

# Discovery of Insurance Claims Files

## *An Analysis of Attorney-Client and Work Product Privilege Defenses*

By Jeffrey J. Wiseman and Joseph W. Rohe

In most litigated cases where an insurance policy may be in play, counsel for the plaintiff will very often seek through discovery a copy of the insurance company's claims files. Not surprisingly, counsel for the defendants and the insurers will fight to prevent disclosure to the plaintiff. Despite an issue so significant in modern litigation, there is very little specific guidance in South Carolina concerning the parameters of discovery of this information.

Pursuant to Rule 26 of the S.C. Rules of Civil Procedure, the General Provisions Regarding Discovery, a party "may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action ..." Moreover, it is widely accepted that "[i]n South Carolina, the scope of discovery is very broad ..." *Samples v. Mitchell*, 329 S.C. 105, 110, 495 S.E.2d 213, 215 (Ct. App. 1997). In fact, the

material sought need not be admissible at trial, so long as it "appears reasonably calculated to lead to the discovery of admissible evidence." Rule 26(b)(1), SCRCP. Accordingly, defending the disclosure of the claims file requires a showing of privilege—either under the attorney-client privilege or the work product doctrine. To that end, advocates for insurance companies often argue that as soon as a claim is made against the insured, statements given by that insured in the course of the investigation, along with any other notes or documentation generated during the investigation, are protected under one or both of these doctrines. It is worth noting that when a party asserts a claim of privilege, the burden of proving the particular document or communication is in fact privileged rests upon the party asserting such privilege. See *State v. Love*, 275 S.C. 55, 271 S.E.2d 110 (1980).



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## Defenses under the attorney-client privilege

Plainly stated, the attorney-client privilege protects against disclosure of confidential communications by a client to his attorney. See *Tobaccoville USA, Inc. v. McMaster*, 387 S.C. 287, 293, 692 S.E.2d 526, 529 (2010). This privilege is based upon a policy that considers that the interests of society are best promoted by inviting the utmost confidence on the part of the client in disclosing his secrets to a professional advisor. *Id.* (citing *State v. Owens*, 309 S.C. 402, 407, 424 S.E.2d 473, 476 (1992)). Obviously, this definition raises questions of applicability when applied to communications between an insured and his insurer.

The Supreme Court has on more than one occasion explained the attorney-client privilege as follows: (1) where legal advice of any kind is sought (2) from a professional legal advisor in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal advisor, (8) except where the protection is waived. See *Tobaccoville USA*, 387 S.C. at 293, 692 S.E.2d at 529 (citing *State v. Doster*, 276 S.C. 647, 651, 284 S.E.2d 218, 219-20 (1981)). Similarly, the American Law Institute's Restatement explains that the attorney-client privilege applies only to "(1) a communication, (2) made between privileged persons, (3) in confidence, (4) for the purpose of obtaining or providing legal assistance for the client." Restatement (Third) of the Law Governing Lawyers § 68 (2000). However, in *Tobaccoville USA*, the court found that retention of counsel was not a component necessary to trigger the privilege. 387 S.C. at 292-93, 692 S.E.2d at 529 (finding solicitation of counsel for legal advice and consultation may give rise to a privilege).

South Carolina courts have not addressed the attorney-client privilege in the context of insurance claims adjusting. The issue is whether the statement, given by the insured to his insurance company—

before defense counsel is ever hired—is protected as attorney-client privilege communication. South Carolina state courts have not ruled, and other state jurisdictions are split, on whether these statements fall within the privilege. See John P. Ludington, Annotation, *Insured-Insurer Communications as Privileged*, 55 A.L.R. 4th at 340-41 (1987); see also *Langdon v. Champion*, 752 P.2d 999, 1003 (Alaska 1988) (rejecting the argument that a privilege exists on the grounds that an insurance company may use the information against the insured to dispute coverage under the policy).

