and amount are covered under the policy, and communicate with the policyholder throughout the process. The claim file is the complete record of the insurer's investigation and evaluation of a policyholder's claim.

In a few states, a policyholder is entitled by statute to receive a copy of the claim file even in the absence of litigation.[2] In all jurisdictions, the claim file is relevant discoverable information. Rule 26 of the Federal Rules of Civil Procedure is typical: "Parties may obtain discovery regarding any non-privileged matter that is relevant to any party's claim or defense. . . . Information within this scope of discovery need not be admissible in evidence to be discoverable." The policyholder's allegation in a claim practices case is that the insurer has violated the legal standard that governs the insurer's processing of the claim. In most jurisdictions that standard is that the insurer is liable for bad faith if it was not "fairly debatable" that the policyholder had a covered claim and the insurer acted intentionally or recklessly in denying the claim;[3] in a minority of jurisdictions the standard is that the insurer acted unreasonably, without a more stringent intent requirement.[4]

Under either of these standards, the information in the claim file is relevant and therefore discoverable. Both standards require evaluating whether the insurer's determination on the policyholder's claim, and the actions it took in making that determination, were reasonable; the claim file reflects what actions the insurer took (and did not take), which are a necessary element of that evaluation. Under the fairly debatable rule, the claim file also provides information about the insurer's intent or knowledge. Therefore, courts hold that "in insurance bad faith litigation, discovery of the insurer's claim file is now routine."[5]

las R. Richmond, *Recurring Discovery Issues in Insurance Bad Faith Litigation*, 52 TORT TRIAL & INS. PRAC. L.J. 749 (2017).

2. *E.g.*, CAL. INS. CODE § 2071; LA. REV. STAT. ANN. § 22:41. Even in states in which there is no specific statutory mandate, insurance companies are under a duty under the state's adoption of the Unfair Claims Settlement Practices Act and its accompanying Model Regulation to provide relevant information and assistance to policyholders, which may be interpreted to require that the insurer furnish a copy of the claim file.

3. The leading case is *Anderson v. Continental Insurance Co.*, 271 N.W.2d 368 (Wis. 1978).

4. The leading case is *Gruenberg v. Aetna Insurance Co.*, 510 P.2d 1032 (Cal. 1973). *See generally* Jay M. Feinman, *The Law of Insurance Claim Practices: Beyond Bad Faith*, 47 TORT TRIAL & INS. PRAC. L.J. 693 (2012).

5. *E.g.*, Stewart Title Guar. Co. v. Credit Suisse, No. 1:11–CV–227–BLW, 2013 WL 1385264 (D. Idaho Apr. 3, 2013); Shaheen v. Progressive Cas. Ins. Co., No. 5:08-CV-00034-R, 2012 U.S. Dist. LEXIS 120475, at *7 (W.D. Ky. Aug. 24, 2012); Consugar v. Nationwide Ins. Co. of Am., No. 3:10cv2084, 2011 WL 2360208, at *2 (M.D. Pa. June 9, 2011); *In re* Bergeson, 112 F.R.D. 692, 697 (D. Mont. 1986); United Servs. Auto. Ass'n v. Werley, 526 P.2d 28 (Alaska 1974); Brown v. Super. Ct., 670 P.2d 725 (Ariz. 1983); Allstate Indem. v.

The baseline proposition that the policyholder is entitled to the claim file is not controversial. Difficulty arises when an insurer claims that some elements of the discovery sought should be excluded because they are subject to attorney-client privilege or work-product protection. The next two sections explain the prevailing approaches to those issues.

B. *Attorney-Client Privilege*

The modern formulation of the attorney-client privilege protects a communication made between an attorney and a client in confidence for the purpose of obtaining or providing legal assistance for the client.[6] As an exclusionary rule that impedes the ordinary fact-finding process in litigation—"an impairment of the search for truth"—the privilege is narrowly construed[7] and the burden of proof is on the party asserting the privilege.

In general, two kinds of issues arise in bad faith litigation with respect to the application of the privilege. First, was the insurer a client seeking, and did the lawyer provide, legal assistance, which would be within the scope of the privilege, or did the client seek and the lawyer provide some other type of service, which would not be privileged? Second, if that element of the standard is met, is there some exception to the privilege such that it does not apply?

In answering the first question, the courts routinely draw the distinction between a lawyer providing legal advice and a lawyer performing functions that ordinarily are performed by an insurer's claims personnel, such as investigating, processing, and evaluating a claim; the former functions are privileged and the latter are not.[8] Often it will be unclear which role an attorney has assumed, or the attorney's role will involve both functions. Courts then may use a "dominant purpose" test to decide these cases, assessing whether the dominant purpose of the relationship was that of an attorney giving legal advice to a client or of a claims adjuster providing a business service.[9]

The second question, the scope of the exceptions to the attorney-client privilege in this context, is more complicated and controversial. Some courts hold that bad faith cases as a class are outside the privilege because

Ruiz, 899 So. 2d 1191, 1129–30 (Fla. 2005); Stewart v. Siciliano, 985 N.E.2d 226, 234 (Ohio Ct. App. 2012).

6. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 68 (AM. LAW INST. 2000).

7. EDNA S. EPSTEIN, 1 THE ATTORNEY-CLIENT PRIVILEGE AND THE WORK-PRODUCT DOCTRINE 12 (6th ed. 2017).

8. APPLEMAN, *supra* note 1, § 16.04[3][c]; 1 EPSTEIN, *supra* note 7, at 389. *See, e.g.*, 2,022 Ranch, L.L.C. v. Super. Ct., 7 Cal. Rptr. 3d 197, 212 (Ct. App. 2003), *as modified on denial of reh'g* (2004); Dakota Minnesota & Eastern R.R. v. Acuity, 771 N.W.2d 623, 638 (S.D. 2009).

9. McAdam v. State Nat. Ins. Co., Inc., 15 F. Supp. 3d 1009, 1013 (S.D. Cal. 2014); Fay Ave. Props., LLC v. Travelers Prop. Cas. Co. of Am., No. 3:11-cv-02389-GPC-WVG, 2014 U.S. Dist. LEXIS 82688 (S.D. Cal. June 17, 2014); Cason v. Federated Life Ins. Co., No. C–10–0792 EMC, 2011 WL 1807427, at *2 (N.D. Cal. May 11, 2011).

the policyholder's claim can be proven only by the material in the claim file, including discussions between the insurer's personnel and attorneys.[10] Other courts treat bad faith as if it falls within the crime-fraud exception to the privilege.[11] Most courts address the issue as whether the privilege has been waived, and there are a range of approaches on the circumstances that give rise to waiver.[12]

One approach limits the privilege as waived in a way that does not accord with the concept of "waiver." Here the privilege does not apply if, because of the claim the policyholder has asserted and its need for proof that may be subject to the privilege, "fairness requires that the privilege be waived irrespective of whether the privileged person intended such waiver."[13] This rule has been much criticized and is not widely applied.

More commonly, the issue is how actions of the insurer in the course of the bad faith litigation waive the privilege.[14] The broadest waiver rule states that an insurer automatically waives the privilege by asserting a claim or defense that potentially puts in issue otherwise privileged material. Most commonly this arises when an insurer asserts that it acted on the advice of counsel at some point in processing the claim. Under this "automatic waiver" rule, that assertion waives the privilege with respect to all related communications.[15]

A narrower approach, originated in *Rhone-Poulenc Rorer Inc. v. Home Indemnity Co.*,[16] states that the privilege is waived only where an insurer asserts a claim or defense "and attempts to prove that claim or defense by disclosing or describing an attorney-client communication."[17] Unlike the automatic waiver rule, under the *Rhone-Poulenc* approach an insurer waives the privilege only where it puts its attorney's advice at issue; the advice is not at issue, and therefore the privilege is not waived, simply because the insurer relied on its attorney's advice in formulating its position on denial of coverage.[18]

10. *E.g.*, Boone v. Vanliner Ins. Co., 744 N.E.2d 154, 156 (Ohio 2001); Silva v. Fire Ins. Exch., 112 F.R.D. 699, 699 (D. Mont. 1986).

11. APPLEMAN, *supra* note 1, § 16.04[4][b]; Steven Plitt, *The Elastic Contours of Attorney-Client Privilege and Waiver in the Context of Insurance Company Bad Faith: There's a Chill in the Air*, 34 SETON HALL L. REV. 513 (2004).

12. Douglas R. Richmond, *Advice of Counsel and Insurance Bad Faith*, 73 MISS. L.J. 95, 105–06 (2003).

13. Plitt, *supra* note 11, at 547.

14. *See generally* APPLEMAN, *supra* note 1, § 16.04[4]; Plitt, *supra* note 11, at 534; Richmond, *supra* note 12, at 105.

15. *E.g.*, Robertson v. Allstate Ins. Co., Civ. No. 98-4909, 1999 U.S. Dist. LEXIS 2991 (E.D. Pa. Mar. 10, 1999). *See* 1 EPSTEIN, *supra* note 7, at 677; Plitt, *supra* note 11, at 535–37.

16. 32 F.3d 851 (3d Cir. 1994).

17. *Id.* at 863.

