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Institutional Bad Faith: Avoiding and Defending Allegations of Company-Wide Schemes to Suppress Claims Payment

Combating Attacks on the Insurer's Policies and Procedures in Claims Handling

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Today's faculty features:

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CARLTON FIELDS

An Update on Top-Down Discovery in Actions Alleging "Institutional Bad Faith"

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INTRODUCTION

Bad faith litigation springs from claims handling gone awry. "Institutional bad faith" claims allege that the policies and practices of the insurer mandated, caused or contributed to the improper conduct of the insurer's claims personnel. Essentially, institutional bad faith claims try the insurer, instead of, or in addition to, the claim handling.

This article is based on the premise that the insurer's contractual liability and the insured's contract damages have been established and that the insured, or the dissatisfied third party plaintiff, has filed suit alleging extra-contractual damages proximately caused by the insurer's bad faith.[3]

Bad faith actions are discovery intensive[4] and institutional bad faith claims are even more so. The plaintiff is certain to propound requests that the insurer deems intrusive, expensive and burdensome. Discovery battles will follow. Bad faith attacks the claims handling process. Plaintiffs may allege that the claims professional was inept, prejudiced, or venal and, as a result,

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[1] This article is an updated version of an article that was presented at the ABA Litigation Section, Insurance Coverage Litigation Committee 2011 CLE Seminar. Katherine L. Heckert of Carlton Fields and Kathryn H. Christian and Ashley M. Daugherty, formerly of Carlton Fields, contributed to the original article.

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All underscoring in this article is supplied unless otherwise noted.

[3] Various jurisdictions take different approaches regarding simultaneous prosecution of the underlying claim and a bad faith claim. For example, Florida decisions hold that a bad faith action may not be pursued unless and until coverage and damages have been established in the underlying case. A bad faith claim will be stayed or dismissed without prejudice until the underlying case is resolved, including all appeals. See, *Vest v. Travelers Ins. Co.,* 453 So.2d 1270 (Fla. 2000). Moreover, Florida decisions do not permit discovery of the insurer's claim file, business policies or claims practices until coverage is established "based upon the universally applied rule that discovery which concerns only potential issues of bad faith or other purported improprieties in defending the claim are wholly impermissible unless and until it is determined that the policy indeed provides coverage." *Granada Ins. Co. v. Ricks*, 12 So.3d 276 (Fla. Dist. Ct. App. 2009). *But see Bryant v. Progressive Mountain Ins. Co.*, 243 F. Supp. 3d 1333, 1339 (M.D. Ga. 2017) (permitting breach of contract and bad faith claims to proceed simultaneously); *Cunn v. Automobile Coverage of Hartford*, 971 A.2d 505 (Pa. Super. 2009) (permitting a statutory bad faith claim and an uninsured motorist claim to be pursued simultaneously because the trials of both actions would be severed). See also *Deese v. State Farm Mutual Automobile Insurance Co*., 172 Ariz. 504 (Ariz. 1992) (holding that breach of the insurance policy is not a required element in a bad faith action).

[4] James Shaw, Jr., *Butler Pappas on Bad Faith*, *19 Mealey's Litig. Rep., Ins. Bad Faith 8* (Aug. 16, 2005) ("Bad faith cases are burdensome, expensive, contentious, stressful and difficult.")

failed to fairly and timely investigate the claim, communicate with the insured, evaluate the loss, and settle when appropriate. In these cases, the plaintiff contends that the claims professional was a "B.U.M.," i.e., he was Biased, Unfair or Mean.[5]

Discovery in a bad faith case starts with the claims file. Most jurisdictions permit discovery of the claims file from inception through the judgment or settlement of the underlying case.[6] For example, the Florida Supreme Court has held that "in connection with evaluating the obligation to process claims in good faith under [Florida's bad faith statute] all materials, including documents, memoranda, and letters contained in the underlying claim and related litigation file material that was created up to and including the date of resolution of the underlying disputed matter and pertain in any way to coverage, benefits, liability or damages should also be produced in a first party bad faith action."[7]

If the focus of the bad faith action is the conduct of the claims handler, the discovery will be directed to the claims file materials and depositions of the insurer's personnel who were involved in the underlying case. Essentially, this is "bottom-up" discovery, i.e., the plaintiff's approach focuses on the lower end of the insurer's structure and the people who were "hands on" in the adjusting process. If the plaintiff can establish that the claims handler was, indeed, a "B.U.M." the plaintiff's discovery efforts may be less intrusive. However, as the culpability of the claims handler becomes less obvious, the plaintiff is likely to shift the discovery approach to the "institution."

By attacking the insurer, the plaintiff hopes to establish that the insurer's management created an organizational environment that fosters bad faith. Institutional bad faith claims often involve discovery regarding the insurer's claims handling "patterns and practices."[8] The plaintiff will attempt to demonstrate that the procedures established by upper level management created an

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[5] *Lee Craig, Ten Stupid Things Insurance Companies Do to Mess Up Their Files*, 14 Mealey's Litig. Rep.: Ins. Bad Faith 31 (Nov. 21, 2000), as quoted in Thomas F. Segalla, *Bad Faith As a Continuum: From Claim to Trial*, FICC Quarterly, Vol. 52, No. 1, at n. 13 (Fall 2001).

[6] "Underlying case" refers to the third party plaintiff's suit against the insured or the first party insured's action against the insurer for contract damages.

[7] *Allstate Indemnity Co. v. Ruiz*, 899 So.2d 1121, 1130 (Fla. 2005) (emphasis supplied). The mandate of *Ruiz* appears to be unlimited, which has created conflict with respect to material typically protected by the attorney-client privilege. The Florida intermediate appellate courts have held that *Ruiz* does not extend to materials protected by the attorney-client privilege. See, e.g., *West Bend Mut. Ins. Co. v. Higgins*, 9 So.3d 655, 657 (Fla. Dist. Ct. App. 2009); *XL Specialty Ins. Co. v. Aircraft Holdings, LLC*, 989.So.2d 578, 583 (Fla. Dist. Ct. App. 2006). Federal courts in Florida interpret *Ruiz* differently. They have consistently held that the Florida Supreme Court intended *Ruiz* to extend to claim file materials that would usually be protected by attorney-client privilege. See, e.g., *Law Offices of Lauri J. Goldstein, P.A. v. Maryland Cas Inc. Co*., 08-CV-14260-MARTINEZ/LYNCH (S.D. Fla. July 22, 2009); *Adega v. State Farm Fire & Cas. Ins. Co*., No. 07-20696-CIV, 2008 WL 1009719, at *1 (S.D. Fla. Apr. 9, 2008); *Nowak v. Lexington Ins. Co.*, No. 05-21682CIV-MORENO, 2006 WL 3613760, at *1 (S.D. Fla. June 22, 2006). *But see Sayre Enterprises, Inc. v. Allstate Ins. Co*., No. CIV 506CV00036, 2006 WL 361 3286 (W.D. Va. Dec. 11, 2006) (holding that privileged documents in the claims file are not subject to discovery in a bad faith claim).

[8] See Jonathan Gross, *Defending "Pattern and Practice" Evidence in Punitive Damage Cases*, 61 Def. Coun. J. 403 (1994).

atmosphere where the claims personnel were "just following orders" when they improperly handled the claim.

A classic example of an institutional bad faith claim is found in *State Farm Mutual Automobile Insurance Company v. Campbell*,[9] where the insureds contended that they were exposed to an excess liability judgment because the insurer promulgated a national scheme to meet corporate fiscal goals by capping payouts on claims. Similarly, see *Zilisch v. State Farm Mutual Automobile Insurance Company*[10] where the insured sued for bad faith refusal to pay policy limits on an uninsured motorist claim. The insured introduced evidence suggesting that, to increase profit, the insurer set arbitrary claim payment goals for its claims personnel. The insurer rewarded claims handlers with promotions and salary increases for achieving those goals.

Actions alleging institutional bad faith and actions alleging bad faith by the claims handler are not mutually exclusive. Both may be asserted simultaneously. However, in most situations, the intensity of pattern and practice discovery is in inverse proportion to the degree of culpability by the claims handler. The more obvious it is that the claims handler is a "B.U.M.," the less need there is for the plaintiff to show that the institution caused the conduct in question. Stated differently, the plaintiff's emphasis will be on "bottom-up" discovery when the claims handler's conduct is the gravamen of the bad faith claim and "top-down" discovery when the plaintiff contends that the policies and practices implemented by upper level management created an environment that encouraged bad claims handling.

