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Washington Supreme Court Announces New Presumption of No Attorney-Client Privilege for First-Party Insurers

By Matthew J. Sekits, Daniel R. Bentson

In Washington bad faith actions, first-party insurers now face a presumption that the attorney-client privilege does ***not*** apply. In *Cedell v. Farmers Ins. Co. of Wash.*, 2013 WL 633128 (Wash. Feb. 21, 2013), a fire damaged the policyholder's home. The policyholder, Cedell, was not at home at the time. But Cedell's girlfriend, Ackley, was there and she called the fire department, saying a lit candle caused the fire.

Cedell submitted a claim to Farmers. Although the local fire department determined the fire was likely accidental, "Farmers, nevertheless, delayed its coverage determination, noting that Ackley (who was not an insured) had given inconsistent statements." Ackley's inconsistent statements involved an admission that she might have consumed methamphetamine on the day of the fire. To assist Farmers with making its coverage determination, Farmer's hired a lawyer, who took the EUOs of Cedell and Ackley, sent letters to Cedell, and communicated a settlement offer on Farmers' behalf.

Cedell sued Farmers, alleging bad faith. In response to Cedell's discovery requests, Farmers declined to answer certain interrogatories and redacted its claim file based on the attorney-client privilege. Cedell filed a motion to compel, which the trial court granted. The Washington Court of Appeals granted interlocutory review and reversed.

A divided Washington Supreme Court reversed in a five-to-four decision. The court held that, outside of the UIM context, in a first-party claim for bad faith, there is a presumption of ***no*** attorney-client privilege. In other words, there is a presumption that the insurer has to turn over its entire claim file, including communications with its lawyers, to the insured.

The insurer has a right to overcome this presumption at a private, or in camera, proceeding before the trial court judge. At this proceeding, the insurer must establish that the claimed privileged materials relate only to legal advice regarding the insurer's coverage decision and do not relate to claim-handling functions, such as investigating, evaluating, negotiating, or processing the claim. The court referred to these claim-handling functions as the insurer's "quasi-fiduciary" functions.

Even if the insurer prevails at the in camera proceeding, however, the policyholder may still pierce the attorney-client privilege by showing that the civil fraud exception applies. Proving the civil fraud exception applies involves a two-step process. First, the policyholder must establish that a reasonable person would have a reasonable belief that an act of bad faith occurred. Second, the judge reviews the privileged materials, in camera, and, if the judge finds "there is a foundation to permit a claim of bad faith to proceed," the attorney-client privilege is deemed waived. The court, however, did not clarify or provide further guidance on how to apply this second test.

Cedell significantly limits the attorney-client privilege available to first-party insurers facing allegations of bad faith. One practice suggested by the *Cedell* court is that an insurer hoping to preserve the privilege should set up two separate files for its attorney: (1) a file for providing legal advice and (2) a file for assisting with the investigation of the claim. Insurers who adopt this practice may stand a better chance of establishing and maintaining the attorney-client privilege for communications with their lawyers.