18. *See id.* at 863–64

C. *Work-Product Protection*

The work-product doctrine encourages "the orderly prosecution and defense of legal claims . . . [by preventing] unwarranted inquiries into the files and the mental impressions of an attorney" in the course of litigation.[19] The doctrine is codified in rules of procedure of which Federal Rule of Civil Procedure 26(b)(3) is the model:

> (3) Trial Preparation: Materials.
>
> (A) Documents and Tangible Things. Ordinarily, a party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative (including the other party's attorney. . . . But, subject to Rule 26(b)(4), those materials may be discovered if:
>
> (i) they are otherwise discoverable under Rule 26(b)(1); and
>
> (ii) the party shows that it has substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means.[20]

Because work-product protection is limited to matters that occur in preparation for litigation,[21] in bad faith cases the key issue in determining whether material is entitled to work-product protection is whether it was prepared in the ordinary course of the insurer's business or in anticipation of litigation.[22] This issue contains two components: First, there must be a

19. Hickman v. Taylor, 329 U.S. 495, 510 (1947).

20. Section 26(b)(3)(B) protects against disclosure of "the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation." That subsection is not relevant to the issues discussed here. The subsection applies only to materials that are subject to discovery under 26(b)(3)(A). Under the analysis in this article, documents in the claim file are not prepared in anticipation of litigation and therefore are not within 26(b)(3)(A). That is the logical result in light of the purposes of the rule. The protection of opinion work product rests on the need to keep from an opponent in litigation "[t]he attorney's thinking—theories, analysis, mental impressions, beliefs, etc.—[which] is at the heart of the adversary system." 2 EPSTEIN, *supra* note 7, at 1044. "The types of attorney opinion work product that are accorded absolute or near absolute protection are assessments of the merits of the claims and defenses asserted, assessments of the credibility and usefulness of witnesses, proposed settlement options and possible settlement amounts." *Id.* at 1228. All of these materials are focused on litigation between adverse parties, unlike materials that are not prepared in anticipation of litigation.

21. 2 EPSTEIN, *supra* note 7, at 1040.

22. Under Rule 26(b)(3)(A)(ii), even if material is work-product, it may be discoverable if the insured demonstrates "substantial need." Even under broad readings of work-product protection, in bad faith cases, an insured often will be able to demonstrate that need:

> [B]ad faith actions against an insurer, like actions by a client against an attorney, patient against doctor, can be proved only 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 information in the file is not only substantial, but overwhelming.

threat of litigation. Second, the material must have been prepared because of that threat and not for some other purpose.[23]

In claim practices cases, the relevant ordinary course of business is processing of the claim. Claim file documents that are part of the insurer's investigation and evaluation of a claim are prepared in the ordinary course of business and therefore are not subject to work-product protection.[24] An insurer may anticipate litigation in the sense that litigation is statistically probable to result in a portion of claims, or a particular claim may become troublesome such that litigation is potentially on the horizon, but the insurer is still required to engage in ordinary claim processing, and the products of that processing are not subject to work-product protection. As the court in the leading case of *Harper v. Auto-Owners Insurance Co.* pointed out,

> [W]hile a court's identification of a point in time after which litigation is reasonably anticipated is a legitimate and useful exercise, the protection afforded by the work product rule does not depend solely on the fact that a document was produced after that point in time, but depends primarily on the reason or purpose for the documents' production. Even after litigation is justifiably anticipated, routine or ordinary investigations or reports are not work product and may be obtained as normal discovery without a special showing of need.[25]

Courts use a variety of factors to draw the line between documents prepared in the ordinary course of business and those prepared in anticipation of litigation.[26] The expectation of litigation must be specific rather than generalized and real rather than speculative. In insurance cases, according to the leading treatise, "most courts hold that documents constituting any part of a factual inquiry into or evaluation of a claim, undertaken in order to arrive at a claim decision, are produced in the ordinary course of an insurer's business and, therefore are not work-product protected."[27]

Brown v. Super. Ct., 670 P. 2d 725, 734 (Ariz. 1983). *See* APPLEMAN, *supra* note 1, § 16.04(3)(b). The analysis in this article makes resort to the substantial need exception unnecessary because work-product protection seldom will be afforded.

23. 2 EPSTEIN, *supra* note 7, at 1082–83, 1094.

24. *Id.* at 1179–83. *E.g.*, Raritan Bay Fed. Credit Union v. CUMIS Ins. Soc., Inc., Civ. No. 09–15122010, 2010 WL 4292175, at *12 (D.N.J. Oct. 21, 2010); Country Life Ins. Co. v. St. Paul Surplus Lines Ins. Co., No. 03-1224, 2005 U.S. Dist. LEXIS 39691, at *23 (C.D. Ill. Jan. 31, 2005).

25. Harper v. Auto-Owners Ins. Co., 138 F.R.D. 655, 661 (S.D. Ind. 1991).

26. APPLEMAN, *supra* note 1, § 16.04[3][b]; 2 EPSTEIN, *supra* note 7, at 1097.

27. 2 EPSTEIN, *supra* note 7, at 1101, 1116, 1179. This principle applies in coverage litigation, *id.*, and even more strongly in bad faith litigation, *id.* at 1180.

