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# The Bad Faith Sentinel

Standing guard on developments in the law of insurance bad faith around the country

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## Western District Of Washington: Denial of a Defense Where Additional-Insured Status Was Arguable, and Doing So in Reliance on Extrinsic Evidence, Were Both Acts of Bad Faith

*Tim Ryan Constr., Inc. v. Burlington Ins. Co.*, No. C12-5770 BHS, 2013 WL 1192481 (W.D. Wash. Mar. 22, 2013)

*Western District of Washington holds that an insurer commits bad faith by failing to defend under reservation of rights when coverage was arguable and by considering extrinsic evidence in its denial determination; either action alone is a bad faith violation.*

Plaintiff Tim Ryan Construction ("TRC") was an additional insured under defendant Burlington Insurance Company's ("Burlington") insurance policy issued for TRC's subcontractor Sound Glass Sales, Inc. ("Sound Glass"). In the underlying lawsuit, it was alleged that general contractor TRG was liable for a construction defect caused by several subcontractors, including Sound Glass. TRC tendered the underlying complaint to Burlington. Burlington denied coverage and TRC followed with the present lawsuit alleging, inter alia, bad faith due to Burlington's coverage denial.

In Washington, the insured must be given the benefit of the doubt as to the duty to defend; "if there is any reasonable interpretation of the facts or the law that could result in coverage, the insurer must defend." An insurer commits bad faith by denying an insured a defense when a duty to defend is plausible.

The Additional Insured Endorsement ("AIE") at issue provided an additional insured coverage "only if such claim, loss or liability is determined to be solely due to the negligence or responsibility of the Named Insured." Burlington argued that either the court or Burlington can make a "determination" of liability, and that Burlington denied coverage based upon its determination that liability was not solely due to the negligence or responsibility of Sound Glass. The Court, however, concluded that because it was arguable as to whether the AIE allowed Burlington to make a "determination" of liability, as opposed to the court,

Burlington committed bad faith by failing to defend TRC. Because the AIE was not clear, the proper course of action would have been for Burlington to defend under a reservation of rights and to seek declaratory relief.

The Court also concluded that Burlington committed a separate act of bad faith by considering extrinsic evidence in its decision denying its duty to defend TRC. Burlington's coverage denial letter both denied coverage on the face of the complaint but also referenced extrinsic evidence that appeared to be considered in its coverage denial. The Court noted that

extrinsic evidence only may be considered to grant coverage, it may not be a factor to deny coverage. While Burlington argued that it only considered the extrinsic evidence in an attempt to provide coverage, the Court concluded that Burlington never would have reviewed any extrinsic evidence if there was no doubt as to coverage based upon the allegations in the complaint. Because there was doubt as to Burlington's duty to defend, "Burlington acted in bad faith in its handling of TRC's claims by failing to resolve all doubts about coverage in favor of the insured and resorting to extrinsic evidence to support its denial of its duty to defend."

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## New York Court Rules That Documents Created After Suit Filed Are Not Categorically "Off Limits" in Discovery

*Estee Lauder Inc. v. OneBeacon Ins. Group, LLC, No. 602379/05, 2013 NY Slip Op 30762(U) (N.Y. Gen. Term Apr. 15, 2013)*

*The New York Supreme Court compelled an insurer to produce documents the insurer created after a complaint was filed against it that the insured argued were related to its bad faith claim.*

In 2005, Estee Lauder filed suit to compel OneBeacon to defend and indemnify it for claims brought by the State of New York (the "State") related to the alleged dumping of hazardous materials in two Long Island landfills. In 1999, Estee Lauder settled the claims related to one of the landfills with the State for \$2.4 million. In 2001, the State filed a complaint against Hickey's Catering, another party allegedly involved in dumping hazardous materials at the second landfill. Hickey's Catering filed a third-party complaint against Estee Lauder and the State later added Estee Lauder as a primary defendant. After OneBeacon refused to defend or indemnify it for these claims, Estee Lauder filed a complaint alleging breach of contract and seeking a declaration that OneBeacon must indemnify it and pay any future attorney's fees accrued in the Hickey's Catering action.

In 2009, the New York Supreme Court, in ruling on the parties' respective motions for summary judgment, held that Estee Lauder was entitled to "all post-tender reasonable fees and expenses necessarily incurred in defense of the [Hickey's catering action], plus prejudgment interest . . . ." The court specifically noted that its grant of declaratory judgment applied only to future defense costs.