The elements required to prove a bad faith claim differ significantly from state to state. Some states define bad faith as an action in tort,[11] others as a contract claim.[12] In some states bad faith suits are a creature of statute.[13] Some states require proof of outrageous or wrongful conduct,[14] others employ the reckless test,[15] and others have reduced the standard to mere negligence.[16] In some states an insurer may defend a bad faith action by showing that its conduct

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[9] *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003).

[10] *Zilisch v. State Farm Mut. Auto. Ins. Co*., 995 P.2d 276 (Ariz. 2000). *Zilisch and Campbell*, *supra*, involved claims for punitive damages. Obviously, top-down discovery becomes critical in punitive damage cases because of the need to show institutional culpability. The discovery approaches discussed herein will be applicable to punitive damage cases. However, the standards for awarding punitive damages are beyond the scope of this article and there will be no attempt to distinguish between claims for compensatory or punitive damages in the discussion that follows.

[11] E.g., *State Farm Fire & Cas. Co. v. Brechbill*, 144 So. 3d 248, 258 (Ala. 2013); *Noble v. Nat'l Am. Life Ins. Co.*, 624 P.2d 866, 868 (Ariz. 1981).

[12] E.g., *Cramer v. Ins. Exch. Agency*, 675 N.E.2d 897, 904 (Ill. 1996); *Spencer v. Aetna Life & Cas. Ins. Co.*, 611 P.2d 149, 158 (Kan. 1980). Illinois, Maryland, and others recognize both contract and tort theories. E.g., *Cramer*, 675 N.E.2d at 904.

[13] E.g., Florida considers bad faith actions to be grounded in contract, but first party bad faith suits are limited to violations of §624.155, Florida's bad faith statute. In Georgia, O.C.G.A. § 33-4-6 provides the exclusive remedy for an insurer's bad faith refusal to pay insurance proceeds. *Valles v. State Farm Fire & Cas. Co.*, No. 1:19-CV-5593-MLB, 2021 WL 322097, at *7 (N.D. Ga. Feb. 1, 2021).

[14] In Ohio, the insurer must act with a dishonest motive.

[15] In New York, the test is gross disregard for the insured's interests. *VanNostrand v. New York Cent. Mut. Fire Ins. Co.*, 131 N.Y.S.3d 399, 401 (N.Y. App. Div. 2020).

[16] E.g., Massachusetts.

was "fairly debatable"[17] or the subject of a "genuine dispute."[18] Florida has established the rule that bad faith is determined by the "totality of the circumstances."[19]

The jurisdictional disparities regarding bad faith preclude a universal definition of permissible top-down discovery. This article is intended to serve as a primer for the discovery process in an institutional bad faith action. It will discuss what discovery may be propounded by the plaintiffs; what objections may be made by the insurer; what approaches courts have implemented to resolve the disputes; and, what strategies may be successful for the parties.

GENERAL DISCOVERY PRINCIPLES:

IS IT RELEVANT?

Relevance is the ultimate criterion for all discovery. Rule 26 of the Federal Rules of Civil Procedure provides that the parties may obtain discovery regarding any matter, not privileged, which is relevant to the issues in the action and proportional to the needs of the case, irrespective of the admissibility of the information at trial. All jurisdictions promote liberal discovery - if the information is admissible at trial or reasonably calculated to lead to the discovery of admissible evidence, objections based solely on the ground of relevance will be difficult to sustain.

Nevertheless, an insurer opposing discovery in an institutional bad faith action should consider a relevance objection, especially if it can be joined with other objections. The most fertile source for developing a viable relevance objection is the published opinions in the applicable jurisdiction. For example, in *State Farm v. Campbell*,[20] the Utah trial court allowed the plaintiffs to introduce testimony regarding fraudulent practices by State Farm in its nationwide operations "orchestrated from the highest levels of corporate management." Many of the practices had no connection to third-party automobile insurance, the type of claim at issue in the case. In reversing a punitive damage award, the Supreme Court noted that State Farm was being punished for a 20-year period of malfeasance, including conduct that may have been lawful in the state where it occurred, and which bore no relationship to the conduct alleged by the plaintiff.

Relevance is a basis for an insurer to object to top-down discovery that is unrelated to the allegations in the plaintiff's bad faith complaint. For example, if the bad faith claim is based on the insurer's refusal to settle a liability suit within policy limits, a request for production of all bad faith complaints filed against the insurer in first party bad faith actions, may be subject to a relevance objection. Similarly, patterns and practices that are applied in different jurisdictions may not be relevant. The potential for having a relevance objection sustained is enhanced if the

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[17] E.g., *Sch. Excess Liab. Joint Ins. Fund v. Illinois Union Ins. Co.*, No. CV 20-4951(SDW)(LDW), 2021 WL 248860, at *4 (D.N.J. Jan. 26, 2021) (applying New Jersey law); *Preis v. Lexington Ins. Co.*, 508 F. Supp. 2d 1061, 1077 (S.D. Ala. 2007)(applying Alabama law).

[18] Under California law, for example, there can be no finding of bad faith "if the insurer conducts a 'thorough and fair' investigation, after which there remained a 'genuine dispute' as to coverage liability." *Ives v. Allstate Ins. Co.*, No. 220CV02505ABAGRX, 2021 WL 667591, at *4 (C.D. Cal. Feb. 19, 2021).

[19] *Berges v. Infinity Ins. Co.*, 896 So. 2d 665, 680 (Fla. 2004).

[20] See *supra* note 8.

objection can be linked to other objections such as privilege, overbreadth, or that the insurer will be subjected to undue burden and expense.

IS IT PRIVILEGED?

The Attorney-Client Privilege. The purpose of the attorney-client privilege is to encourage candid communications between the client and counsel and, thus, enhance the administration of justice.[21] Discovery which may invade the attorney-client privilege is often attempted in bad faith actions alleging improper claims handling. Issues pertaining to the attorney-client privilege occur less frequently in institutional bad faith actions because those cases are directed at the patterns and practices established by upper level management. Nevertheless, insurers must be sensitive to the fact that discovery requests in an institutional bad faith action may invade the attorney-client relationship. For example, the insurer may have consulted counsel to obtain advice regarding the drafting of policy language to achieve a certain result. A plaintiff's request for documentation pertaining to the preparation of a policy form should draw an objection regarding communication with insurer's counsel regarding on the intended interpretation of the policy. Likewise, a request by the plaintiff for other similar claims files to seek evidence that the insurer's practices and procedures encourage bad faith will require disclosure of attorney-client communications in every file that is produced.

The Work Product Privilege. The work product privilege is less applicable to top down discovery seeking evidence of institutional bad faith. The purpose of the work product privilege is to protect materials prepared in anticipation of specific litigation. The insurer's patterns and practices that allegedly encourage wrongful claims handling may not be protected by the work product privilege unless the discovery seeks the insurer's work product related to defense of the bad faith action.[22] The privilege may also be asserted to protect work product in situations the court permits the discovery of other bad faith claims, especially if the files contain mental impressions, conclusions or legal theories related to the defense of those claims.

[21] See *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981).

[22] Although it is not germane to the topic of top-down discovery, it is appropriate to note that insurers should anticipate the likelihood that the claims file of the underlying case will be produced in a bad faith action. Therefore, it is appropriate to carefully review the claims file to ensure that it does not contain documentation relating to work product in anticipation of bad faith litigation and to object to production of those documents. For example, the claims file may reflect that bad faith was threatened before the underlying case was concluded and that claims personnel included comments reflecting their opinions, theories, or mental impressions regarding the potential claim and the defense thereof. An effort should be made to protect those documents under the work product theory. It is also prudent for insurers anticipating bad faith claims to open separate files for handling the insurance claim and evaluating or preparing for bad faith litigation and delegate different personnel to handle the underlying claim and the potential bad faith action. This is equally true in jurisdictions where the bad faith action and the underlying case may be prosecuted simultaneously.

