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Claims investigation, although performed by a lawyer, is deemed by courts to be the ordinary business of insurance and, therefore, not protected by the attorney-client or work-product privilege.

Limitations on Privilege When Attorneys Act as Claims Handlers

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Since the mid-1990s, and especially since the rush of insurance claims following the September 11 terrorist attacks and Hurricane Katrina, insurance companies increasingly have turned to outside counsel to assist or supervise the handling of all sorts of insurance claims. On some level, it makes sense for an insurance company to turn to attorneys for help in responding to a set of claims that present common fact patterns and questions of policy interpretation. Yet the decision to involve attorneys in what is commonly understood to be the business function of claims handling has significant implications for the privileges that typically protect against the disclosure of communications with, or work by, such attorneys.

The conflict between an attorney's obligation to act as a zealous advocate for his or her client (the insurance company) and the obligation of a claims handler to protect the policyholder's interests can make it difficult, if not impossible, for the attorney to be all things to all parties involved. Policyholders need to be aware of these potential conflicts — and be prepared to challenge insurance company assertions of attorney-client privilege and work-product privilege when the attorney is acting as a claims handler. Ensuring that claims are being handled properly is a challenge when attorneys — acting as claims handlers — improperly undermine policyholders' interests and cloak such actions behind supposed privileges.

The Inherent Conflict When Attorneys Act as Claims Handlers

The ethical obligations of an attorney retained to represent an insurance company are fundamentally distinct from those of a claims handler. On the one hand, the attorney is ethically bound to represent his or her client zealously.[1] On the other hand, insurance company claims handlers are ethically and legally bound to investigate policyholders' claims in a fair and evenhanded manner, giving as much consideration to the policyholders' interests as they give to their own. For example, it is illegal under New York's Unfair Claims Handling Practices Act for a claims handler to delay in effectuating a fair settlement of claims submitted in which liability has become reasonably clear.[2]

Ultimately, in most cases, outside counsel cannot act fairly as attorney and claims handler simultaneously.

To get a feel for the conflicts that lurk when an attorney acts as a claims handler, consider the following standards for ethical claims-handling conduct, taken from a respected text used to train claims handlers, and query whether an attorney duty bound to advocate for its client's interests with "zeal" can possibly comply with both sets of directives:

- "The primary duty of the claim representative is to deliver the promise to pay. Therefore, the claim representative's chief task is to seek and find coverage, not to seek and find coverage controversies or to deny or dispute claims."
- "[T]he insurance company should not place its interests above the insured's."
- "[A]ll honest and reputable insurers recognize that claims are an expected part of business and are to be paid fully and fairly. No honest and reputable insurer has either explicit or implicit 'standing orders' to its claim department to delay or underpay claims."
- "The claim professional must dispense his or her knowledge and skills for the benefit of society."
- "The claim representative's primary duty is to fulfill the insurance company's promises to the insured."[3]

Ultimately, in most cases, outside counsel cannot act fairly as attorney and claims handler simultaneously. This is not to say that attorneys cannot play a role in the investigation of insurance claims or provide legal advice about how courts interpret and apply particular policy provisions in various jurisdictions. But to the extent that outside counsel is assuming the responsibilities of a claims handler, the privileges typically attendant to that attorney's communications with and work for his or her client (the insurance company) may not apply.

Attorney-Client Privilege May Not Apply in Connection With Claims-Handling Activities

Although the attorney-client privilege generally is highly protected, such protection extends only to communications in which the client is seeking, or the attorney is providing, legal advice. Claims handling is part of the regular, ordinary business activities of an insurance company and normally is performed by an insurance company's nonlawyer employees.[4]

Typical claims-handling functions not requiring the skills of a lawyer include:

- investigating the existence of the relevant policies;
- investigating underlying liability claims;
- gathering and evaluating facts to determine whether coverage applies and the value of the claim;
- making coverage determinations;
- drafting and issuing reservation of rights letters or letters declining coverage to policyholders;
- setting loss reserves and revising them to reflect the insurance company's probable exposure relating to the claim; and

- monitoring the defense of an underlying liability claim.

Claims-Handling Activity Cannot Be Shielded From Discovery

Just as a manufacturer cannot shield its manufacturing activity from discovery by hiring attorneys to staff and supervise its factories, an insurance company cannot shield its claims-handling activity by hiring attorneys to conduct it.