In 2012, the court granted Estee Lauder's motion for leave to file a third amended complaint. The third amended complaint added a cause of action for bad faith coverage denial pertaining to the payment of defense costs. The court limited Estee Lauder's bad faith claim to OneBeacon's alleged failure to pay any of Estee Lauder's defense costs after the court's ruling on summary judgment.

In furtherance of its bad faith claim, Estee Lauder sought documents from OneBeacon related to the insurer's delay in paying the attorney's fees at issue. Specifically, Estee Lauder sought documents concerning the availability of coverage and the process OneBeacon used to readjust Estee Lauder's claim during the period relevant to the bad faith claim. OneBeacon refused to produce the documents and Estee Lauder filed a motion to compel. In response, OneBeacon filed a motion for protective order asserting attorney-client privilege to preclude Estee Lauder from obtaining the documents, arguing that all of the documents were prepared as part of its larger litigation strategy.

In support of its motion to compel, Estee Lauder argued that the readjustment of claims is part of the ordinary course of an

insurance company's business and as such, it is irrelevant that some of the individuals involved in the readjustment process were attorneys. OneBeacon argued, in response, that (1) an insurance company's deliberations after an insured has filed an action against it are protected and (2) the deliberations as to the payment of the attorney's fees were "deliberations on litigation" that inherently involved attorney-client communications and attorney work product. With respect to OneBeacon's first argument, the court concluded that those documents prepared in connection with post-suit deliberations relating to the pay-

ment of attorneys' fees were "clearly relevant" and not entitled to categorical protection simply because they were created after Estee Lauder filed its complaint. The court similarly concluded that OneBeacon's second argument was without merit, reasoning that the payment of attorney's fees to a covered client is an ordinary part of an insurers' business. The resulting documents consequently could not be considered attorney work product simply because they were created mid-stream of a litigation.

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## Western District of Washington: No Attorney-Client Privilege for Communications with In-House Counsel When the Only Claim is Bad Faith

*Ten Talents Investment 1, LLC v. Ohio Security Ins. Co.*, No. C12-5849RBL, 2013 WL 1618780 (W.D. Wash. Apr. 15, 2013)

*Western District of Washington held that communications between an insurer and its attorney are not privileged with respect to the insured when the insured brings a bad faith action against the insurer.*

Ten Talents Investments 1, LLC and Ten Talents Investments 2, LLC (collectively, "Ten Talents") owned adjoining buildings in downtown Vancouver, Washington. Ten Talents filed a claim with its property insurer Ohio Security Insurance Company ("Ohio Security") in or around June 2012 for damage to its buildings caused by heavy rains. Ohio Security denied Ten Talents' claims under the general property damage provisions of the policy, but allowed coverage under an endorsement for "water back-up and sump overflow." The endorsement had a limit of \$250,000, which was below the amount requested for the repairs. Thereafter, Ten Talents filed suit against Ohio Security.

During discovery, Ohio Security produced its claims file, including its claims log. The log reflected that there were a number of communications between the claims adjuster, the claims supervisor and in-house counsel, Conway McAllister. Ohio Security refused to produce those communications, including an email in which McAllister gave an opinion that there was no coverage. Ohio Security noted on its privilege log that the communications with McAllister were protected by the work

product privilege. Ten Talents moved to compel the production of those communications. In support of its motion to compel, Ten Talents made several arguments.

First, Ten Talents argued that the business of insurance involves investigating claims and determining whether there is coverage. Ten Talents asserted that McAllister acted as a claims adjuster by assisting his co-workers in making a decision on coverage and, therefore, the attorney-client privilege did not apply. In addition, the attorney-client privilege could not be asserted because the issue in the case was whether the insurer acted in bad faith. In opposition, Ohio Security stated that there was no evidence that McAllister stepped outside of his role as an attorney, including in providing a legal opinion regarding coverage or reviewing the coverage letter sent by the claims adjuster.