II. RETHINKING THE DOCTRINES

The general contours of the attorney-client privilege and work-product doctrine are well established, and although their application in bad faith cases is not uniform, at least the areas of debate are well-defined. The argument in this article, however, is that the proper approach to the application of the doctrines is not to begin with the doctrines themselves but with the subject matter to which they are being applied. Focusing on the insurer's obligations in the claim process and how it conducts that process provides a strikingly different perspective on the attorney-client privilege and work-product doctrine in this context.

A. *The Claim Process*

In a bad faith case, the policyholder alleges that the insurer has violated the relevant legal standard, either the fairly debatable rule, reasonableness, or one of their variations, in processing the claim. The claim file obviously is relevant to assess the insurer's conduct. Claims of privilege in the bad faith case as described above largely rest on two points. The claim of attorney-client privilege is based on the distinction between a lawyer providing legal advice and a lawyer performing functions that ordinarily are performed by an insurer's claims personnel; the former are privileged and the latter are not. The key point in determining whether a document is entitled to work-product protection is whether it was prepared in the ordinary course of the insurer's business or in anticipation of litigation.[28] Both of these embody a similar distinction between the ordinary processing of an insurance claim and something else. In the case of privilege, the "something else" is what a lawyer does that is different than what claims personnel do. In the case of work-product, the "something else" is anticipation of litigation rather than claim processing. Therefore, the necessary starting point for both is a description of the claim process.

A classic text in claims adjusting, long used to train claims personnel, is James Markham's *The Claims Environment*.[29] It is worth quoting at length from Markham's description of the claim process.

> A claim representative must follow a systematic process for gathering information and must be proficient in resolving issues of coverage, legal liability, and damages.[30]
>
> Successful claim representatives follow a systematic approach to resolving key issues in the claims they handle. First, claim representatives verify cover-

28. The doctrine extends to materials obtained by adjusters as well as attorneys. CHARLES A. WRIGHT & MARY K. KANE, LAW OF FEDERAL COURTS 596 (6th ed. 2002).

29. JAMES J. MARKHAM, KEVIN M. QUINLEY & LAYNE S. THOMPSON, THE CLAIMS ENVIRONMENT (1st ed., 1993).

30. *Id.* at 8–9.

age, which may require investigation. Once coverage has been determined, the claim representative continues to gather facts about the claim through careful investigation. This investigation often requires taking statements from people involved in the loss. As the facts are collected, the claim representative determines liability to assess how the insurance coverage will respond. The claim representative must also gather and evaluate facts about the damages to determine the value of the claim.[31]

Claim professionals should have expert knowledge of insurance policy coverages, the law, and determination of damages.[32]

Framework for Analysis of Coverage

1. Is the cause of loss covered?
2. Is the automobile or property involved in the loss covered?
3. Is the type of loss covered?
4. Are the types and amounts of damages covered?

. . . .

8. Are the hazards involved in the loss covered?
9. Does any exclusion apply?[33]

Four tasks the claim representative must accomplish:

1. Investigation
2. Evaluation of coverage, liability, and damages
3. Negotiation or alternative dispute resolution (ADR) to achieve settlement
4. If necessary, litigation management.

These tasks overlap. For example, an evaluation of coverage, liability, and damages is essential to knowing what to investigate.[34]

Markham's description of the insurer's duties in the claim process is thorough and accurate. The first edition of Markham's treatise was written at a time when individual claims adjusters had more autonomy, and complex systems of claim management were not yet widespread. Today, as the claim process has become more fragmented, bureaucratized, and automated, it is no longer true that every claim professional possesses expertise about coverage, law, and damages. Nevertheless, it is still true that looking at the claim process as a whole, the claim process requires "gathering information and . . . resolving issues of coverage, legal liability, and

31. *Id.* at 29.
32. *Id.* at 12.
33. *Id.* at 35.
34. *Id.* at 9.

damages," such as "Is the cause of loss covered?" and "Does any exclusion apply?" To fulfill that requirement, the process as a whole must embody that "expert knowledge of insurance policy coverages, the law, and determination of damages."

This description of the claim process is inarguable. Claim handling begins but does not end with fact-finding. It always and necessarily also involves making judgments about facts and drawing conclusions from those facts. What facts are relevant? What type of investigation is needed to determine the relevant facts? Given the facts, are the cause of loss and types and amounts of damages covered? To make judgments and draw conclusions requires understanding of the terms of the policy, the way in which those terms have been interpreted by courts, and, in cases of uncertainty, the analytical processes that courts will apply to resolve the uncertainty—that is, "expert knowledge of insurance policy coverages, the law, and determination of damages."

Markham's account of the claim process does more than describe sound business practice and norms of performance in the insurance industry. It also reflects standards that are created and enforced by law.