SPECIFIC EXAMPLES OF TOP-DOWN DISCOVERY

INSURER'S FINANCES

PLEASE PRODUCE THE INSURER'S FINANCIAL STATEMENTS AND ANNUAL REPORTS FOR THE LAST TEN YEARS INCLUDING, BUT NOT LIMITED TO, DOCUMENTS RELATED TO THE INSURER'S PROFITABILITY AND THE PROFITABILITY OF THE POLICY AT ISSUE IN THE UNDERLYING CASE

Plaintiffs may attempt to obtain financial records from the insurer to demonstrate that the insurer's management had a financial incentive to require that its claims personnel engage in the activity which is the gravamen of the plaintiff's bad faith claim. For example, in *Saldi v Paul Revere Life Insurance Company*[23] the insured sued for wrongful termination of disability benefits. The insured contended that the reason for the insurer's denial of his claim was that the subject policy had proven to be non-profitable and expensive. The insured requested all profitability analyses pertaining to the type of policy owned by the insured, as well as other information regarding "cash flow underwriting," interest rate projections, and the relationship between investment income and premiums charged for individual policies. The insurer objected, arguing that the information was irrelevant, proprietary, privileged, and confidential. The plaintiff proffered that the information was relevant to prove that the insurer knew that the pricing structure for the policy was not profitable unless the insured terminated valid claims or engaged in "post-claim underwriting" and that the insurer had previously acknowledged profitability problems with similar insurance policies. Accordingly, the court found that the information was relevant to the insurer's motivation to terminate the insured's policy.

Similarly, in *Smith v. Life Investors Insurance Company of America*[24] the plaintiff requested financial information and financial statements of the insurer and its corporate parent, contending that the information would demonstrate that the insurer changed the interpretation of a term in a supplemental cancer policy to improve profitability. The court allowed the discovery, although the court's order appears to be based primarily on the plaintiff's entitlement to financial discovery in an action seeking punitive damages.[25]

In short, courts appear willing, subject to appropriate confidentiality orders, to permit discovery of an insurer's communications and financial statements regarding losses on a particular type of policy because that information may relate to the insurer's motivation to deny a claim.[26]

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[23] 224 F.R.D. 169 (E.D. Pa. 2004).

[24] No. 2:07-CV-681, 2009 WL 3364933, at *4-5 (W.D. Pa. Oct. 16, 2009).

[25] See also *Kleinz v. Unitrin Auto & Home Ins. Co.*, No. 2:19-CV-01426-PLD, 2020 WL 7641805, at *1 (W.D. Pa. June 22, 2020) (requiring production of financial statements in bad faith action where plaintiff sought punitive damages).

[26] *Central Ga. Anesthesia Servs. v. Equitable Life Assurance Society of the U.S.*, No. 5:06-CV-25, 2007 WL 2128184, at *3 (M.D. Ga. July 25, 2007). But see *Sinclair Wyoming Ref. Co. v. Infrassure Ltd*, No. 15-CV-194-F, 2016 WL 11588072, at *5 (D. Wyo. Nov. 7, 2016) (denying motion to compel discovery of insurer's financial information and finding such information to be irrelevant to bad faith claim).

CLAIMS HANDLING AND CLAIMS HANDLERS

PLEASE PRODUCE ALL DOCUMENTS PERTAINING TO COMPENSATION AND PERFORMANCE REVIEWS, INCLUDING THE COMPLETE PERSONNEL FILES, OF ALL CLAIMS PERSONNEL WHO WERE INVOLVED IN THE UNDERLYING CASE

Plaintiffs often seek information regarding the insurer's personnel who handled the underlying claim. Who are those individuals? How qualified were they? What is their employment history and education? Were they trained appropriately? Were they supervised? How well did they do their job, as determined by the insurer? Were they on vacation at a crucial juncture in the claim history?[27] Plaintiffs may request discovery of personnel files, as well as records of discipline, complaints, reviews, compensation, claims-handling and denial history of the claims handlers in question. Plaintiffs assert that this information may demonstrate that the insurer encouraged its personnel to "deny, delay or defend" legitimate claims to enhance profitability, and that the institution tracked the employees' performance to reward those who achieved the intended result or discipline those who did not. Other arguments advanced for obtaining personnel files are that the files demonstrate the insurer's "knowledge [and] approval" of improper claims handling practices[28] and greater insight into the insurer's "corporate mentality."[29]

"Federal courts have recognized a 'heightened standard of relevance' for discovery of information contained in personnel files."[30] Nevertheless, courts generally recognize that information regarding the individual claims-handlers actually involved in the underlying claim is

[27] See *Johnson v. GEICO Gen. Ins. Co*., No. 07-80310-CIV, 2007 WL 3344253, at *3, 5 (S.D. Fla. Nov. 7, 2007) (adjuster "allegedly went on vacation during a time period relevant to this claim," and "[information about the dates and hours worked of the individuals assigned to the ... claim is relevant to this bad faith action"); See also *Whitney v. Esurance Ins. Co.*, No. 13-61329-CIV, 2013 WL 12092069, at *2 (S.D. Fla. Oct. 18, 2013)(finding that claims handler personnel files were relevant or likely to lead to the discovery of admissible evidence in bad faith action).

[28] *Grange Mut. Ins. Co. v. Trude*, 151 S.W.3d 803, 815 (Ky. 2004); see also *Welle v. Provident Life & Accident Ins. Co.*, No. 312CV3016EMCKAW, 2013 WL 6020763, at *1 (N.D. Cal. July 31, 2013) (allowing discovery of claims handler performance reviews based on *Trude* rationale).

[29] *Allstate Ins. Co. v. Scroghan*, 851 N.E.2d 317, 323 (Ind. Ct. App. 2006).

[30] *Saldi v. Paul Revere Life Ins. Co.*, 224 F.R.D. 169, 184 (E.D. Pa. 2004).

relevant and discoverable.[31] Of course, the parties may disagree as to who was "involved"[32] and as to the relevance of supervisors' information.[33]

Courts are sensitive to the impact of such disclosure on the individual employees' privacy—typically they are not parties to the suit.[34] Accordingly, courts often protect information such as medical history and social security numbers,[35] explicitly subject the information to a

[31] See *Wiggins v. Gov't Employees Ins. Co.*, No. 316CV01142TJCMCR, 2017 WL 3720952, at *2 (M.D. Fla. July 10, 2017) (compelling documents related to "the training, competency, performance evaluations and other information of" the primary claims adjusters and two supervisors because "employee incentives, training, and competence [are] relevant in bad faith insurance claims"); *Waters v. Continental Gen. Ins. Co*., No. 07-CV-282-TCK-FHM, 2008 WL 2510039, at *1 (N.D. Okla. June 19, 2008) (finding relevant and requiring production of "information from the personnel files which pertains to the adjusters' background, qualifications, training and job performance," but "only for those adjusters who actually handled some aspect of Plaintiff's claim"); *Jones v. Liberty Mut. Fire Ins. Co*., No. 3:04-CV-l 37-MO, 2008 WL 490584, at *3 (W.D. Ky. Feb. 20, 2008) (compelling production of "job performance information" for "the adjuster and other employees who bore any responsibility, directly or indirectly, for the handling of this claim"); *Stokes v. Life Ins. of N. Am*., CV 06-41 1-S-LMB, 2008 WL 2704564, at *1-2 (D. Idaho July 3, 2008) (compelling production of "personnel files for four specific claims handlers who had substantial involvement" with plaintiff's claim); *Saldi*, 224 F.R.D. at 184-85 (evaluations of the "individuals or units involved in investigating Plaintiff's claim" were relevant and discoverable, as well as documents explaining "the criteria and process used in those evaluations," and "personnel files and performance reviews of the employees who handled Plaintiff's claim"). But see *Fullbright v. State Farm Mut. Auto. Ins. Co*., No. CIV-09-297-D, 2010 WL 300436, at *4 (W.D. Okla. Jan. 20, 2010) (refusing to permit discovery of the involved adjusters' "merit pay or related salary information," or the "disciplinary materials" in their personnel files, in light of the plaintiff's "speculation" and lack of "justification").