Second, Ten Talents asserted that Ohio Security waived the attorney-client privilege by asserting as an affirmative defense that its actions were reasonable and in compliance with Washington law. By claiming that its actions were reasonable,

Ohio Security put at issue McAllister's opinions since it would rely on those opinions to demonstrate that it acted reasonably. Ohio Security stated that there was no authority to support Ten Talents' position that its affirmative defense of reasonableness had waived its attorney-client privilege. Ohio Security claimed that the mental impressions of and communications with attorneys are privileged under Washington law, absent a plaintiff showing fraud.

Finally, Ten Talents argued that the work product doctrine did not apply to the communications it was seeking because an insurer must investigate and determine whether claims exist, even in the absence of litigation. Thus, Ten Talents asserted that all documents prepared in connection with the claims process are prepared in the ordinary course of business and should be discoverable. Ohio Security rebutted this argument by stating that Ohio Security had threatened litigation before the coverage opinion was issued, and that, following the threat, it reasonably asked its attorney to review the coverage position letter before sending it out.

In its ruling on plaintiffs' motion to compel production of documents, the Western District of Washington addressed instances in which communications between an attorney and an insurer would not be privileged. The District Court held that to the extent that an attorney acts as a claims adjuster, claims process supervisor, or claims investigation monitor, and not as a legal advisor, the attorney-client privilege does not apply. Also, in bad faith actions brought by an insured against an insurer, communications between the insurer and its attorney are not privileged with respect to the insured. The Court noted that the mental impressions of the insurer's attorney may be relevant to the disputed issues where the only issue in the case is whether the insurer acted in bad faith in processing the insured's claim and thus would not be protected by the work product rule. The Court determined that McAllister had acted in the role of a claims adjuster or supervisor during the communications related to the formulation of Ohio Security's coverage position. Moreover, finding Ohio Security relied on "advice of counsel" as an affirmative defense, the Court granted Ten Talents' motion to compel.

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## Florida Appellate Court Holds an Insured Must Obtain a Favorable Resolution in the Underlying Litigation for Benefits Prior to Bringing a Bad Faith Action

*Hunt v. State Farm Florida Ins. Co.*, No. 2D11-6484, 2013 WL 1352471 (Fla. App. Apr. 5, 2013)

*In Florida, an insured must receive a favorable resolution in the underlying litigation for insurance benefits as a condition precedent to filing a bad faith action. However, the favorable resolution does not necessarily mean that the insured must obtain a judgment in the insured's favor in the underlying action.*

In July 2006, Terry Hunt's home sustained damage from a sinkhole. He filed a claim with his insurer, State Farm Florida Insurance Company ("State Farm"). Mr. Hunt disagreed with State Farm's damages estimate and in April 2007, he sued State Farm. He also filed a civil remedy notice of insurer violation ("CRN") pursuant to Florida Statutes section 624.155.

State Farm moved to dismiss the lawsuit and to require an appraisal. The trial court abated the lawsuit and granted the motion for appraisal. In October 2008, a \$162,571.61 appraisal award was entered in Mr. Hunt's favor and the trial court

awarded Mr. Hunt attorneys' fees in February 2010. Mr. Hunt voluntarily dismissed his lawsuit, but, in the fall of 2010, he filed a bad faith action against State Farm. State Farm moved for summary judgment, or in the alternative, for dismissal. The trial court granted State Farm's motion for summary judgment because: (1) Mr. Hunt had not obtained a judgment against State Farm for breach of contract in the underlying lawsuit, and (2) Mr. Hunt had not specified a cure amount in his CRN.

The appellate court held that the trial court erred and that a judgment against State Farm for breach of contract was not a

condition precedent to a bad faith action. The panel acknowledged that a bad faith action cannot accrue until the underlying lawsuit seeking insurance benefits is resolved in the insured's favor. However, a judgment was not the only way to obtain a favorable resolution. In this case, the appraisal award satisfied the condition precedent necessary for Mr. Hunt to bring a bad faith claim against State Farm.

The appellate court also held that the trial court erred in granting summary judgment based on its finding that Mr. Hunt did

not specify a cure amount in his CRN. The panel held that Florida law did not require that an insured must include the amount of the demand in the CRN. In fact, the Florida Supreme Court had previously stated that an insured may submit a CRN before liability or damages have been determined and that the insurer must make a good faith evaluation of what is owed based upon the proof of loss and its expertise in advance of a determination by a court or arbitration. Consequently, the appellate court reversed the trial court's ruling and remanded the matter for further proceedings.

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