The insurer's legal obligation to adjust the claim begins with its contractual obligation to the policyholder—the "primary duty . . . to fulfill the insurance company's promises to the insured . . . contained in the insurance policy."[35] Under the policy, the insurer has a duty to adjust the claim. Typically, that duty is defined only in general terms. A typical HO-3 homeowners policy, for example, expressly requires the company to pay claims within sixty days of agreement or adjudication and to participate in appraisal; it does not specify any other duties concerning processing of a claim.[36] Nevertheless, the insurer's obligations expressly created in the policy are further defined and supplemented by the obligation of good faith inherent in every contract, including insurance contracts.[37] Courts use the duty of good faith as a starting point for specifying duties under insurance policies,[38] and stat-

35. *Id.* at 59.

36. Insurance Services Office, Inc., Homeowners 3—Special Form HO 00 03 10 00, pp. 14–15 (1999), *available at* http://doi.nv.gov/scs/HomeownersPolicyForms//HartfordForms/Hartford_HO_00_03_10_00.pdf.

37. An early case is *Brassil v. Maryland Casualty Co.*, 104 N.E. 622 (N.Y. 1914); leading third-party and first-party cases declaring the principle are *Gruenberg v. Aetna Insurance Co.*, 510 P.2d 1032, 1038 (Cal. 1973), and *Anderson v. Continental Insurance Co.*, 271 N.W.2d 368, 375 (Wis. 1978). *See* STEVEN PLITT ET AL., COUCH ON INSURANCE § 198:4 (3d ed. 2011). On good faith in general, see JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACTS § 11.38 (6th ed. 2009); RESTATEMENT (SECOND) OF CONTRACTS § 205 (AM. LAW INST. 1981) (hereinafter RESTATEMENT). ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.")

38. *E.g.*, Bowler v. Fid. & Cas. Co. of N.Y., 250 A.2d 580, 587–88 (N.J. 1969*)*: "Insurance policies are contracts of the utmost good faith and must be administered and performed as such by the insurer. . . . In all insurance contracts, particularly where the language expressing

utes impose it as well.[39] Good faith fulfills the parties' reasonable expectations by guaranteeing "the right of the other to receive the benefits of the agreement" and imposing "a duty to do everything that the contract presupposes the parties will do to accomplish the contract's purpose."[40]

The claim process is also regulated by statute, administrative regulation, and common law in ways that parallel Markham's description. The widely adopted model Unfair Claim Settlement Practices Act (UCSPA) dictates that a company must "adopt and implement reasonable standards for the prompt investigation and settlement of claims arising under its policies."[41] The UCSPA, other statutes, and judicial decisions prescribe specific instances of the requirement of reasonableness. For example, an insurer must investigate a claim adequately and objectively.[42] It must "assess claims as a result of an appropriate and careful investigation and . . . its conclusions should be the result of the weighing of probabilities in a fair and honest way."[43] The insurer must attempt "in good faith to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear."[44]

B. *Attorney-Client Privilege*

The types of situations in which an attorney may be involved after a claim is filed can be arrayed along a spectrum, from those in which the attorney is acting just like claims personnel, to those that involve mixed functions, to those that more closely resemble pure lawyer functions. The traditional law would be more likely to grant protection through attorney-client privilege the farther along the spectrum one goes; the approach of this article suggests that the privilege does not attach to any lawyer-client communications until the claim process is concluded and the insurer has made a final determination on the claim and communicated that determination to the insured.

Sometimes an insurer uses one of its employees, who is a lawyer, to adjust a claim, including investigating the claim, analyzing it, and determining whether payment should be made. Here the insurer's employee engages in the ordinary claim process, and whether the employee happens

the extent of the coverage may be deceptive to the ordinary layman, there is an implied covenant of good faith and fair dealing that the insurer will not do anything to injure the right of its policyholder to receive the benefits of his contract."

39. *E.g.*, COLO. REV. STAT. § 10-3-1113 (2006); LA. REV. STAT. ANN. § 22:1220 (A) (2007); TENN. CODE ANN. § 56-6-902 (8)(B) (2007); WASH. REV. CODE § 48.01.030 (2012).

40. COUCH ON INSURANCE, *supra* note 37.

41. NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, MODEL UNFAIR CLAIMS SETTLEMENT PRACTICES ACT § 4.C.

42. State Farm Fire & Cas. Co. v. Simmons, 963 S.W.2d 42, 45 (Tex. 1998); Indus. Indem. Co. of the Nw., Inc. v. Kallevig, 792 P.2d 520, 526 (Wash. 1990).

43. *Anderson*, 271 N.W.2d at 375.