There are compelling arguments on both sides of this issue. The Illinois courts have since 1964 recognized as privileged those communications between an insured and the insurer where the insurer is under an obligation to defend. See *People v. Ryan*, 197 N.E.2d 15, 17 (Ill. 1964). The basis for this privilege is that although communications by an insured were made to a layman and oftentimes no lawyer would actually be retained for a defense, by the terms of the insurance contract the insured effectively delegated selection of counsel and conduct of the defense to its insurer. See *id.* Accordingly, the Court in *Ryan* found that "under such circumstances ... the insured may properly assume that the communication is made to the insurer as an agent for the dominant purpose of transmitting it to an attorney for the protection of the interests of the insured." *Id.* at 17. Moreover, the Court held that public policy dictates that such statements are to be clothed with the attorney-client privilege while in control of the insurer. See *id.*

Conversely, several federal courts have expressly rejected the argument that the communication is privileged. See *Better Gov't Bureau v. McGraw (In re Allen)*, 106 F.3d 582, 602 (4th Cir. 1997) (noting that "no privilege attaches when an attorney performs investigative work in the capacity of an insurance claims adjuster, rather than as a lawyer."). Because the federal courts have spoken on this issue, it is likely our state courts would follow suit

"[s]ince our Rules of Procedure are based on the Federal Rules [and] where there is no South Carolina law, we look to the construction placed on the Federal Rules of Procedure." *Gardner v. Newsome Chevrolet-Buick, Inc.*, 304 S.C. 328, 330, 404 S.E.2d 200, 201 (1991). The Fourth Circuit has held that privilege attaches only after the claims adjuster hires a lawyer. See *Zurich Am. Ins. Co. v. Tessler (In re J.A. Jones, Inc.)*, 492 F.3d 242, 246 (2007); cf. *Tobaccoville USA*, 387 S.C. at 292-93, 692 S.E.2d at 529 (holding that the retention of counsel is not a necessary component to triggering privilege). These courts reason that the privilege should not apply because insurers are free to use the information learned from the insured for purposes adverse to the insured's interests—for example, coverage actions against the insured seeking to disclaim coverage. See *Tessler*, 492 F.3d at 246; see also *Langdon*, 752 P.2d at 1003.

For the jurisdictions that do allow a carrier to assert a privilege in this circumstance, courts generally recognize many exceptions to this privilege. One exception to such privilege occurs when the investigation/interview was conducted by an independent insurance adjuster hired to investigate the claim against the insured. See *Shere v. Marshall Field & Co.*, 327 N.E.2d 92, 94 (Ill. App. Ct. 1974) (noting that the "attorney-client privilege has never been extended to cover communications to such third parties."). Thus, claims handled by the insurer internally may be protected, while those outsourced will likely be subject to discovery.

Because state courts may look to federal decisions under the doctrine espoused in *Gardner*, the Fourth Circuit decisions are likely to carry some influence with the South Carolina courts. Accordingly and under the persuasive authority of the Fourth Circuit in *Tessler*, it is likely South Carolina courts would not apply the attorney-client privilege prior to the matter's referral to defense counsel. However, pursuant to *Tobaccoville USA*, one must be mindful that the "retention" of

counsel is not necessary to trigger the privilege; therefore, the courts may well uphold the attorney-client privilege beginning as early as counsel is consulted regarding the case—albeit prior to formal retention. See *Tobacoville USA*, 387 S.C. at 287, 692 S.E.2d at 526.

### Defenses under the work product doctrine

Unlike the attorney-client privilege, the attorney work product doctrine applies only to tangible discovery. The work product doctrine protects from discovery documents prepared in anticipation of litigation, unless a substantial need can be shown by the requesting party. *Id.* at 294, 692 S.E.2d at 530. Unfortunately, the South Carolina courts have not specifically addressed whether a claims adjuster's investigational file is protected by the work product doctrine. However, and as noted above, guidance may be garnered from the federal courts' interpretation of the federal procedural rules. See *Gardner*, 304 S.C. at 330, 404

S.E.2d at 201.