Accordingly, in the insurance context, it is widely recognized that where an attorney acts as a claims handler and not as a legal advisor, the attorney-client privilege is inapplicable.[5] Indeed, courts regularly reject claims of privilege over claims-handling files generated by attorneys. See, e.g., *Securities & Exchange Commission v. Credit Bankcorp, Ltd.* In this case, the court held that investigative documents are not privileged, even if generated by an attorney:

> The privilege does not apply … because [the law firm] appears to have been hired to investigate the facts surrounding the two claims and make a recommendation to the Insurers. The documents at issue here were part of the regular course of business for an insurance company. In determining whether to pay a claim, the Insurers hired an outside investigator, here a law firm, to investigate the claim.[6]

Similarly, in *First Aviation Services, Inc. v. Gulf Ins. Co.*, the policyholder moved to compel production of documents that the insurance company claimed fell within the attorney-client and work-product privileges. The "claims file" produced by the insurance company was devoid of any evidence of an investigation or claims-handling activity by the insurance company's employees, and the policyholder sought the production of the documents generated during the claim investigation conducted by an outside law firm hired by the insurance company. In holding that the insurance company must produce the claims files of its attorneys, the court stated:

> [The fact that the insurance company] has no claims manuals or underwriting manuals for D&O Liability Insurance Policies suggest that [the insurance company] might outsource all claims arising thereunder. Such a practice cannot become a mechanism for avoiding disclosure of documents through an assertion of privilege.[7]

Significantly, the court noted that an insurance company "may not insulate itself from discovery by hiring an attorney to conduct ordinary claims investigation."[8] Thus, it is unlikely that the attorney-client privilege will attach to communications between an insurance company and its outside counsel where such counsel is performing tasks within the purview of claims department employees.

An insurance company cannot shield its claims-handling activity by hiring attorneys to conduct it.

Work-Product Doctrine May Not Apply in Connection With Claims-Handling Activities

Like the attorney-client privilege, the work-product doctrine's protections do not extend to all work done by insurance company attorneys in connection with a policyholder's claim. As a general matter, the work-product privilege applies only where documents are prepared in anticipation of litigation. In the insurance context, the privilege does not apply to documents generated pursuant to an insurance company's duty to investigate claims and the handling of such claims as part of its ordinary business practices. As the court held in *National Farmers Union Prop. & Cas. Co. v. District Court*:

> [The insurance company] may not avail itself of the protection afforded by the work product doctrine simply because it hired attorneys to perform the factual investigation into whether the claim should be paid. The attorneys were performing the same function a claims adjuster would perform, and the resulting report is an ordinary business record of the insurance company.[9]

Consistent with this reasoning, "[m]ost courts have held that documents constituting any part of a factual

inquiry into or evaluation of a claim, undertaken in order to arrive at a claim decision, are produced in the ordinary course of an insurer's business and not work product."[10] Generally, in determining whether the work product doctrine applies, courts seek to distinguish between documents generated in the ordinary course of business and those documents specifically and truly prepared "in anticipation of litigation."[11]

Even actual coverage litigation does not automatically cloak all documents and information within the protection of the work-product doctrine.

No Bright-Line Rule

While no bright-line rule exists to determine when litigation may be reasonably anticipated, courts have provided some helpful events to use as guideposts. For example, some courts have considered work done by an attorney before the events listed below to be part of the ordinary course of the insurance company's claims investigation and work done after as having been prepared in anticipation of litigation:

- the date on which the adjuster assigned the file to an attorney for the policyholder's defense;[12]
- the date on which the insurance company made its coverage determination;[13] or
- the date on which a claimant's settlement demand was rejected.[14]

Yet, even actual coverage litigation between an insurance company and its policyholder does not automatically cloak all documents and information within the protection of the work-product doctrine. As the Connecticut Supreme Court held in *Stanley Works v. New Britain Redevelopment Agency*, where there is actual coverage litigation, the work product doctrine applies only where the attorney "performed duties normally attended to by attorneys."[15]

Case Study

A brief case study may help put this issue in context. In *Mission National Insurance Co. v. Lilly*, a restaurant operator lost his restaurant to a fire and submitted the claim to his property insurance company. The insurance company turned the claims investigation of the matter over to a law firm, Cozen & O'Connor. The insurance company thereafter denied coverage, claiming that the operator had committed arson. The operator moved to compel the production of documents authored by Cozen & O'Connor attorneys and the deposition of certain employees. The insurance company resisted, asserting the attorney-client and work-product privileges. The court ordered the insurance company to provide the sought-after discovery on the grounds that claims investigation, although performed by a lawyer, is the ordinary business of insurance and, therefore, not protected by the attorney-client or work-product privilege, even with respect to work performed after counsel began preparing for litigation:

> [T]he difficulty exists because of plaintiffs [sic] decision, immediately upon receiving notice of the fire, to employ attorneys to fulfill its ordinary business function of claims investigation. Counsel for plaintiff agrees that Cozen & O'Connor was the only party responsible for performing that pure, ordinary business function. As it aptly points out, however, that singular function, at some point, came to be a concurrent one with the preparation of a legal stance in the event of trial. Cozen & O'Connor, through the same personnel who performed the pure business function, also acted in the role of counsel.
>
> No one other than plaintiff itself contributed to the difficult state of events arising from the concurrent role of Cozen & O'Connor. It would not be fair to allow the insurer's decision in this regard to create a blanket obstruction to discovery of its claims investigation. To the extent that Cozen & O'Connor acted as claims adjusters, then, their work product, communications to client, and impressions about the facts will be treated herein as the ordinary business of plaintiff, outside the scope of the asserted privileges.[16]

Conclusion

Thus, as with the attorney-client privilege, it is unlikely that the work-product doctrine will preclude the disclosure of files prepared by outside counsel where such counsel is performing tasks within the purview of claims department employees. Policyholders should therefore be prepared to aggressively pursue the disclosure they need and are entitled to in order to determine whether their claim has been handled fairly and accurately.

Endnotes

1. See, e.g., *N.Y. Code of Professional Responsibility* EC 7-1 ("The duty of a lawyer, both to the client and to the legal system, is to represent the client zealously within the bounds of the law, which includes Disciplinary Rules and enforceable professional regulations.") and DR 7–101.
2. See *N.Y. Ins. Law* §2601(a)(4) (West 2008).
3. Markham, James J., Kevin M. Quinley, and Layne S. Thompson, *The Claims Environment (1st ed.)* (Malvern, PA: Insurance Institute of America, 1993): 12–13, 17, 26, 28, 59.
4. See *Chicago Meat Processors, Inc. v. Mid-Century Ins. Co.*, 1996 WL 172148, *3 (N.D. Ill. Apr. 10, 1996) (noting that reviewing and investigating claims is part of the regular and ordinary business of insurance companies).
5. See *Stephenson Equity Co. v. Credit Bancorp. Ltd.*, 2002 WL 59418, at *3 (S.D.N.Y. 2002) (ordering insurance company to produce attorney files related to the investigation of certain securities claims upon a finding that the attorney's claims investigation reports were "prepared by attorneys … as part of the 'regular business' of the [insurance] company"); *Amerisure Ins. Co. v. Laserage Technology Corp.*, 1998 WL 310750, at *1 (W.D.N.Y. 1998) ("In the insurance context, 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."); *Diversified Indus., Inc. v. Meredith*, 572 F.2d 596 (8th Cir. 1977), *on rehearing*, 572 F.2d at 606 (8th Cir. 1978) (*en banc*) (attorney's status as an investigator prevents communications from being protected by the attorney-client privilege); *First Aviation Services, Inc. v. Gulf Insurance Company*, 205 F.R.D. 65, 69 (D. Conn. 2001) (insurance industry's practice of using attorneys to perform the tasks of claims handlers "cannot become a mechanism for avoiding disclosure of documents through an assertion of privilege"); *O'Leary Ltd. Partnership v. Travelers Prop. Cas. Co.*, 2001 WL 417698 (Conn. Super. Ct. 2001); *Continental Casualty Co. v. Marsh*, 2004 WL 42364 at *3 (N.D. Ill. 2004) ("Unless the party opposing production comes forth with specific evidence to rebut the presumption [that investigative reports were prepared in the ordinary and routine course of the insurer's business], demonstrating there was a reasonable anticipation of litigation at the time the document was created, and that the primary reason for creating the document was to prepare for litigation, the work product doctrine will not apply."); *Chicago Meat Processors Inc. v. Mid-Century Ins. Co.*, 1996 WL 172148 (N.D. Ill. 1996); *Dawson v. New York Life Ins. Co.*, 901 F. Supp. 1362, 1367 (N.D. Ill. 1995) (attorney-client privilege did not attach where attorneys were acting more as "couriers of factual information" rather than as "legal advisors"); *Allendale Mutual Ins. Co. v. Bull Data Systems, Inc.*, 152 F.R.D. 132, 138 (N.D. Ill. 1993) ("The fact that the material was produced originally by a lawyer is irrelevant if, as is the case here, the material reflects ordinary insurance information."); *Country Life Ins. Co. v. St. Paul Surplus Lines Ins. Co.*, No. 03-1224 at *8 (C.D. Ill. Jan. 31, 2005) ("[I]n the insurance context, 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"); *Stout v. Illinois Farmers Ins. Co.*, 852 F. Supp. 704, 707 (S.D. Ind. 1994) ("Defendant contends that because counsel was hired to provide advice on the legal requirements for making a good faith decision on plaintiff's claim, all documents, reports and tangible things produced by its hired investigators or its own claims adjusters to evaluate plaintiff's claims are privileged. Not surprisingly, defendant has not cited in either of its briefs any case law supporting such a broad interpretation of the privilege."); *Mission National Ins. Co. v. Lilly*, 112 F.R.D. 160, 163 (D. Minn. 1986).
6. *Securities & Exchange Commission v. Credit Bankcorp, Ltd.*, 2002 WL 59418 (S.D.N.Y. 2002) at 3. See also, *Tayler v. Travelers Ins. Co.*, 183 F.R.D. 67 (N.D.N.Y. 1998); *Amerisure Ins. Co. v. Laser Ridge Tech. Corp.*, 1998 WL 310750 (W.D.N.Y. Feb. 12, 1998); *Arkwright Mut. Ins. Co. v. National Union Fire Ins. Co.*, No. 90 Civ. 7811, 1994 WL 510043, at *5 (S.D.N.Y. Sept. 16, 1994) ("[A]n insurance company may not insulate itself from discovery by hiring an attorney to conduct ordinary claims investigation. Nor do reports generated by the investigation of a claim become work product simply because the claim is potentially litigatable."); *Merrin Jewelry Co. v. St. Paul Fire & Marine Ins. Co.*, 49 F.R.D. 54, 57 (S.D.N.Y. 1970); *Mission National Ins. Co. v. Lilly*, 112 F.R.D. 160, 163 (D. Minn. 1986) ("[An] attorney