44. UNFAIR CLAIMS SETTLEMENT PRACTICES ACT, *supra* note 41, § 4D.

to possess a license to practice law or, like her colleague sitting at the next desk, does not, is irrelevant; the employee is engaging in the ordinary claims function.[45] Other times an insurer chooses not to have its claim processing done by its employees but instead outsources the process. Here it makes no difference whether the outside entity is a third-party administrator—an entity that provides claim services on a contract basis—or a law firm; in either case, the outside entity is simply filling the role of the insurer's claims department. Even if the outside entity is a law firm, the insurer is not a client who seeks and obtains legal advice from the lawyer, so attorney-client privilege does not attach.[46]

An insurer may retain an outside law firm to go beyond investigation and to make a coverage determination under the policy, either on its own or in conjunction with the insurer's own personnel.[47] The law firm investigates or is given the facts, examines the policy language, determines how the language might be interpreted by courts, and develops legal opinions about issues of coverage and damage. The law firm uses its expert knowledge of the law—how courts have interpreted or might interpret a particular policy term, for example—to make a judgment about the application of the law to the facts of the claim. This appears to be paradigmatic lawyer's work, so the claim of privilege is at its strongest.

But recall the summary description of the claim process from the Markham text: "gathering information and . . . resolving issues of coverage, legal liability, and damages," such as "Is the cause of loss covered?" and "Does any exclusion apply?" Even where it makes or advises on a coverage determination, the law firm is simply carrying out part of the ordinary claim process. The job of the insurer's claims personnel in performing that process is to examine the policy, investigate facts, and reach a conclusion about whether the cause of loss and the amount of damages are covered. Often reaching that conclusion requires analyses of what are essentially legal questions, such as questions of policy interpretation. Claim representatives must have some legal knowledge to fulfill their ordinary duties; when they use that knowledge, they are engaged in the ordinary work of claim handling, such as "resolving issues of coverage," and are not engaged in distinctly legal tasks. Sometimes, however, they may need to consult a lawyer because of the lawyer's greater expertise in the

45. *E.g.*, 2,022 Ranch, L.L.C. v. Super. Ct., 7 Cal. Rptr. 3d 197, 212 (Ct. App. 2003), *as modified on denial of reh'g* (Jan. 5, 2004).

46. *E.g.*, Mission Nat'l Ins. Co. v. Lilly, 112 F.R.D. 160, 163 (D. Minn. 1986).

47. *E.g.*, 1550 Brickell Assocs. v. Q.B.E. Ins. Co., 253 F.R.D. 697, 699–700 (S.D. Fla. 2008); Harper v. Auto-Owners Ins. Co., 138 F.R.D. 655, 671 (S.D. Ind. 1991); Aetna Cas. & Sur. Co. v. Super. Ct., 200 Cal. Rptr. 471, 476 (Ct. App. 1984).

law—just as claims personnel may be required to consult a variety of other experts such as fire science investigators, accountants, architects, and appraisers.[48] The reports of these other experts become part of the claim file and are discoverable without any claim of privilege. The same is true of the lawyer. If there are issues in the claim process that require legal expertise, claims personnel are required to consult a lawyer as part of their ordinary claim handling responsibility, and there is no more reason that a privilege should attach to the products of the lawyer's expertise than that of other experts. In short, there is essentially no difference between the insurer's obligation in ordinary claim processing whether or not a lawyer participates.

The insurer's obligation in claim processing provides a second reason that privilege should not attach. As noted, proper claims adjusting is not only compliance with an industry norm; it also is an obligation created by contract law, statutes such as the UCSPA, and the common law.[49] The presence of that obligation renders the reasons for the attorney-client privilege irrelevant in this context.

In an often-cited passage, the U.S. Supreme Court summarized the purposes of the attorney-client privilege:

> The attorney–client privilege is the oldest of the privileges for confidential communications known to the common law. Its purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice. The privilege recognizes that sound legal advice or advocacy serves public ends and that such advice or advocacy depends upon the lawyer's being fully informed by the client. As we stated last Term in *Trammel v. United States*: "The lawyer–client privilege rests on the need for the advocate and counselor to know all that relates to the client's reasons for seeking representation if the professional mission is to be carried out." And in *Fisher v. United States*, we recognized the purpose of the privilege to be "to encourage clients to make full disclosure to their attorneys."[50]

Accordingly, the attorney-client privilege has two principal aims. The first is client-centered. The privilege reinforces the confidential relationship between lawyer and client, encouraging clients to consult lawyers and to make full and frank disclosure when they do so and encouraging lawyers to be forthcoming with advice. The second aim serves a broader public interest. By encouraging clients to consult lawyers and lawyers to give

48. 1 PROPERTY LOSS ADJUSTING 222–25 (James J. Markham ed., 2d ed. 1995).
49. *See* text at notes 35–44 *supra*.
50. Upjohn Co. v. United States, 449 U.S. 383, 389 (1981) (citations omitted).

advice on the legal status of the client's conduct, the privilege fosters compliance with the law.[51]

