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INSURANCE LAW

The Claims File: Key Discovery for Bad-Faith Insurance Litigation

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Bad-faith lawsuits against insurance carriers are on the rise. Bad-faith patterns and practices have been noted in the January 10, 2008, Report by J. Robert Hunter, Director of Insurance at the Consumer Federation of America, entitled: "Property/Casualty Insurance in 2008: Overpriced Insurance and Underpaid Claims Result in Unjustified Profits, Padded Reserves and Excessive Capitalization." "At the same time that the insurance industry is enjoying unprecedented profits, excess surplus and redundant reserves ... many consumers have had to purchase overpriced insurance ... and have confronted claims practices designed to systematically underpay the claims that consumers dare to file." As many national law firms have sizable insurer-based defense practices, conflicts have arisen resulting in their clients having to go elsewhere to pursue bad-faith claims against insurance companies referred to as "insurance recovery" departments, these niche practice groups are flourishing at prestigious midsize regional as well as national firms.

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Law of Bad Faith

Bad-faith claims are where the insured seeks extracontractual damages from the insurance carrier. There can be a recovery above the policy limits on a tort theory if the insurance company acted in bad faith. "Both the agent of the insurer and the insurer owe fiduciary duties to the insured, which includes the duty of good faith and fair dealing in the performance and enforcement [of] the insurance contract." *Miglicio v. HCM Claim Corp.,* 288 N.J. Super. 331, 339 (1995), citing *Pickett v. Lloyd's,* 131 N.J. 457 (1993). These duties require the insurers to refrain from conduct that will injure the insured's right to recover benefits. *Griggs v. Bertram,* 88 N.J. 347 (1982).

Badges of bad faith include: (1) misrepresenting pertinent facts or policy provisions relating to coverage; (2) failing to adopt and implement reasonable standards for prompt investigation of claims; (3) refusing to pay claims without conducting a reasonable investigation; (4) not attempting in good faith to effectuate prompt, fair and equitable settlements where liability has become clear; and (5) attempting to settle a claim for less than the amount which is reasonable by forcing the insured to institute litigation to obtain benefits or by demanding terms as a condition for payment not legally permissible. See N.J.S.A. 17:29B.

Discovery Standards

Pursuant to R. 4:10-2, parties may obtain discovery regarding any matter not privileged, which is relevant to the subject matter involved in the action, whether it relates to the claim or defense of the party seeking discovery. Relevancy includes facts that tend to raise an inference of state of mind where state of mind, e.g., bad faith, is an issue in the case. See *Wilson v. Amerada Hess Corp*., 168 N.J. 236, 253-254 (2001). The insurer must produce documents for inspection as they are kept in the usual course of business or shall organize and label them to correspond with categories in the request. R. 4:18-1(b). Electronically stored information should be produced in a form or forms in which it is ordinarily maintained or in a form or forms that are reasonably usable.

The Claims File

The claims file maintained in the ordinary course of business by the insurer could serve as a virtual minefield of evidence of bad-faith conduct. The claims file is a repository of relevant facts underlying the insurer's decision to

deny or underpay a claim. The information may exist in many different forms, including hard copy and electronic data formats. Discovery may also involve the insurer's software programs which are utilized to adjust claims. In *Victor Opperman, et al. v. Allstate New Jersey Ins. Co., et al.*, No. 07-1887, slip op. (D.N.J. Apr. 15, 2009), the magistrate ordered the production of certain customized software programs for inspection by the insureds and their expert. *Opperman* is a pending class action where the insureds claim that the insurer manipulated pricing information utilizing the specialized software to achieve unreasonably low claim estimates.