must be acting in the role of legal counsel with respect to the information in issue before the privilege may attach. If the attorney is acting in some other role, as an ordinary businessman for example, the privilege may not be properly claimed.").

7. *First Aviation Services, Inc. v. Gulf Ins. Co.*, 205 F.R.D. 65 (D. Conn. 2001) at 69.
8. Id.
9. *National Farmers Union Prop. & Cas. Co. v. District Court*, 718 P.2d 1044 (Colo. Supr. 1986) at 1048.
10. *Harper v. Auto-Owners Ins. Co.*, 138 F.R.D. 655 (S.D. Ind. 1991).
11. See *Logan v. Commercial Union Ins. Co.*, 96 F.3d 971, 977 (7th Cir. 1996); *Harper v. Auto-Owners Ins. Co.*, 138 F.R.D. 655, 663 (S.D. Ind. 1991) ("[m]ost courts have held that documents constituting any part of a factual inquiry into or evaluation of a claim, undertaken in order to arrive at a claim decision, are produced in the ordinary course of an insurer's business and not work product."); *Ledgin v. Blue Cross & Blue Shield of Kansas City*, 166 F.R.D. 496, 498 (D. Kan. 1996) (the mere fact that there is always a possibility of litigation when a liability carrier investigates a claim against one of its policyholders is not enough to invoke the work product privilege, instead, there must be "a substantial probability of imminent litigation or a lawsuit must already have been filed"); *APL Corp. v. Aetna Cas. & Sur. Co.*, 91 F.R.D. 10 (D. Md. 1980).
12. See *State v. Pavin*, 494 A.2d 834, 838 (N.J. Super. A.D. 1985); *Langdon v. Champion*, 752 P.2d 999, 1005–06 (Alaska 1988).
13. See *Logan v. Commercial Union Ins. Co.*, 96 F.3d 971, 977 (7th Cir. 1996); *Lyvan v. Harleysville Ins. Co.*, Civ. A. No. 93–6145, 1994 WL 533907 at * 3–4 (E.D. Pa. Sept. 29, 1994).
14. See *Henry P. Roberts Investments, Inc. v. Kelton*, 881 S.W.2d 952, 956–67 (Tex. App. 1994).
15. *Stanley Works v. New Britain Redevelopment Agency*, 155 Conn. 86, 95, 230 A.2d 9, 14 (1967).
16. *Mission National Insurance Co. v. Lilly*, 112 F.R.D. 160 (D. Minn. 1986) at 163.

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