[32] See *Hamilton Mut. Ins. Co. of Cincinnati v. George*, No. 2005-SC-000818-MR, 2006 WL 1652237 at *2-3 (Ky. June 15, 2006) (insurer contended that personnel files were irrelevant because the individuals had "nothing to do with the claim handling in this case," but the court concluded otherwise, where they "all participated 'in a round-table discussion,'" and "were involved in internal discussions of the insurance claim ... conducted in furtherance of the...processing of the claim").

[33] See *Fullbright*, 2010 WL 300436, at *4 (information regarding the adjusters involved was discoverable, but not "the background, qualifications, and job performance of all supervisory personnel"); *Waters*, 2008 WL 2510039, at *1 (finding relevant and requiring production of "information from the personnel files which pertains to the … background, qualifications, training and job performance," for "those supervisors [who] participated in adjusting the claim in some manner"); *DeKnikker v. Gen. Cos., No*. Civ. 07-41 17, 2008 WL 1848144, at *2 (D. S.D. April 23, 2008) ("[P]ersonnel files are not discoverable" for persons not "directly involved in the decisions about plaintiff's claim"); *Saldi*, 224 F.R.D. at 184-85 ("personnel files and performance reviews" were relevant and discoverable, as to the supervisors "of the employees who handled Plaintiff's claim").

[34] See *Fullbright*, 2010 WL 300436 at *2 ("Personnel files are regarded as private and contain material which employees regard as confidential, and a court must be cautious in ordering their disclosure."); *Pochat v. State Farm Mut. Auto. Ins. Co*., No. Civ. 08-5015-KES, 2008 WL 5192427 at *6 (D. S.D. Dec. 11, 2008) ("As attested to by State Farm through affidavit, personnel files contain the employees' confidential information .... These employees are not parties to this lawsuit, but rather are private individuals with legitimate privacy concerns.").

[35] See *DeKnikker*, 2008 WL 1848144, at *3 ("[P]rivate information such as personal identification information and health information" would be excluded from discovery).

confidentiality order,[36] restrict the use of the information to the instant lawsuit,[37] and/or hold an in-camera review[38] of the requested records. Also, the court may require plaintiff to state what specific materials are sought, and limit the production rather than order production of the entire file.[39] Some documents may be subject to further pruning, such as producing only those portions of performance evaluations that "relate to claims handling conduct."[40] Finally, as with other categories, such discovery may be confined to a reasonable time frame.[41]

CLAIMS HANDLING POLICIES, PROCEDURES AND MANUALS

PLEASE PRODUCE ALL CLAIMS MANUALS OR OTHER DOCUMENTATION RELATING TO INSURER'S POLICIES AND PROCEDURES FOR CLAIMS HANDLING

Plaintiffs often seek to discover an insurer's claims handling policies and procedures by requesting claims manuals or similar documentation. Court decisions differ based, in part, on the substantive law of the jurisdiction. For example, in states that apply an objective standard of bad faith, courts may find that the liability insurer's claims handling manuals are not relevant to that objective determination.[42] However, where the standard requires the plaintiff to demonstrate an "intentional act," courts have concluded that manuals are relevant to demonstrate that the claims handler did not follow mandated policies and procedures.[43] Stated differently, "top-down" discovery may be relevant for the purpose of evaluating "bottom-up" conduct.

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[36] See *Fullbright*, 2010 WL 300436, at *5 (information produced from personnel files would be subject to the parties' agreed protective order); *Pochat*, 2008 WL 5192427, at *6 (personnel file materials subject to a limited protective order, to prevent the information "from being disseminated to third parties"); *Saldi*, 224 F.R.D. at 185 n. 22 ("We have addressed any potential concerns about maintaining the privacy of the employees with our general order requiring that Plaintiff not exchange or disclose these records to anyone not associated with the case.").

[37] See *Waters*, 2008 WL 2510039, at *1 ("The information produced from the personnel files may be used in this case only.").

[38] See *DeKnikke*r, 2008 WL 1848144, at *3 ("If there is other information the defendants believe fits the category of 'private' which should not be discoverable, the information should be provided to the court for an in camera inspection."); *Hamilton Mut. Ins. Co*., 2006 WL 1652237, at *4 ("The trial court insured that privileged information not be furnished...by offering to conduct an in camera review of the documents before they were ordered released.").

[39] See *Fullbright*, 2010 WL 300436, at *4 ("The Court sees no justification for producing the entire personnel file of any employee." Thus, only enumerated information would be produced.); *Grange Mut. Ins. Co.*, 151 S.W.3d at 815, 818 ("[M]any of the items likely to be found in personnel records (e.g., original job application, marital information, tax and dependent data, medical information, health insurance data, worker's compensations claims, and retirement account data) are irrelevant to a bad faith claim and thus are not discoverable," whereas other information "(e.g., related to job performance, bonuses, wage and salary data, disciplinary matters) is relevant").

[40] *Cunningham v. Standard Fire Ins.*, No. 07-cv-02538-REB-KLM, 2008 WL 2668301, at *4 (D. Colo. July 1, 2008) ("[T]o the extent that the performance evaluations address other subjects, they are not relevant").

[41] See *Saldi*, 224 F.R.D. at 184 (denying defendants' request for protective order against disclosure, but "chang[ing] the relevant dates in the discovery request" from 1992 "to June 1996, when Plaintiff first applied for benefits").

[42] See *Hadenfeldt v. State Farm Mut. Auto. Ins. Co*., 239 N.W.2d 499, 504 (Neb. 1976) (insurer's standards or rules and the manuals were not relevant to any issue in the case and no good cause was shown for their production).

[43] See *Miel v. State Farm Mut. Auto. Ins. Co*., 912 P.2d 1333, 1337, 1339 (Ariz. Ct. App. 1995), review granted, (Mar. 19, 1996) and review dismissed, 923 P.2d 836 (Ariz. 1996) (under an "intentional act" standard). See also, *APL Corp.*

Issues relating to discovery of claims manuals are the centerpiece of the nationwide litigation sparked by Allstate's adoption of certain policies and guidelines known as part of its "Claim Core Process Redesign" ("CCPR"). The development of Allstate's CCPR is the subject of David J. Berardinelli's book *From Good Hands to Boxing Gloves*: *The Dark Side of Insurance, and numerous lawsuits*. In those lawsuits, plaintiffs allege that Allstate hired McKinsey & Company ("McKinsey") to analyze Allstate's automobile bodily injury claims and handling procedures.[44] According to an appellate court in Washington, the "concepts and motivations that McKinsey suggested are summarized in a series of slides, which have become known as the McKinsey documents."[45] Allstate's CCPR implemented changes to its business practices in response to the McKinsey documents.[46]

Plaintiffs allege that Allstate employed the McKenzie procedures to reduce payments by mandating different claims handling approaches for represented and unrepresented claimants.[47] Colossus, a computer program, was "an integral part" of CCPR as a claim evaluation tool.[48]

Allstate has waged discovery battles to limit discovery of documents and information related to the CCPR manual, the McKenzie documents, and Colossus with varying levels of success. Courts have implemented three general approaches, including (1) refusing to permit discovery because it is irrelevant to a bad faith action; (2) permitting discovery but making it subject to a confidentiality order; and (3) permitting discovery without requiring a confidentiality order. These approaches are generally applicable to claims manual discovery in all bad faith cases.

Claims manuals irrelevant. Some courts have refused to permit discovery of information related to CCPR, the McKenzie documents, and Colossus, reasoning that such information is not relevant to the bad faith claim before the court.[49] This approach prevails in jurisdictions where bad

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v. Aetna Cas. & Sur. Co., 91 F.R.D. 10, 14-15 (D. Md. 1980) (where the court compelled production of the claims manuals to determine whether the claims handler properly investigated the claim. It should be noted that the court rejected a work product privilege objection because the manuals were prepared in the ordinary course of business and not in anticipation of litigation.)

[44] *McCallum v. Allstate Prop. & Cas. Ins. Co*., 204 P.3d 944, 946-47 (Wash. Ct. App. 2009); *Loubier v. Allstate Ins. Co*., No. 3:09cv261JBA, 2010 WL 1279082, at *2 (D. Conn. March 30, 2010).

[45] *McCallum*, 204 P.3d at 946-47.

[46] *Allstate Ins. Co. v. Scroghan*, 851 N.E.2d 317, 324 (Ind. Ct. App. 2006).