A variety of issues can arise during the claim process, including, for example, whether a claim is covered under the language of the policy, what communications the insurer must make to a policyholder, how broad its investigation must be, whether it must retain experts, and whether it must pay the claim and at what amount.[52] The argument in favor of a privilege suggests that the privilege encourages non-lawyer claim personnel to consult with counsel on any of these or other issues that arise; the privilege provides the incentive to do so knowing that the discussions will not be revealed in a subsequent bad-faith action. This argument is typical:

> It is also almost certain that clients generally rarely worry about the possibility that their communications might not be covered by the privilege because of the subject being discussed or the type of work to be performed . . .
>
> . . . There is a real danger that the expansion of the exceptions to the attorney-client privilege will destroy the basic understanding between lawyers and their clients that communications are confidential. Further, expansion of these exceptions . . . could well destroy the ability of lawyers to assess the merits of their clients' cases based upon full information.[53]

But that is not a correct assessment of the incentives. Claim personnel do not—or should not—consult with counsel because they know the consultation is confidential. Whether the issue is the interpretation of policy language or the requirements of good-faith claim handling, they consult with counsel in order to adjust the claim properly, as they are required to do by law.

And that is the point at which the aims of the privilege and the claim context do not match up. In that context, the privilege is irrelevant to the incentives of the insurer. The insurer is under an obligation by contract, statute, and judicial decision to adjust the claim properly; if that requires the insurer's personnel to consult counsel, they are required to do so. The insurer's obligation is comprehensive, distinct from obligations in other contexts, and well-articulated. Any of the tasks that the lawyer performs

51. Restatement (Third) of the Law Governing Lawyers § 68, cmt. c (Am. Law Inst. 2000). The Restatement suggests a third aim, i.e., to protect the privacy of the client concerning potentially personal or embarrassing facts, but it acknowledges that aim is "controversial," and it is not relevant in the present context.

52. Feinman, *supra* note 4, at 718–36.

53. Kenneth A. Hindman & M. Colston Jones, *Preserving Candor between Lawyers and Clients: The Hidden Danger from Exceptions to the Attorney-Client Privilege*, *in* The Attorney-Client Privilege in Civil Litigation 175, 175–76 (Vincent S. Walkowiak & Oscar Rey Rodriguez eds., 6th ed. 2015).

are within the scope of the claim adjusting process. Therefore, the privilege is not needed to provide an additional incentive.[54]

What follows from all of this is a restricted application for attorney-client privilege in bad faith litigation. The core concept is that ordinary claim processing is not privileged, even if it is conducted by or involves lawyers. The corollary of the concept defines the extent of the rule: As long as the insurer is engaged in processing the claim, communications are not protected by attorney-client privilege. When an insurer has concluded processing a claim, the concept no longer applies, and privilege may attach if its ordinary requirements are met. That is, up until the point when the insurer has made a final determination on the claim—approved or denied it, in whole or part—and has communicated that determination to its insured, there is no privilege. After that point, actions of a lawyer are more likely to be directed at litigation with the policyholder than claim processing; determination of a privilege as to those actions follows the ordinary analysis of attorney-client privilege.

C. *Work-Product*

In a similar way, an understanding of the claim process leads to a narrow scope for the work-product doctrine in bad faith cases. The essential distinction underlying work-product protection is that materials acquired in the ordinary course of business are open to discovery and materials developed in anticipation of litigation are protected by the work-product doctrine.[55] The purpose of the doctrine is to further the ability of a party and its lawyers to properly conduct litigation and prepare for trial. As the U.S. Supreme Court noted in *Hickman v. Taylor*, the doctrine's foundational case, "Proper preparation of a client's case demands that [the lawyer] assemble information, sift what he considers to be the relevant from the irrelevant facts, prepare his legal theories and plan his strategy without undue and needless interference."[56]

Because "work-product protection is limited to matters that occur in preparation for litigation,"[57] the first key to determining the application

54. See Boone v. Vanliner Ins. Co., 744 N.E.2d 154, 157 (Ohio 2001):

> Vanliner further contends that if insureds alleging bad faith are able to access certain attorney-client communications within the claims file, then insurers will be discouraged from seeking legal advice as to whether a certain claim is covered under a policy of insurance. This argument is not well taken because it assumes that insurers will violate their duty to conduct a thorough investigation by failing, when necessary, to seek legal counsel regarding whether an insured's claim is covered under the policy of insurance, in order to avoid the insured later having access to such communications, through discovery.

Id.

55. *See* text at notes 21–27 *supra*.

56. 329 U.S. 495, 511 (1947).

