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Discoverability of Documents in Insurance Bad Faith Claims

Typically on the Hoosier Litigation Blog, we focus our discussions on decisions from one of the federal circuit courts – typically the 7th Circuit – or an Indiana appellate court. This week we are breaking that usual mold and taking a look at a decision by a federal district court. Specifically, we are taking a look at the decision of Southern District of Indiana Magistrate Judge Dinsmore in *Woodruff v. American Family Mutual Insurance Company*.

Before we launch into a discussion of the decision, a brief explanation of federal district court decisions is in order. Under the principle of *stare decisis* there are certain prior cases that are binding upon a court's analysis of the law while others are not. Generally, the only cases with binding precedential value are those of appellate courts. As a federal district court is the federal version of a trial court, its decisions are not binding upon any other court. However, given the high quality of federal court judges and the need for guiding decisions on trial level issues, federal district court decisions hold a high level of value in the law. Though the conclusions and analyses in district court decisions are not binding, they are what is called persuasive authority. That is, though a court is not bound to follow the decision it is free to consider the decision and consider the approach that was taken.

Now that you have an understanding of the value of a district court opinion,

let us discuss the specifics of the *Woodruff* case and why it is so important as to merit an entire blog post.

I. Background

The procedural posture of the decision is a bit abnormal. The case stems from one that we have discussed before. My first ever post was entitled *Think Before You Wave* and discussed the Indiana Court of Appeals decision *Key v. Hamilton*. In *Key*, the court held that a truck driver who waved the driver of a car into an intersection resulting in the driver pulling in front of and seriously injuring a motorcyclist was liable to the motorcyclist. This case has become a bit of a mainstay on the Hoosier Litigation Blog as this is now the fourth post discussing it.

This case arises from the attempt to collect the judgment to which the motorcyclist, Mr. Hamilton, was entitled. At trial, the jury found that Key was liable to Hamilton for $990,000. Key's insurance policy, like many commercial automobile policies, had a cap of $250,000. Thus, the only amount of the policy to which Mr. Hamilton was entitled to recover from the insurance company was the $250,000 policy limit. If this is where the case stopped, then the procedural posture would not be abnormal.

The case becomes quirky because of the concept of insurance bad faith. We have discussed insurance bad faith claims before in a prior post. To give it a brief summary for our purposes here, the claim arises because an insurance company has a duty to not expose its insured to liability where possible. Despite sound logic to the contrary and a Ninth Circuit case – *Du v. Allstate Ins. Co.* – finding as such, Indiana does not recognize an affirmative duty for the insurance company to specifically try to settle a case for policy limits. However, where the plaintiff has offered to resolve the case within policy limits and it is reasonably likely that at trial a jury could award in excess of the policy limits, the insurance company does have a duty to settle the case so as to not expose its insured to personal liability.

Prior to Mr. Hamilton receiving the verdict for $990,000 – which exceeded the policy limit by $740,000 – his attorney had offered to settle the case for $100,000. This likely stemmed from an erroneous belief that the policy limit was $100,000 – a fairly typical limit in a personal automobile insurance policy but would be much lower than expected in a commercial policy. The insurance company did not accept the offer. Later, the offer was raised to $250,000 and again not accepted by the insurance company. Though the offer had increased, it was still within the policy limit. Thus, had the insurance company accepted the offer Mr. Key would never have been exposed to personal liability. Alas, the offer was not accepted and Mr. Key was subject to $740,000 of personal liability.

Due to the failure to accept the offer and the subsequent exposure of to personal liability, Mr. Key gained the right to sue his insurance company for a bad faith claim. Mr. Key also filed for bankruptcy protection. As a result, his right to sue his insurance company became an asset of his bankruptcy estate. Therefore, it is not Mr. Key who is suing American Family, but rather Mr. Woodruff as the trustee of Mr. Key's bankruptcy estate. Hence, the procedural posture is a bit abnormal.

