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Are Pre-Denial Claims Communications Admissible In Court?: Clarifying Protections Afforded By Attorney-Client Privilege and Work-Product Doctrine

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The attorney work-product privilege is one of the three primary privileges incorporated into Exemption 5 of the Freedom of Information Act (FOIA), 5 U.S.C. § 552(b)(5). It protects materials prepared by an attorney or others in anticipation of litigation, ostensibly shielding materials that would disclose the attorney's theory of the case or trial strategy. President Lyndon B. Johnson originally signed FOIA into law by on July 4, 1966 and it went into effect the following year.

To qualify as attorney work-product, a document must be "prepared in anticipation of litigation." This means that the privilege does not attach until "at the very least some articulable claim, likely to lead to litigation," has arisen. So are documents compiled prior to a claims decision always protected, or are they fair game during litigation? Well, it depends.

In a recent $70 million lawsuit involving turbine damage, a New York court held that an insurer cannot withhold pre-denial documents and communications simply because an attorney conducted the coverage investigation. In essence, the court asserted that neither the attorney-client privilege nor the work-product doctrine applied to reports prepared by outside counsel because the reports were created before the insurers made a "firm decision" to either approve or deny the claim, which involved $5 million in property damage and another $65 million in business interruption (BI) losses.

The case was National Union Fire Ins. Co. of Pittsburgh, Pa. v TransCanada Energy USA, Inc., and other courts have ruled similarly. Below, we examine the reasons behind the TransCanada ruling in order to *contemplate implications for p&c insurance carriers.*

A Damaged Power Generator

The court in *National Union Fire Ins. Co. of Pittsburgh, Pa. v TransCanada Energy USA, Inc.*, No. 650515/2010, 2013 N.Y. Misc. LEXIS 3735 (N.Y. Sup. Ct., August 15, 2013), held that neither the attorney-client privilege nor the work product doctrine applied to reports prepared by outside counsel for their insurer-clients in connection with a coverage investigation because the reports were created before the insurers made a "firm decision" to deny coverage for the claim.

The coverage dispute in *TransCanada Energy* turned on whether four property insurers were obligated to cover repair costs and business interruption losses (BI) relating to a damaged steam turbine power generator owned by the insured. The steam turbine was insured under a "quota share" property insurance program in which each of the insurers issued a separate policy to the insured that applied to a pre-determined percentage of covered losses.

After receiving notice of the damage to the turbine, the insurers collectively retained a law firm to investigate the facts and evaluate whether the claim was covered. In connection with their investigation, the attorneys collected documents, hired and supervised investigators, and prepared reports summarizing the results of the investigation.

After their investigation was complete, the insurers denied coverage and filed a declaratory judgment action against the insured. During discovery, the insurers refused to produce the attorneys' reports and related documents, invoking attorney-client privilege and the work-product doctrine.

Following an *in camera* review of the withheld documents, the court held that all documents prepared before the insurers denied coverage must be produced. The court provided several reasons in support of its ruling:

The Work Product Doctrine Is Inapplicable to Documents Created Before an Insurer Makes a "Firm Decision" to Deny Coverage

The attorney work product doctrine shields from discovery documents prepared by an attorney during litigation, or in anticipation of litigation. The court held that the reports at issue were not protected work product because "[a]n insurance company cannot claim documents are prepared in anticipation of litigation until it makes a firm decision to deny coverage." Because the insurers could not prove that they made a "firm decision" to deny coverage before the attorneys prepared their reports, the work product doctrine was inapplicable.

The Attorney-Client Privilege Is Inapplicable to Documents Prepared in the "Ordinary Course of Business" Which, for an Insurer, Includes Evaluating Whether a Claim Is Covered

In order to withhold a document from production based on the attorney-client privilege, the party seeking to withhold the document must show that it is a confidential communication between an attorney and a client made primarily for the purpose of furnishing legal advice, rather than a document prepared "in the ordinary course of business." The court held that the communications between the insurers and their attorneys regarding the coverage investigation and evaluation were not privileged because they related to the insurers' "ordinary business activities." As the court explained, "[i]nsurance companies investigate claims and decide whether to accept or deny coverage as part of their regular business activities, and . . . the use of attorneys to perform such work does not cloak the documents in privilege."

The Common Interest Doctrine Does Not Apply to Communications Among Co-Insurers Prior to Coverage Denial

The court also held that to the extent documents created before the insurers denied coverage were privileged, the insurers nevertheless waived that privilege by sharing the documents amongst themselves as part of their joint coverage investigation. In so ruling, the court rejected the insurers'

position that they had not waived the attorney-client privilege because the insurers shared a "common interest." Noting that the common interest doctrine is not an independent privilege but, rather, an exception to the general rule that a party waives the attorney-client privilege when it discloses otherwise privileged information to a third party, the court explained that the common interest exception applies only when the parties share a common legal—rather than commercial—interest. As such, the court held that the common interest doctrine was inapplicable to communications made before the insurers denied coverage because prior to that time, the insurers' common interest was commercial, not legal.

Other courts similarly have held that an insurer cannot withhold pre-denial documents and communications simply because an attorney conducted the coverage investigation. *See, e.g., Country Life Ins. Co. v. St. Paul Surplus Lines Ins. Co*., No. 03-1224, 2005 U.S. Dist. LEXIS 39691, at *23 (C.D. Ill. January 31, 2005) (coverage opinion and related documents prepared by outside counsel for insurer not protected work product because to "the extent that these attorneys were opining about whether the relevant facts fit within the various terms of the policy, they were doing exactly what a claims adjuster does . . . . [A]n insurer cannot delegate its obligation to make a coverage determination, which is after all its business, to an attorney and then claim 'work product privilege.'").

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