Generally, in determining whether a document has been prepared "in anticipation of litigation," courts look to whether the document was prepared *because* of the prospect of litigation. *Tobacoville USA*, 387 S.C. at 294, 692 S.E.2d at 530; see also *Nat'l Union Fire Ins. Co. v. Murray Sheet Metal Co., Inc.*, 967 F.2d 980, 984 (4th Cir. 1992) (finding that the document "must be prepared because of the prospect of litigation when the preparer faces an actual claim or a potential claim," as contrasted to "materials prepared in the ordinary course of business or pursuant to regulatory requirements or for other non-litigation purposes."); *U.S. v. Torf (In re Grand Jury Subpoena)*, 357 F.3d 900, 907 (9th Cir. 2004) (holding a document "should be deemed 'in anticipation of litigation'... if ... [it] can be fairly said to have been prepared or obtained because of the prospect of litigation."); *DeNova v. U.S. Dep't of Labor (In re Kaiser Aluminum & Chem. Co.)*, 214 F.3d 586, 593 (5th

Cir. 2000) (holding the primary motivation behind creating the document must be to aid in possible future litigation). For instance, in *Sham v. Hyannis Heritage House Hotel, Inc.*, 118 F.R.D. 24, 25 (D. Mass. 1987), a Massachusetts federal district court espoused that, under Rule 26(b)(3) of the Federal Rules of Civil Procedure, the test to determine whether information may be characterized as work product is whether the material in question: (1) is a document or tangible thing; (2) prepared in anticipation of litigation; and (3) was prepared by or for a party, or by or for its representative.

The general rule appears to be that materials compiled through the ordinary course of business are discoverable, as opposed to those prepared "in anticipation of litigation." See *id.* at 25. However, the issue of whether a claims file is in fact prepared in anticipation of litigation is a divided issue among jurisdictions.

### The minority view

The minority position adopted

## HARRY L. GOLDBERG MEDIATOR



### Attorney At Law

CERTIFIED MEDIATOR SINCE 1995 IN STATE & FEDERAL COURTS

**Personal Injury  
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PO Box 1799 \* Columbia, SC 29202  
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by some jurisdictions is that “all materials located in an insurance claims adjuster’s files must be deemed to have been collected or created in anticipation of litigation because it is in the nature of the insurance business to always be preparing for litigation.” *S.D. Warren Co. v. Eastern Elec. Corp.*, 201 F.R.D. 280, 283 (D. Me. 2001). However, this bright-line view is frequently rejected as it would afford insurance companies special treatment. *See id.* In rejecting this position, courts have noted that it “does not necessarily follow that because insurance claims sometimes require litigation, all claim related documents prepared by an insurance company and its agents are also prepared in anticipation of litigation.” *Id.* at 284 (emphasis added). It has also been reasoned that this view is contrary to the duty of good faith owed by an insurer to both the insured and third party claimants, because the duty requires that an insurance company first make a good faith attempt to avoid litigation by paying deserving, valid

claims. *Id.*; *see also Allendale Mut. Ins. Co. v. Bull Data Sys., Inc.*, 145 F.R.D. 84 (N.D. Ill. 1992) (noting that the courts must allow claimants “the hope that the insurer will cover a loss potentially under a policy without the necessity of litigation.”); *Gillette v. Estate of Gillette*, 837 N.E.2d 1283, 1286 (Ohio Ct. App. 2005) (“Generally, an insurer has a duty to exercise good faith in the processing and payment of valid claims of its insured.”); *Dairyland Ins. Co. v. Herman*, 954 P.2d 56, 61 (N.M. 1997) (“It is common knowledge that a large percentage of the claims covered by insurance are settled without litigation and that this is one of the most usual methods by which the insured receives protection.”). Finally, this rule ignores the reality that insurance companies very often use the same statements against their insured to avoid coverage. *See Tessler*, 492 F.3d at 246 (internal quotations omitted).