Understanding the "inside" of how a claim department and its various internal hierarchies and adjustment systems operate is essential to crafting effective discovery. During the claims process and continuing through litigation, insurers may take active steps to shroud the claims process in secrecy to fend off claims of bad faith and to mask conduct, discovery of which could lead to potential adverse jury verdicts, negative publicity and regulatory scrutiny. The retention of a claims expert may be a pivotal tool to assist the insured's attorney in navigating the complexities and vagaries of a particular insurance carrier's claims process. The expert may be proffered to testify on whether the company handled the claim processing or investigation properly, in bad faith or in accordance with commonly accepted industry practices. Because claims files are typically electronically stored, a forensic computer expert may be required to effectively "mine" claims data.

Insurance carriers generate claim files to process claims. Claim adjusters are obligated to use claim files to ensure good-faith adjustment of claims and document an account of the process. Claim adjuster notes, typically in electronic form, offer a visual snapshot of the day-to-day adjustment process. These material claim adjuster notes, in certain instances, are accessible, as "live notes" to brokers and agents depending on the particular contractual arrangements and protocols between the carrier and agent. The claims file may contain evidence to corroborate whether (a) the insurer exercised its good faith duty, (b) the insurer's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim and/or (c) whether the insurer's conduct was reasonable. It is a fruitful area of inquiry to discover whether motivations unrelated to the merits of the claim played a decisive role in the claim processing.

The Unwarranted Assertion of Privilege To Block Discovery

One of the abuses that may be encountered in the discovery process is the unwarranted assertion of privileges, such as the attorney/client privilege and work product privilege. There may be a pattern and practice of having claims adjusters interface with other adjusters having legal degrees and describe the interactions as seeking "legal advice." By no means does holding a law degree within an insurance company designate one as in-house counsel or "claims counsel" nor does it make information transmitted to such a person privileged.

Harper v. Auto-Owners Ins. Co., 138 F.R.D. 655 (S.D. Ind. 1991), is persuasive authority that an insurer may not hide behind a privilege in refusing to produce its claims file. *Harper* brings into focus why the claims file should not be shielded from discovery.

The district court of New Jersey has cited to the *Harper* analysis. See *In re Gabapentin Patent Litig.*, 214 F.R.D. 178, 183-85 (D.N.J. 2003) ("This Circuit has imposed an additional requirement beyond that embodied in the reasonable anticipation test. Thus, the second prong of the test is whether 'the material [was] produced because of the prospect of litigation and for no other purpose.'"). The guiding principle is that there is no privilege or protection for documents generated in the ordinary course of an insurance claim investigation. If documents are generated after litigation is anticipated, they are still discoverable unless they were created for no purpose other than litigation.

In *Harper,* outside counsel was retained almost immediately (five days after the insurance company was noticed of a claim), to monitor progress, ensure compliance with state reporting requirements and conduct an examination under oath. "To the extent that this attorney acted as a claims adjuster, claims process supervisor, or claim investigation monitor, and not as a legal adviser the attorney client privilege would not apply." Moreover, any anticipation of litigation must have a reasonable basis, and as *Harper* points out, courts:

> concur that a party must show more than a 'remote prospect,' an 'inchoate possibility,' or 'a likely chance' of litigation. Rather, a party must demonstrate that 'at the very least some articulable claim, likely to lead to litigation' had arisen, that the probability of litigation is 'substantial and imminent', 'objective facts establishing an identifiable resolve to litigate,' or 'an identifiable specific claim or impending litigation when the materials were prepared.'

In *Harper,* the insurance company was compelled to produce, *inter alia:* (1) expert consultant communications and reports; (2) correspondence to and from attorneys; (3) test results; (4) time and expense logs of investigators; (5) communications to outside third parties; (6) memos regarding reasons to deny claim; (7) investigator's prospective plans; (8) correspondence of in-house employees as to retention of outside counsel; (9) records that logged activity on the claim; and (10) memos by in-house counsel on the claim.

Depending on the complexity and size of a claim, it is essential that an insured claimant seek the guidance from competent counsel to process or prosecute a claim either through effective negotiation or litigation. A claimant must proceed with eyes wide open to the reality that insurers will vigorously defend a claim, especially when bad faith is alleged as an extracontractual remedy. ■