

First-Party Insured's Bad Faith Allegations Not Sufficient to Defeat Insurer's Attorney-Client Privilege

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In a published opinion issued August 3, 2010, Division 2 of the Washington Court of Appeals held that an insurance company is entitled to the attorney-client privilege in a first-party claim for bad faith. The privilege may be overcome if there is evidence of fraud, but fraud is more than bad faith.

Bruce Cedell's house was damaged by fire, and he made a claim to Farmers under his homeowners policy. Farmers investigated and consulted with an attorney in making its coverage determination. When Farmers disputed the claim, Cedell sued, alleging bad faith. In discovery, Cedell requested Farmers' claim file and all information related to Farmers' claim investigation. Farmers' responses withheld information and documents on the grounds of attorney-client privilege and work product. Cedell then moved to compel Farmers to provide complete responses, without regard to attorney-client privilege or work product, arguing that his allegations of bad faith overcame Farmers' claim of privilege.

In *Escalante v. Sentry Insurance Co.*, decided in 1988, Division 1 of the Court of Appeals had held that a UIM insurer could not be compelled to produce information protected by the attorney-client privilege. The privilege could be overcome, however, upon a showing that the insurer had engaged in fraud. The court endorsed a two-step procedure whereby the insured, to overcome the insurer's privilege, must first make a factual showing adequate to support a good faith belief by a reasonable person that wrongful conduct amounting to civil fraud has occurred. If the insured makes such showing, the trial court will then review the disputed documents in camera.

The trial court in *Cedell*, citing *Escalante*, found that Farmers' claim handling—including offering to resolve the claim for less than the full amount of the appraised damage even though Cedell had been left homeless by the fire—was evidence that Farmers had engaged in wrongful conduct sufficient to invoke the fraud exception. Essentially, the trial court found that, in the context of a first-party claim, any facts indicating insurer bad faith invoked the fraud exception. Accordingly, the trial court reviewed Farmers' claim file documents in camera and ordered that they be produced.

Farmers sought discretionary review in the Court of Appeals, which granted review and stayed the trial court's order of production. In reversing the trial court, the Court of Appeals said: "An insurance company does not lose attorney-client privilege protection simply because its litigation opponent raises an issue where advice of counsel may be relevant. While an attorney's impressions may be relevant to a bad faith claim, an automatic removal of attorney-client privilege would frustrate the purpose of the attorney-client privilege without cause."

Escalante described a fraud exception to the privilege, but, the court said, "[P]roving fraud is different from proving bad faith." Bad faith conduct, for example, may be established by proof of an unreasonable violation of administrative regulations, whereas fraud requires a knowing and intentional misrepresentation of fact. Because there was no foundational showing of fraud to support the trial court's decision, it must be reversed. Significantly, the court held that a

statement made in *Barry v. USAA* (a 1999 opinion from Division 3) that a first-party insurer was not entitled to attorney-client privilege was dicta, did not correctly state Washington law, and would not be followed.

The *Cedell* decision has important lessons for insurers:

- A first-party insurer has a right to privileged attorney-client communications;
- The insurer's attorney-client privilege cannot be overcome by allegations of bad faith; to overcome the privilege, the insured must lay a foundation of facts from which a reasonable person could conclude the insurer engaged in civil fraud;
- An insurer "may not hire an attorney as a claims adjuster just to fall within the attorney client privilege."