### **The majority view**

Conversely, the majority of

jurisdictions that have addressed the issue hold that “any report or statement made by or to a party’s agent (other than to an attorney acting in the role of counsellor [*sic*]), which has not been requested by nor prepared for an attorney nor which otherwise reflects the employment of an attorney’s legal expertise must be conclusively presumed to have been made in the ordinary course of business and thus not within the purview of the limited privilege of ... Rule 26(b)(3) and (b)(4).” *McDougall v. Dunn*, 468 F.2d 468, 473 (4th Cir. 1972) (*citing Thomas Organ Co. v. Plovidba*, 54 F.R.D. 367, 372 (N.D. Ill. 1972)). However, being a presumption, this may be rebutted by evidence to the contrary. Thus, the majority rule is that courts should employ a fact-specific inquiry in deciding whether the work product doctrine will shield a particular document from discovery. *S.D. Warren*, 201 F.R.D. at 283-84 (“The overwhelming majority of federal courts ... have chosen not to accord insurance companies special treatment during discovery and have maintained the fact specific approach in this context.”). “This approach realistically recognizes that at some point an insurance company shifts its activity from the ordinary course of business to anticipation of litigation and no hard and fast rule governs when this change occurs.” *State Farm Fire & Cas. Ins. Co. v. Perrigan*, 102 F.R.D. 235, 238 (W.D. Va. 1984) (internal quotations omitted). The “distinction [between “ordinary course of business” and “anticipation of litigation”] lies at the pivotal point where the probability of litigating the claim is substantial and imminent.” *Id.* (quoting *Carver v. Allstate Ins. Co.*, 94 F.R.D. 131, 134 (S.D. Ga. 1982)). Additionally, the Second Circuit has stated the test to be whether the document was “prepared principally or exclusively to assist in anticipated or ongoing litigation.” *United States v. Constr. Prods. Research, Inc.*, 73 F.3d 464, 473 (1996) (emphasis added).

The Fourth Circuit somewhat clouded the issue in holding that

the document must be “prepared because of the prospect of litigation when the preparer faces an actual claim following an actual event or series of events that reasonably could result in litigation.” *Murray Sheet Metal*, 967 F.2d at 984 (emphasis added). Also, a discovery opponent must show “objective facts establishing an identifiable resolve to litigate.” *Bull Data*, 145 F.R.D. at 87. The truth-seeking policy behind broad discovery rules precludes insurers from withholding the discovery of materials that are produced in connection with the routine investigation and evaluation of an insurance claim merely because that material was prepared in regard to a specific claim. *Id.* at 87-8.

These cases suggest that South Carolina’s broad discovery rules will likewise preclude insurers from withholding discovery under such a policy as espoused in *Bull Data*. As such, claims handling practices should be tailored so as to provide the greatest possible protection to this information.

### Protecting the claims file

Notwithstanding South Carolina’s broad scope of discovery, there are several steps that may be taken to increase the chances that the claims file will remain protected.

First, when an insurer receives a claim that it suspects may eventually go to litigation, an explanatory notation to that effect should be included in the file. For example, if the claimant is represented by an attorney and that attorney has given an indication that his or her expectations of settlement or liability are unrealistic, a notation should be included in the file stating, “This claim is almost certain to end up in litigation due to [list the reasons]. I am preparing this file for litigation by doing [list investigative steps].” There is very little, if any, risk in being wrong on this point—if the insurer is able to resolve the claim without litigation, there is no harm in having this notation in the file. In the event the claim cannot be settled and does end up in litigation, this notation is evidence to be

submitted to the court supporting an argument that everything done after the date of the notation was “in anticipation of litigation” and therefore protected by the work product doctrine.

Secondly and where possible, insurers should involve defense counsel earlier in the claims process rather than later—where the insurer knows the claim is likely to go to litigation, it should not wait until after a summons and complaint have been served to consult counsel. This may be as simple as contacting counsel to briefly discuss the main issues of the case before proceeding with the investigation of the claim. These simple steps may well determine whether privilege attaches and, if so, when privilege attaches to the file.

*Jeffrey J. Wiseman is an associate with Young Clement Rivers, LLP in Charleston in the Commercial Litigation and Insurance Coverage practice groups. Joseph W. Rohe is law clerk to the Hon. Robin B. Stilwell, Circuit Judge, 13th Judicial Circuit, in Greenville.*

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