[47] See, e.g., *Loubier*, 2010 WL 1279082, at *2; *Jacobsen v. Allstate Ins. Co.*, 215 P.3d 649, 653-54 (Mont. 2009) (stating that the CCPR "implemented certain policies and guidelines designed to promote quick settlements with unrepresented claimants").

[48] *Quynh Truong v. Allstate Ins. Co*., 227 P.3d 73, 76 (N.M. 2010).

[49] See *Dombach v. Allstate Ins. Co*., No. CIV. A. 98-1652, 1998 WL 695998, at *7 (E.D. Pa. Oct. 7, 1998) (denying discovery request related to CCPR as "obviously overbroad" in spite of allegations Allstate acted in bad faith due to an alleged "corporate policy of training and encouraging its claims personnel to pay as little as possible as late as possible on the claims of its insureds in order to reduce the amount of the average paid claim and maximize claims profit," because "discovery should be aimed at disclosing whether defendant in this particular case (1) did not have a reasonable basis for offering $10,000: and (2) knew or recklessly disregarded its lack of a reasonable basis."): cf. *Milhone v. Allstate Ins. Co.*, 289 F. Supp. 2d 1089, 1101 (D. Ariz. 2003) (granting Allstate's motion for summary judgment in a case alleging Allstate committed bad faith by implementing the CCPR after Allstate performed an internal audit and concluded that it was routinely overpaying claims by 15%, and by requiring adjusters to keep payments under the amount suggested by Colossus or suffer a negative performance review, and concluding "general

faith claims must be based upon conduct and practices applied in the specific case, not all of the insurer's practices and procedures. For example, a federal court in Pennsylvania held that:

> This court has typically dealt with such disputes by allowing "pattern and practice" requests only "when a bad faith policy or practice of an insurance company is applied to the specific plaintiff." . . .Limiting discovery to the practices applied to the individual plaintiff is the preferable approach, as the "issue in a bad faith case is whether the insurer acted recklessly or with ill will towards the plaintiff in a particular case, not whether the defendants' business practices were generally reasonable." ... That is because "[w]hat constitutes a reasonable set of business practices for the investigation and evaluation of claims is a question properly left to the Pennsylvania Insurance Commissioner, not a judge or a jury."[50]

Claims manuals may be produced subject to confidentiality order. In other jurisdictions, courts have held that information related to CCPR, the McKenzie documents, and Colossus is relevant but should be protected pursuant to Allstate's trade secret and confidentiality objections.[51] It is important to note, however, that the insurer must establish a basis for confidential treatment.[52]

Claims manuals discoverable. Courts in some jurisdictions have required production of CCPR, the McKenzie documents and Colossus notwithstanding relevance objections and

allegations of bad faith, assuming they are true, did not affect the processing of Plaintiff's claim in this case ... the Court finds that a cause of action for bad faith cannot lie based on these allegations").

[50] *Santer v. Teachers Ins. & Annuity Ass'n*, No. 06-CV-1863, 2008 WL 755774, at *2-3 (E.D. Pa. March 18, 2008) (internal citations omitted).

[51] See, e.g., *Allstate Ins. Co*., 851 N.E.2d at 319-20 (trial court abused its discretion in denying protective order for McKenzie and Colossus documents, but did not abuse its discretion in finding such information was relevant over Allstate's objection that "such information is irrelevant to his bad faith claim because its general business practices and motivations are not at issue; only its behavior regarding Scroghan's claim is at issue"); see also, *Brown v. Great Northern Ins. Co*., No. 3:CV-05-0439, 2006 WL 2246408, at *1 (M.D. Pa. Aug. 4, 2006) (holding that an insurance claims manual is discoverable in a bad faith claim, but the contents must remain confidential).

[52] See *McCallum*, 204 P.3d at 946-47 (declining to grant protective order for Allstate's claim manuals, claim bulletins, CCPR, and the McKinsey documents because insurer failed to provide concrete examples to illustrate how its strategies or procedures in handling claims were materially different from those of its competitors. Affidavits provided by insurer consisted of conclusory statements and unsubstantiated assertions that were insufficient to establish that manuals and bulletins contained trade secrets).

Allstate's requests for protective orders.[53] Such decisions hold that under certain circumstances an insurer's internal policies and procedures for adjusting claims are relevant to a bad faith claim.[54]

OTHER CLAIMS FILES

PLEASE PRODUCE ALL DOCUMENTS RELATING TO BAD FAITH CLAIMS ASSERTED AGAINST INSURER DURING THE LAST TEN YEARS

Discovery of other claims against the insurer is a hotly contested subject in institutional bad faith cases. Plaintiffs contend that the information is relevant for many reasons, including, that other claim files will demonstrate the insurer's pattern and practice of bad faith; the insurer's knowledge of poor performance of claims handlers; and the insurer's interpretation of policy language. In punitive damage cases, the plaintiff will argue that the existence and frequency of bad acts are relevant to punitive damages. Often the unstated reason for discovery of other claims is to demonstrate that the insurer is an evil institution.[55] In order to oppose the plaintiff's production of other claims, insurers must challenge similar claim-file discovery on many grounds, including relevance, undue burden, disclosure of privileged information, and invasion of the privacy of innocent persons not party to the case.

Courts have used different approaches in permitting discovery of other insureds' claim files or limiting the discovery. The first inquiry is relevancy. For example, courts are willing to restrict the time period of the plaintiff's request. Evidence of events occurring after commission of the alleged bad faith may not be probative regarding the insurer's state of mind at the time of the

[53] See *Doan v. Allstate Ins. Co.*, No. 5:07-CV-l 3957, 2008 WL 2223123, at *3 (E.D. Mich. May 23, 2008) (denying protective order regarding CCPR and McKinsey documents over Allstate's objection that such information is not relevant in a first party bad faith claim and is "unique to Allstate's claim handling process, has independent economic value to Allstate, was prepared at great expense to Allstate, is not provided to other carriers, with access to said information limited to a small group of authorized individuals"); *Jacobsen*, 215 P.3d at 661 ("The McKinsey documents were indeed critical to Jacobsen's theory that Allstate's policies regarding unrepresented claimants constituted bad faith.").

[54] See *Grange Mut. Ins. Co*., 151 S.W.3d at 812-13 ("The question is whether Grange's own policies, as described in the manuals, embody or encourage bad faith practices …. Grange's training and policy manuals are relevant to Wilder's bad faith claim, and absent some sort of privilege or other showing of irreparable harm, they are discoverable."); *Moe v. Sys. Trans., Inc*., 270 F.R.D. 613, 631 (D. Mont. 2010) (claims manuals, and related policies, memoranda, correspondences, letters or other documents "relative to the subject of claims handling are relevant at least with respect to" common law bad faith claims).

[55] Discoverability and admissibility of other bad faith claims are different issues. For discovery issues, relevance is the key, i.e., does the information potentially lead to the discovery of admissible evidence. However, evidence of other wrongs is not admissible as character evidence to show the insured's disposition to commit bad acts. Nevertheless, the information may be admitted for other purposes such as to demonstrate motive, opportunity, intent, knowledge or absence of accident or mistake. See Fed. R. Evid. 404(b).

conduct in question.[56] Moreover, the insurer's actions at a remote period of time[57] or at a remote location[58] have been held to be irrelevant and, therefore, not discoverable.

Some courts decline to require insurers to produce other claims files reasoning that past claims by other insureds are not relevant to the plaintiff's bad faith claim.[59]

The key to relevancy is similarity between the case at issue and the requested discovery. There must be "some nexus or connection" between the prior cases and the case before the court.[60]

Courts have also demonstrated concern for confidentiality of non-parties who were involved in the other bad faith actions.[61] For example, one court observed that "insureds who are not involved in this litigation have a recognized privacy right with regard to information maintained by their insurers" and directed the insurer to redact the complaining parties' names, addresses, and other identifying information before producing the documents.[62]

Insurers frequently assert undue burden and expense as a basis for denying or limiting discovery of other bad faith files. Courts are sensitive to the practical considerations implicated

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[56] *Schneider v. Revici*, 817 F.2d 987 (2d Cir. 1987) (not a bad faith case).

