Washington Supreme Court: insurer's communications with coverage counsel now presumptively discoverable

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The Washington Supreme Court recently issued a landmark decision barring insurance companies from relying on the attorney-client privilege to avoid disclosure of communications with outside counsel related to the investigation, evaluation, negotiation or processing of bad faith insurance claims. *Cedell v. Farmers Insurance Company of Washington*, 295 F.3d 239 (2013). Because national insurance companies frequently rely on the expertise of local Washington coverage attorneys to adjust construction defect claims only to hide behind the cloak of attorney-client privilege after denying coverage, this decision will benefit all in the construction industry – contractors, subcontractors, and developers alike – by exposing insurance companies' bad faith practices and subjecting them to liability under Washington's Insurance Fair Conduct Act.

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The policyholder in this case, Cedell, suffered a loss in 2006. The insurance company, Farmers, delayed its coverage determination and eventually retained coverage counsel to assist with the handling of Cedell's insurance claim. Eight months after the loss, Farmer's coverage counsel sent Cedell a "one-time offer of $30,000" to settle Cedell's insurance claim; an amount significantly less than the $105,000 exposure Farmers initially estimated. Cedell accordingly filed suit alleging, among other things, that Farmers acted in bad faith in handling his insurance claim.

After filing suit, Cedell issued discovery requests to Farmers. Farmers produced a heavily redacted claims file and refused to answer interrogatories on grounds that the information sought was privileged. Cedell accordingly moved to compel the disclosure of that information and the superior court ordered that Farmers produce the documents it previously withheld or redacted.

The Court of Appeals reversed the superior court ruling, but the Washington Supreme Court granted review. In siding with Cedell, the Washington Supreme Court established a four-step process by which insurance companies must abide to avoid disclosure of communications which may otherwise be protected by the attorney-client privilege:

- First, the Washington Supreme Court established that there is a "presumption that there is no attorney-client privilege relevant between the insured and the insurer in the claims adjusting process, and that the attorney-client and work product privileges are generally not relevant."
- Second, "the insurer may overcome the presumption of discoverability by showing its attorney was not engaged in the quasi-fiduciary tasks of investigating and evaluating or processing the claim, but instead in providing the insurer with counsel as to its own potential liability; for example, whether or not coverage exists under the law."
- Third, if the insurance company makes such a showing, the insurance company is entitled to an *in camera* review of the questioned communications and "to the redaction of communications from counsel that reflected the mental impressions of the attorney to the insurance company, unless those mental impressions are directly at issue in the quasi-fiduciary responsibilities to its insured."
- Finally, if the court finds the attorney-client privilege applies, "then the court should next address any claims the insured may have to pierce the attorney-client privilege," such as the fraud exception.

The Washington Supreme Court's four-step process was established to protect two fundamental public policy pillars: (1) that insurance companies have a good faith, quasi-fiduciary duty to their policyholders under Washington law; and (2) that insurance policies, practices, and procedures are highly regulated in Washington and of substantial public interest. Those two fundamental public policy pillars apply to first-party insurance policies and third-party liability insurance policies alike; in fact, those two public policy pillars have even greater import in the context of third-party liability insurance policies because third-party liability insurers have an *enhanced* duty of good faith under Washington law. Thus, while insurers will likely argue the *Cedell* decision only applies to bad faith insurance claims involving first-party insurance policies, the four-step process established by the Washington Supreme Court necessarily applies to first-party insurance policies and third-party liability insurance policies alike.

Accordingly, insurance companies defending against bad faith claims in Washington can no longer rely on the attorney-client privilege to avoid disclosure of communications with outside counsel related to the investigation, evaluation, negotiation or processing of a policyholder's insurance claim. As the Washington Supreme Court aptly noted, "[t]o permit a blanket privilege in insurance bad faith cases because of the participation of lawyers hired or employed by insurers would unreasonably obstruct discovery of meritorious claims and conceal unwarranted practices." *Id.* at 245.

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