57. 2 EPSTEIN, *supra* note 7, at 1040.

of the doctrine is identifying the point during the claim process at which the insurer shifts from the ordinary business of claim processing to acting in anticipation of litigation. That point does not arise at least until there is a final determination of coverage and the determination has been communicated to the insured. Until that point, the insurer in the ordinary course of its business has a contractual, statutory, and common law duty for the entire process of "investigation" and "evaluation of coverage, liability, and damages." Accordingly, all of the material in the claim file is prepared in the ordinary course of business and is not in anticipation of litigation such that it would be protected as work product.[58]

Of course, in a non-technical sense an insurer's personnel often will "anticipate" that litigation may arise from a claim. An insurer knows, often with statistical certainty, that a given proportion of claims will result in litigation. A particular claim may become contentious and a policyholder may threaten litigation. But neither statistical nor particular probability is the test. Rather, the test is whether the material in the claim file "can fairly be said to have been prepared or obtained because of the prospect of litigation."[59] Work-product protection does not attach just because litigation was anticipated, even reasonably anticipated; instead the material for which protection is sought "must have been produced because of that prospect of litigation and for no other purpose."[60] As the Wright and Miller treatise notes,

> Prudent parties anticipate litigation, and begin preparation prior to the time suit is formally commenced. Thus the test should be whether, in light of the nature of the document and the factual situation in the particular case, the documents can fairly be said to have been prepared or obtained because of the prospect of litigation. But the converse of this is that even though litigation is already in prospect, there is no work product immunity for documents prepared in the regular course of business rather than for purposes of the litigation.[61]

The Epstein treatise likewise frames the inquiry in two questions:

> (1) Were the documents prepared in the ordinary course of business, such as an insurance company's investigatory files?
>
> (2) Was there an independent business purpose for which the document would have been prepared even if there had been no litigation anticipated?

58. *Id.*

59. 8 WRIGHT & MILLER, FEDERAL PRACTICE & PROCEDURE, CIVIL § 2024, cited in Binks Mfg. Co. v. National Presto Indus., Inc., 709 F.2d 1109, 1118–19 (7th Cir.1983).

60. Harper v. Auto-Owners Ins. Co., 138 F.R.D. 655, 660, (S.D. Ind. 1991) (citations omitted). *See* Signature Dev., LLC v. Mid-Continent Cas. Co., 2012 WL 4321322, at *11 (D.S.D. Sept. 18, 2012)

61. WRIGHT & MILLER, *supra* note 59.

> If the answer to either question is yes, then there is no need to accord the document work-product protection.[62]

Under this standard, material in the claim file that the insurer prepared for the purpose of fulfilling its obligation to fully and fairly investigate and evaluate the claim is not prepared in anticipation of litigation, regardless of whether it is prepared by a lawyer, claim personnel, or other parties and regardless of the prospect of potential litigation. The insurer's obligation to process the claim in good faith and according to reasonable standards means that claim file material is not prepared for the purpose of engaging in litigation with its policyholder. Therefore, it is not subject to work-product protection. "Claim file documents, materials that are part of a factual evaluation or investigation into an insured's claim, if created prior to a final coverage decision, are presumed to have been prepared in the ordinary and routine course of the insurer's business and not for litigation, thus they are not protected by the work-product privilege."[63]

The point at which the claim process is concluded and the insurer may anticipate litigation in the technical sense demanded by work-product doctrine is only the first step in its application, however. Even after that point, material is protected as work product only if it is prepared in anticipation of litigation. Even after the final decision, an insurer is under a continuing duty to investigate and evaluate. If new information arises, material developed in furtherance of that duty still is prepared in the ordinary course of business and not in anticipation of litigation. Only other materials that are prepared exclusively in anticipation of litigation are protected. Thus, ordinary investigative materials are not protected, but exchanges between a claims representative and a lawyer concerning "legal strategy,"[64] for example, would be protected.

CONCLUSION

Epstein's leading treatise on the doctrines that are the subject of this article concludes, "The contours of the attorney-client privilege and work-product doctrines are now fairly set . . . Further substantial doctrinal development . . . is no longer likely."[65] It may be true that there will be no substantial doctrinal development, but in insurance bad faith cases, the application of the doctrines is ripe for change. The starting point for

62. 2 EPSTEIN, *supra* note 7, at 1115.

63. Med. Assur. Co. v. Weinberger, 295 F.R.D. 176, 183 (N.D. Ind. 2013). *See* ALLAN D. WINDT, 2 INSURANCE CLAIMS & DISPUTES: REPRESENTATION OF INSURANCE COMPANIES & INSUREDS § 9:19 (6th ed. 2016).

64. Magee v. Paul Revere Life Ins. Co., 172 F.R.D. 627, 638, 640–41 (E.D.N.Y. 1997).

65. 2 EPSTEIN, *supra* note 7, at 1801–02.

change is the subject matter of the disputes, not the doctrinal contours themselves. Focusing on the claim process yields a new approach: Neither attorney-client privilege nor work-product protection attaches to any communication made before the insurer has made a final determination on the claim and has communicated that determination to the insured.