[57] See *Allstate Ins. Co. v. Scroghan*, *supra* note 28 (where the plaintiff requested all documents relating to bad faith claims or lawsuits filed against Allstate since 1990, the court limited the request to the time period from 1994 to 1997 and limited the plaintiff's request to the state where the insured resided).

[58] See *Dombach*, *supra* note 48 (where the court refused to compel discovery of "all complaints against (the insurer) in any court outside Pennsylvania" because it was overbroad.)

[59] *Ex parte Finkbohner*, 682 So.2d 409, 413-14 (Ala. 1996) (affirming denial of motion to compel information regarding "similarly situated insureds who had valid claims wrongfully denied by Principal Mutual, wherein the insurer misapplied its own definition as contained in the policy drafted by the insurer" where insured argued "this discovery may identify a pattern, practice, scheme or plan, on behalf of the insurer to wrongfully deny claims based upon its undisclosed and secret definition of 'cosmetic surgery.'"); *Adams v. Allstate Ins. Co*., 189 F.R.D. 331, 333 (E.D. Pa. 1999) ("Plaintiff requests documents and information relating to past claims brought by other Allstate insureds. Past claims by other insureds are not relevant to the present bad faith action before the court."); *National Sec. Fire & Cas. Co. v. Dunn*, 751 So.2d 777, 778-79 (Fla. Dist. Ct. App. 2000) (denying discovery of other claims files despite plaintiffs assertion those files "were of significant relevance to prove a general business practice of bad faith claims" where no showing of need or inability to obtain the substantial equivalent without undue hardship had been made).

[60] *Saldi*, 224 F.R.D. at 196 (limiting plaintiff's requests to bad faith cases in Pennsylvania involving a similar policy to the policy in the underlying case and handled by the same adjusting unit that handled the plaintiff's case). In *Fullbright*, 2010 WL 300436, at *6 (narrowing the scope of the plaintiff's request for production of other bad faith claims to "documents reflecting other Oklahoma complaints regarding the processing of uninsured or underinsured motorists claims handled by the same adjusters who investigated plaintiff's claim for the time period of two years preceding the submission of the plaintiff's claim.").

[61] *See Aztec Life Ins. Co. of Texas v. Dellana*, 667 S.W.2d 911, 915-16 (Tex. Ct. App. 1981) (where the appellate court ordered the trial court to examine the other claims files in camera to determine whether the files contained privileged matter or other non-discoverable matters).

[62] *Fullbright*, *supra* note 30; *Peco Energy Co. v. Insurance Co. of North America*, 852 A.2d 1230, 1235 (Pa. Super. Ct. 2004).

by expansive discovery requests, e.g., "discovery should go forward but, if challenged, a balance must be struck between the need for information and the burden of supplying it."[63]

Some courts refuse discovery of overly broad requests, e.g., see *Domboch v. Allstate Ins. Co.*[64] where the court denied a motion to compel production of other bad faith cases because, "where counsel, as here, makes an obviously overbroad request for documents, I do not think it is the responsibility of the trial judge to redefine and redraft the request. Counsel should tailor requests to meet proper discovery needs that will be useful in the preparation for the trial of the issues in litigation."[65]

Other courts use their own discretion in limiting expansive requests. For example, in one case the court took a more lenient approach motivated, perhaps, by the plaintiff's willingness to cooperate, i.e. "[having considered plaintiff's request, its offer to narrow the scope of same, and the justifications given for obtaining the requested documents, the Court finds that plaintiffs have not given sufficient justification to produce the broad scope of material requested. However, the Court finds that the document request, if narrowed in scope, may lead to discovery of" admissible evidence.[66] Accordingly, the court compelled discovery of other bad faith claims pursuant to the court's view of what was reasonable.

Counsel for insurers opposing discovery requests for other claims files are reminded that the mere allegation of undue burden and expense is not likely to succeed. "Objections that state that a discovery request is 'vague, overly broad or unduly burdensome' are, standing alone, meaningless and fail to comply with the local rules and Rule 34's requirement that objections contain a statement of reasons."[67] An objection should be supported by an affidavit stating the number of claims files subject to the request, whether the information is kept in paper files or electronic medium, and the amount of time and expense necessary to identify and review the files.

Some courts, however, flatly refuse to limit discovery of other bad faith claim files. In *Mayfair House v. QBE*, a federal court held that *Allstate v. Ruiz*,[68] which made the claim files in the underlying case discoverable also required the discovery of "other insured claims files which

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[63] *WTHR-TV v. Cline*, 693 N.E.2d 1, 6 (Ind. 1998). In *Allstate Ins. Co. v. Scroghan*, *supra* note 28, at 323-24 ("[T]he trial court's actions in limiting Scroghan's discovery requests rather than finding them overly burdensome strikes the kind of discovery balance contemplated in *WTHR-TV*.")

[64] See *supra* note 48.

[65] *Id.* at *7.

[66] *Fullbright*, *supra* note 30, at *6.

[67] *Bank of Mongolia v. M&P Global Fin. Servs.*, 258 F.R.D. 514, 519 (S.D. Fla. 2009) (emphasis supplied) (The court admonished "[a] party objecting on these grounds must explain the specific and particular way in which a request is vague, overly broad, or unduly burdensome. In addition, claims of undue burden should be supported by a statement (generally an affidavit) with specific information demonstrating how the request is overly burdensome.") (This was not a bad faith case.)

[68] See *supra* note 6.

relate to and illuminate the manner in which the company handles claims of its other policy holders in the general course of its business."[69]

Courts not constrained by *Ruiz* have considered work product and attorney client privileges pertaining to other claim files.[70] Even *Mayfair House* noted that documents in the other claims files prepared after the underlying litigation was concluded would be protected by privilege. Thus, the insurer must comb the other files to construct the appropriate privilege log.[71]

Privacy of other insureds is frequently cited as an objection to production of other bad faith files. Recent legislation, such as the Health Insurance Portability and Accountability Act and Gramm-Leach-Bliley, requires that certain information must be considered confidential, although these statutes have exceptions for judicial process. Moreover, some claim files will contain information protected by other privileges, such as claims for mental health. If the court requires production, it is appropriate to redact information which would violate the privacy of other claimants. Of course, the process of reviewing the other files to redact confidential information adds considerable expense to the process.

APEX DEPOSITIONS

SUBPOENA: THE PRESIDENT-CEO OF THE DEFENDANT INSURANCE COMPANY IS COMMANDED TO APPEAR TO TESTIFY AT THE TAKING OF A DEPOSITION IN THE BAD FAITH CASE

An attempt to depose the senior officers of the insurer is an example of top-down discovery that is likely to generate intense opposition. There is no per se rule prohibiting apex depositions. Nevertheless, courts appear to recognize that the technique is more tactical than probative and usually require a special showing before allowing the plaintiff to proceed. "Courts frequently restrict efforts to depose senior executives where the party seeking the deposition can obtain the same information through a less intrusive means, or where the party has not established that the executive has some unique knowledge pertinent to the issues in the case."[72] For example, in a suit

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[69] *Mayfair House Ass'n, Inc. v. QBE Ins. Corp*., No. 09-80359-CIV, 2010 WL 472827, at *4 (S.D. Fla. Feb. 5, 2010). The court's decision may have been influenced by the fact that the plaintiff was seeking punitive damages under the Florida statute which requires proof that the bad faith claims practices occur with such frequency as to indicate a general business nature. See § 625.155, Florida Statutes. This statute requires that the plaintiff pursuing punitive damages shall "post in advance the costs of discovery" to be awarded to the insurer if plaintiff does not recover punitive damages.

[70] E.g., *Aztec Life Ins. Co*., 667 S.W.2d at 915-16 (where the court ordered an in camera inspection of the other claims files to determine whether the material was privileged).

[71] *North River Ins. Co. v. Mayor & City Council of Baltimore*, 680 A.2d 480 (Md. 1996).