II. Discussion of the Decision

The *Woodruff* opinion stems from a motion by American Family Insurance to resist production of documents. Specifically, the plaintiff sought the production of American Family's claim file and the reserve determinations. Additionally, American Family sought to prevent the depositions of attorneys involved with the case. American Family set forth three basic arguments: (1) that the documents are not relevant to the current case; (2) that the documents were protected by the attorney-client privilege; and (3) that the documents were protected by the work product doctrine. Rejecting every argument of the insurance company, the court ordered that the every document was to be produced.

The court first noted that American Family's relevance objection failed to meet the requirement of explaining why, on a document-by-document analysis, each document was not relevant and that the mere blanket assertion was not enough. The court then went on to reject American Family's argument because, as the court determined, the requested documents were relevant, within the liberal construction of the federal discovery rules.

The court then turned to the attorney-client privilege argument. The court applied Indiana law in its determination of application of the attorney-client privilege. Indiana Code section 34-46-3-1(1) governs this privilege.

> Except as otherwise provided by statute, the following persons shall not be required to testify regarding the following communications:
> (1) Attorneys, as to confidential communications made to them in the course of their professional business, and as to advice given in such cases.

After a lengthy and extremely thorough review of numerous cases and the Indiana Rules of Professional Conduct, the court found that even if the attorney hired by the insurance company on behalf of Mr. Key were to be considered the attorney for both the insurance company and for Mr. Key, that fact would not prevent Mr. Key in a subsequent suit from waiving the attorney-client privilege and seeking production of the documents.

The court more easily, but with no less thorough an analysis, overcame the work product argument. The work product doctrine requires, among other things, that the documents be made in anticipation of litigation. While the documents were indeed made in anticipation or in the course of litigation, they were not made in anticipation of litigation between Mr. Key and his insurance company. Rather, they were made in anticipation of litigation between Mr. Hamilton and Mr. Key. Thus, the documents were not subject to protection from Mr. Key – the man for whose benefit they were made in the first place.

Lastly, as a separate issue, American Family sought to prevent the discovery of its "reserves" for the case. Typically, when an insurance company receives a claim, it allocates and sets aside a specific amount of money for that claim. It then attempts to resolve the case for some amount within the margin of the reserve. As documents related to the reserve were no more subject to the work product doctrine or the attorney-client privilege, the only issue for the court to determine was whether they were relevant to the case.

Quoting another case, the court stated, "[W]hen an insurer, by its actions, acknowledges the potential for liability and fails to attempt to settle a claim against its insured and/or fails to defend, reserve information is relevant to the issue of good faith." Further, the court rejected an argument that because "evidence or remarks about liability insurance in a negligence case is inadmissible" the reserve information in this case would not be relevant. It is important to note first that just because evidence is not admissible at trial does not lead to the conclusion that it is not subject to discovery. The discovery standard only requires that the sought after documents/information is "reasonably calculated to lead to the discovery of admissible evidence."

More specific to this case is the fact that this is not a case in which the evidence of insurance is being used to prove liability for negligence in a case. Rather, the entire case stems from the existence of an insurance policy and the failure to abide by the duty of good faith that accompanies such a policy. Thus, evidence of insurance is not barred by the evidence rule that generally prevents the mention of insurance in a negligence trial. As a result, there is no colorable argument to find documents related to reserves to be irrelevant.

For these reasons, the court ordered that American Family must disclose the documents to the plaintiff in the case. The decision, though not wholly novel, is extremely informative. It provides a very thorough analysis of the reasons mandating disclosure of this information. More importantly, it provides an example or the dangers to insurance companies that fail to act in the best interest of their policyholders. It is a reminder that though the insurance company may hire the

attorney, the attorney is still bound to represent the best interest of the policyholder – i.e. the defendant.

Join us again next time for further discussion of developments in the law.

Sources

- *Woodruff v. Am. Family Mut. Ins. Co.*, No. 1:12-CV-00859-TWP, 2013 WL 1729403 (S.D. Ind. Apr. 22, 2013).
- *Key v. Hamilton*, 963 N.E.2d 573 (Ind. Ct. App. 2012), *trans. denied*.
- *Du v. Allstate Ins. Co.*, 681 F.3d 1118 (9th Cir. 2012), *amended and superseded on denial of reh'g en banc*, 697 F.3d 753 (9th Cir. 2012).
- Indiana Code section 34-46-3-1(1).

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