[72] *Cardenas v. Prudential Ins. Co. of Am*., No. Civ.99-1421, 2003 WL 21293757, at *1 (D. Minn. May 16, 2003). See, e.g., *Thomas v. Int'l Bus. Mach*., 48 F.3d 478, 483-84 (10th Cir. 1995) (upholding protective order prohibiting deposition of senior executive where lower level employees were available for deposition and where senior executive lacked personal knowledge of case); *Porter v. Eli Lily & Co*., No. 1:06-CV-l 297-JOF, 2007 WL 1630697, at *3 (N.D. Ga. June 1, 2007) (upholding protective order prohibiting deposition of CEO where plaintiff failed to show that executive has personal knowledge); *Baine v. Gen. Motors Corp*., 141 F.R.D. 332, 334-35 (M.D. Ala. 1991) (issuing a protective order and noting that where a high-level decision maker "removed from the daily subjects of litigation" has no unique personal knowledge of the facts at issue, a deposition of the official is improper).

alleging bad faith and fraud arising from a medical negligence claim, the Southern District of Florida refused to permit the deposition of the CEO of the defendant's holding company where the CEO "averred that he does not possess 'relevant unique knowledge as to the Defendant's defense strategy at issue in this case' and plaintiff was "given ample opportunity to obtain the desired information by other less intrusive means."[73]

On the other hand, in *Kelly v. Provident Life and Accident Insurance Co*.[74] the court denied a request for a protective order preventing the deposition of the regional vice president of claims, even though she had no personal involvement in the decision to deny the plaintiff's claims, because her information on how claims were handled was potentially relevant to the plaintiff's bad faith claim and the other supervisors of the claims handler were no longer employed. The court also observed that a vice president is "hardly the 'apex' of (the) Company."[75]

RESERVES

PLEASE PRODUCE ALL DOCUMENTS RELATING TO RESERVES ESTABLISHED IN THE UNDERLYING CASE

Plaintiffs frequently seek to discover the insurer's policies and procedures for establishing reserves as well as the actual reserves set by the claims handler. Plaintiffs argue that reserves are relevant to the insurer's evaluation of the exposure in the underlying case. Plaintiffs also contend that reserve information may show a "self conscious disconnect" between the insurer's internal evaluation of the underlying claim and its settlement conduct.[76] Insurers oppose disclosure of reserve information arguing that loss reserves are required by law and depend on various uniquely confidential assumptions and business considerations rather than the insurer's own evaluation of liability.[77]

The majority of courts hold that reserves are discoverable in bad faith actions because, although mandated by law, the reserves bear some relationship to the insurer's calculation of its potential liability.[78] The insurer opposing disclosure of reserve information should establish that reserves are not relevant to the issue of bad faith because reserves are a product of regulatory requirements, business considerations, the inclusion of costs in the reserve amount, and statistical

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[73] *Simon v. Pronational Ins. Co*., No. 07-60757-CIV, 2007 WL 4893478, at *l-2 (S.D. Fla. Dec. 13, 2007).

[74] *Kelly v. Provident Life and Acc. Ins. Co*., 695 F. Supp. 2d 149, 156-57 (D. Vt. 2010).

[75] *Id.* at 157.

[76] *Flintkote Co. v. Gen. Acc. Assurance Co. of Canada*, No. C 04-01 827 MHP, 2009 WL 1457974, at *3 (N.D. Cal. May 29, 2009).

[77] See *U. S. Fire Ins. Co. v. Bunge N. Am., Inc*., 244 F.R.D. 638, 644 (D. Kan. 2007) (insurers argued "that their loss reserves, which are required by law, are not evaluations of the particular claims, but instead depend on various assumptions and business considerations"); see also *U.S. Fire Ins. Co. v. City of Warren*, No. 2:10-CV-13128, 2012 WL 1454008, at *10 (E.D. Mich. Apr. 26, 2012) ("A reserve is … merely a business judgment made by an insurance company to guard against future loss; it does not reflect a legal determination of the validity of an insured's claim against the company.").

[78] See, e.g., *Park-Ohio Holdings Corp. v. Liberty Mut. Fire Ins. Co.*, No. 1:15-CV-943, 2015 WL 5055947, at *4 (N.D. Ohio Aug. 25, 2015); *Central Ca. Anesthesia Servs. v. Equitable Life Assurance Society of the U.S*., No. 5:06-CV-25 (CAR), 2007 WL 2128184, at *2-3 (M.D. Ga. July 25, 2007).

components applicable to setting and changing the reserve. These approaches persuade some courts to resolve disclosure of reserve information on a "case by case basis."[79] Moreover, reserves may not be relevant, e.g., in a case where the bad faith claim was based upon the insurer's denial of coverage, the court rejected a request for reserve information because "[t]he amount established as reserves does not demonstrate that [insurer] expected such claims to be covered by the policy and thus is not relevant."[80]

WHAT'S AN INSURER TO DO?

SOME STRATEGIES FOR OPPOSING TOP-DOWN DISCOVERY

In 1988, Thomas Workman wrote:

> Almost from the beginning of insurance litigation, securing access to the insurer's claims file has been one of the principal objectives of plaintiffs in cases involving insurance company defendants. In the past two decades plaintiffs have become increasingly successful in achieving this objective.[81]

Workman's observation about the discovery trends in insurance litigation, "in the past two decades" was both historically accurate and prescient. Two decades later, James Varner described institutional bad faith as "the 'Ebola' virus of extracontractual litigation"[82] and in 2010 Douglas R. Richmond wrote:

The theory of institutional bad faith allows a plaintiff to expand a dispute over a single loss into a widespread attack on an insurance company's practices and procedures as a theory of liability or as a means of establishing reprehensibility for punitive damage purposes. Regardless, institutional bad faith litigation poses a substantial challenge for insurance companies. At the lighter or less-threatening end of the litigation spectrum, institutional bad faith allegations spawn expensive and time-consuming discovery disputes. At their worst, institutional bad faith claims can produce sizable compensatory and punitive damage awards.[83]

The preceding parts of this article have discussed strategies employed by plaintiffs in actions alleging institutional bad faith and courts' treatment of efforts to obtain top-down

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[79] See *Heights at Issaquah Ridge Owners Ass'n v. Steadfast Ins. Co*., No. C07-1045RSM, 2007 WL 4410260, at *3 (W.D. Wash. Dec. 13, 2007), where the court denied the plaintiff's motion to compel reserve information because the plaintiff did not establish how the information would be relevant to a bad faith claim.

[80] *Oak Lane Printing & Letter Service v. Atlantic Mut. Ins. Co*., No. 04-3301, 2007 WL 1725201, at *4 (E.D. Pa. July 13, 2007). *But see Richman v. GEICO Gen. Ins. Co.*, No. CV 12-2948, 2013 WL 12145865, at *3 (E.D. Pa. Feb. 27, 2013) (finding reserve information relevant to bad faith claim which was based on insurer refusal to settle or disputed value of claim).

[81] Thomas E. Workman, *Plaintiff's Right to the Claim File, Other Claim Files and Related Information*: *The Ticket to the Goldmine*, *Tort and Insurance Law Journal* (Fall 1988).

[82] J*ames A. Varner, et al*., *Institutional Bad Faith*: *The Darth Wader of Extra-Contractual Litigation*, 57 Fed'n Def. & Corp. Court: Q. 163 (2007).

[83] Douglas R. Richmond, *Defining and Confining Institutional Bad Faith in Insurance*, *Tort Trial & Insurance Practice Law Journal* (Fall 2010).

discovery. This section suggests strategies that may be used by insurers to oppose or limit the process.

BE REASONABLE, BE REASONABLE, BE REASONABLE [84]

Every litigator knows that judges hate discovery disputes. Often, legitimate reasons for compelling or opposing discovery are treated with the same disdain. Decisions tend to be inconsistent, if not whimsical. The advocate who appears to be reasonable gains credibility and enhances potential for a favorable ruling. Stated differently, it is strategically wise to pick the right fight. If the precedent for opposing discovery is weak (often, it is); or the court appears to favor full discovery; or the requested materials are not harmful; it may be prudent to concede some points. As noted above, courts attempt to balance the need for information and the burden of supplying it.[85]

The advocate who is perceived to be forthcoming regarding discovery issues has a better opportunity for success. If the insurer's lawyer is selective regarding discovery objections, it may help persuade the court that the objections which are pursued are serious and likely to have merit.

EMPHASIZE LACK OF RELEVANCY

Many courts are inclined to believe that all discovery requests must be relevant because the plaintiff would not request the information if it made no difference. However, relevancy arguments may succeed if they are based on the legal elements of the bad faith claim. For example, if the bad faith action is grounded on a denial of coverage, there may be no relevance to pattern and practice discovery or discovery related to the personnel files of the claims handlers. If the underlying claim was denied because there was no coverage, the insurer's use of a computer model to evaluate damages is not relevant. Conversely, a request for similar files pertaining to the same coverage issue may be relevant. In short, if the court can be persuaded that the requested materials are not responsive to the elements of plaintiff's bad faith case, the discovery is irrelevant and should not be produced.[86]

RAISE ALL APPLICABLE PRIVILEGES

As noted above, work product and attorney-client privileges are determined by the jurisdiction where the action is pending. The emerging trend is to disallow privilege objections, at least as to the claims file in the underlying case. However, privileges not raised are waived. It may be an effective strategy for the insurer to raise the privilege and advise the Court that the insurer did not want to waive the privilege because it is applied in some jurisdictions; however,

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[84] The "*Rule of Three*." "If you want your message to be remembered put it into a list of three." Presentation Magazine.

[85] *WTHR-TV v. Cline*, *supra* note 62.

[86] See, e.g., *Diamond State Ins. Co. v. His House, Inc*., No. 10-20039-CIV, 2011 WL 146837, at *4 (S.D. Fla. Jan. 18, 2011) (not a bad faith case), where the issue was construction of an insurance policy. The plaintiff sought to depose the insurer on a wide variety of issues including the application process and the basis for denying the claim. The court granted a protective order because construction of a policy was an issue of law for the court and the topics of the deposition were irrelevant. See also *Allstate Ins. Co. v. Shain*, 921 So.2d 717, 719 (Fla. Dist. Ct. App. 2006), where the court quashed an order compelling discovery concerning drafting, marketing and interpretation of an allegedly ambiguous policy because the requested discovery was "completely unnecessary."

the insurer concedes that the privilege is not recognized in the forum court. This approach may enhance the insurer's credibility for other issues that the insurer must argue.

It is also important to determine when the privilege attaches. In Florida, the claims file is not privileged with respect to matters before the underlying case is resolved. However, privileges may be asserted as to attorney-client communications or work product material placed in the claims file after the underlying case is over. Furthermore, in the event that a bad faith claim is threatened before the underlying case is resolved, there may be documents in the claim file that reflect work product and legal opinions related to the potential bad faith action rather than the underlying case. In that event, the insurer should raise the privilege and seek an in *camera* inspection. It may convince the court that the particular document should be protected from disclosure.

It should be noted that documents withheld solely on the ground of privilege must be referenced in a privilege log when there is no other objection. Failure to produce a detailed privilege log may be ground for the plaintiff to argue that the privilege has been waived.[87]

ASK FOR IN *CAMERA* INSPECTIONS

In most jurisdictions a party opposing discovery on the basis of privilege is entitled to an in *camera* review by the trial court before disclosure.[88] Indeed, in *camera* inspections may be requested by either side in any case of doubt.[89]

An in *camera* inspection may be more persuasive regarding the insurer's discovery objections than arguments of counsel.

PROVIDE EVIDENTIARY SUPPORT FOR OBJECTIONS ASSERTING THAT THE DISCOVERY REQUESTS ARE OVERBROAD OR CREATE UNDUE BURDEN AND EXPENSE

An insurer's allegation of undue burden will not be persuasive unless it is supported by evidence. Insurer's counsel should present an affidavit explaining why the cost and effort to find and produce the documentation requested by the plaintiff is out of proportion to the potential relevance of the materials. The affidavit should be specific concerning the locations where the files are kept, the methods by which they are categorized, the numbers of personnel needed to search the files, the effort necessary to search the files for privilege or redacting confidential information, and the cost of accomplishing the task. Similar information must be provided for documentation stored electronically. As the effort and cost of discovery increases, the court's inclination to "balance the interests of the parties" will be enhanced.

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[87] E.g., *Honda Lease Trust v. Middlesex Mut. Assur. Co.*, No. 3:05CV1426, 2008 WL 349239, at *3 (D. Conn. Feb. 6, 2008).

[88] E.g., *Alliant Ins. Servs. Inc. v. Reimer Ins. Grp.*, 22 So. 3d 779 (Fla. Dist. Ct. App. 2009).

[89] See *Brown v. Superior Court*, 137 Ariz. 327, 670 P.2d 725 (Ariz. 1983); *Group Hospital Services v. Dellana*, 701 S.W.2d 75 (Tex. Ct. App. 1985); *Sandalwood Estates Homeowners Ass'n v. Empire Indem. Inc. Co.*, No. 09-CV-80787, 2010 WL 41 1088 (S.D. Fla. Jan. 29, 2010).

REQUEST STAGED DISCOVERY

Insurers should request that the court "stage" the discovery in order to limit the cost until the significance of the materials is established. For example, if the plaintiff is seeking ten years of documentation, the court may be asked to limit the inquiry to one or two years, in order to avoid a "fishing expedition." If a review of documentation from one year fails to provide relevant or admissible evidence, the court can stop the process because the cost of continuing the discovery is not likely to be justified.

The staging approach is also helpful in preventing apex depositions. If the proposed apex deponent can supply the court with an affidavit indicating lack of personal knowledge of the key facts and identifying lower level employees who can answer the plaintiff's questions, the court may refuse to allow the apex deposition, at least until the plaintiff can demonstrate why it is necessary, based upon the depositions of the witnesses who do have personal knowledge.

EMPHASIZE THE NEED FOR PROTECTIVE AND CONFIDENTIALITY ORDERS

Protective orders and confidentiality orders should be requested in situations where the plaintiff is given access to files that disclose information that may invade the privacy rights of nonparties. For example, certain information from claims handlers' personnel files may be redacted. If the court permits the inspection of other claims files, the personal information regarding the insureds in those matters should be removed or redacted.

Confidentiality and protective orders are essential if the plaintiff's discovery requests invade the proprietary business information or trade secrets of the insurer. Once a court determines that certain information should be disclosed, courts must balance the plaintiff's need for information against the harm suffered by the insurer if the confidential information is publicly disseminated. For example, disclosure of the insurer's proprietary business methods, trade secrets, research or marketing strategies may damage the insurer's competitive position in the marketplace.

Courts have broad discretion to implement protective orders to minimize the negative consequences resulting from public disclosure of a party's confidential and proprietary business information. Most commonly, the courts will condition discovery of confidential documents by preventing the party obtaining the documents from sharing that documentation with others and by using that documentation for any use other than the present litigation.[90]

An excellent example of a protective order directed to confidential information is found in *Allstate v. Scroghan*[91] where the Indiana Court of Appeals instructed the trial court to enter a protective order that provided:

[90] *Saldi*, 224 F.R.D. 169.

[91] See *supra* note 26.

1. Plaintiffs will return all materials, including all copies, to the insurer at the conclusion of the action, including all copies given to co-counsel, witnesses, court reporters and experts.

2. Plaintiffs and their counsel will not copy any material provided by the insurer except for use in the case.

3. Plaintiffs and their counsel will not use any material or copies thereof in any other action.

4. Plaintiffs and their counsel will not distribute any copies of documents to any other person or entity except to co-counsel, court personnel, witnesses, or court reporters.

5. Plaintiffs will not disclose any of the materials produced by the insurer except to the extent necessary to prosecute the action.

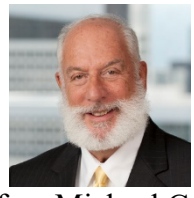
6. All materials produced by the insurer shall be deemed confidential without the necessity to have the documents marked "Confidential."

The benefit to the insurer of the foregoing order is “res ipsa loquiter.”

It must be noted that the party seeking a protective order has the burden to demonstrate that good cause exists for the order, i.e., the insurer must demonstrate that disclosure of the information will cause a clearly defined and serious injury.[92]

CONCLUSION

Institutional bad faith claims are a significant part of the bad faith landscape. They are driven by top-down discovery. Counsel for plaintiffs and insurers must understand what types of top-down discovery are available, how the courts are likely to resolve the inevitable discovery battles, and what strategies may be implemented to obtain meaningful discovery and restrict harmful and burdensome disclosure.



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[92] *Saldi*, *supra* note 84.