

# Watch What You Say About Insurance Claims

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*"The charm of fishing is that it is the pursuit of what is elusive but attainable."* —John Buchan, *His Excellency the Right Honorable Lord Tweedsmuir* It's not news that plaintiffs' lawyers contrive far-fetched rationales for rummaging through insurer's records, but a recent case from South Dakota illustrates just how much discovery even flimsy arguments can yield—especially when ambiguous evidence provides an opening. In [Andrews v. Ridco Inc. \(S.D. April 29, 2015\)](#), a workers compensation claimant obtained **200 complete set of notes from wholly unrelated claims**, using one poorly-worded memo to suggest the insurer had formed a "plan" to "blackmail" injured workers, and then nakedly asserting that he had been subjected to "closely similar" practices. To make matters worse, it took an appeal to the state's Supreme Court to overcome the additional argument that an insurer had **waived the attorney client-privilege**, merely by including legal correspondence in the claim files.

## **There's Gold in Those Hills**

The plaintiff in *Andrews* worked as a polisher for Ridco, a Rapid City firm that manufactures Black Hills gold jewelry. Mr. Andrews suffered work-related back and neck injuries in March 2005; he received temporary disability payments from Ridco's wc carrier through May of that year, and he got payments for medical treatment through March 2006. In 2012, an administrative law judge for the South Dakota Department of Labor ruled that he was entitled to payment for continued treatment. In 2010, while the administrative action was still pending, Mr. Andrews also filed a lawsuit against Ridco and its insurer, Twin City Fire Insurance Company, alleging that his claim had been handled in bad faith. Twin City is a subsidiary of The Hartford Financial Services Group, Inc. (Full disclosure: the author represents The Hartford and Twin City in matters unrelated to the *Andrews* and *Hammonds* cases.) Years earlier, another Hartford subsidiary had successfully defended an unrelated bad faith suit in South Dakota, brought by the same firm that represented Mr. Andrews. The plaintiff in *Hammonds v. Hartford Fire Ins. Co.*, 501 F.3d 991 (8th Cir. 2007), an incomplete quadriplegic, focused on a "Large Loss Initiative" that Hartford adopted in 1998, to review open workers compensation claims with reserves of more than \$1 million. An internal Hartford document declared an "expectation" that nearly 25% of those claims could be resolved by settlement, and that the effect of those settlements on the company's reserves could "significantly impact the financial status of The Hartford." In *Hammonds*, after the district court examined the evidence relating to the Large Loss Initiative, it found that the plaintiff had **failed to identify any action taken by Hartford without**

**reasonable cause**, and the Eighth Circuit affirmed. The Large Loss Initiative was discontinued in 2001, although an e-mail from 2001 suggested making a **proposal** to company management to "prioritize" claims with reserves over \$500,000, "with the emphasis on the right decision for settlement." The claim in *Andrews* was not filed until 2005, and it was reserved for only \$322,000. Nevertheless, the plaintiff in *Andrews* asked Twin City to produce not only his own claim file, but also the complete notes for every one of the 247 claims that were reviewed under the Large Loss Initiative in the 1990s. In a motion to compel production, plaintiff asserted, in effect, that the federal courts which ruled in *Hammonds* had **gotten the facts wrong**: he claimed that "[t]he essential plan" of the Large Loss Initiative had been "to intimidate, coerce, and (as in the case of Jackie Hammonds' claim) sometimes blackmail seriously injured claimants into agreeing to reductions in ... benefits." Plaintiff further asserted (i) that his claim had been subjected to practices that were "**closely similar to those**" he said had been employed under the Initiative, and (ii) that it had been handled by personnel who "**were also involved**" in handling or supervising claims that the Initiative reviewed. In June 2013, **the trial court granted the motion to compel**. The insurer complied by **producing 199 sets of claim notes** (another 48 files had not been preserved). **"At-Issue" Waiver**

The fight that made it to the South Dakota Supreme Court was not over the 199 old claim files, but about certain attorney-client communications those files contained—communications that were redacted in the sets of claim notes produced in discovery. In South Dakota, certain features of insurers' claim files are governed by a statute, S.D.C.L. § 58-3-7.4. The plaintiff made this statute a centerpiece of his argument over privilege, and the trial court agreed:

Pursuant to 58-3-7.4, an insurer is required to maintain '[d]etailed documentation ... in each claim file [sufficient] to permit reconstruction of the insurer's activities related to each claim.' Thus, where a plaintiff ... alleges that a defendant insurer's [claim decision] ... lacked a reasonable basis, *and* the insurer denies such allegation, the contents of the claim file are placed directly at issue. ... To the extent that [the claim handler] embedded attorney-client communications going to the factual grounds (i.e., the reasonable basis or lack thereof) of her benefits decisions in the claim file's central document (i.e., the activity log), the statutory purpose of which document is to provide a record of the insurer's claim-handling decisions, she 'inject[ed] the attorney's advice into the case.' ... Pursuant to SDCL 58-3-7.4, and to the extent necessary to ascertain the factual grounds (or, lack thereof) supporting [the] denials and/or terminations of Timothy Andrews' claims for workers' compensation benefits, attorney-client communications embedded in the claim file's activity log are not privileged and are subject to discovery.

The trial court reasoned, that is, that legal communications simply "are not privileged" if it is **possible** to use them in furtherance of the statutory goal of "reconstruction of the insurer's activities." Put differently, the court found that the statute governing claim files **deprives an insurer of any choice over whether to assert a defense based on advice of counsel**: if the records that must, by law, be included in the claim file include privileged communications; and if the *court* decides that those

communications are "necessary" to the insurer's defense, then the privileged documents **must be produced, even if the insurer does not wish to rely on them.** Using the language of "at-issue" waiver, the court found it possible for an insurer to "inject" legal advice into a case **against its own will. But Wait. There's More!**

In its ruling of June 2013, the court ordered Twin City to apply the foregoing reasoning by including privileged materials in the claim notes it had been ordered to produce. Andrews, however, found the insurer's efforts insufficient, and he filed a second motion to compel, seeking "wholly unredacted" files. Ruling on that motion in November 2013, the trial court found that Twin City had "injected" legal advice into its defense of Mr. Andrews's claim. It **also** found that the privilege had been waived for all attorney-client communications in the **199 other files** Mr. Andrews had requested—including the Hammonds file, as to which two federal courts had already ruled, on the basis of **non-privileged** records, that the insurer had acted with reasonable cause. The court's ruling prompted the following exchange:

**Twin City:** Is there a specific thing that the Court finds was a constitute [sic] of the waiver? **The Court:** Well, I believe it is implied. **Twin City:** And would it be implied for the Andrews[] claims and the other 199 claims? **he Court:** Yes. We'll be in recess.

### The Supreme Court to the Rescue

On appeal, the South Dakota Supreme Court asserted that "at issue" waiver can result only from an "affirmative act" that injects legal advice into the case "specifically."

Regardless of whether [the insurer] 'embedded and redacted' attorney-client communications into the claim notes ..., **this practice does not demonstrate that [it] injected its reliance on the advice of counsel into the bad faith litigation.** [The party asserting waiver] must demonstrate that [the party claiming privilege waived it] **as a result of an affirmative act, such as raising an affirmative defense, and then that [it] specifically relied on the advice of counsel to support its argument that it acted in good faith.**

Merely "alleg[ing] that it did not act in bad faith," the court spelled out, is **insufficient** to "place[] at issue [an insurer's] subjective good-faith reliance on the advice of counsel." Consequently, it was error to find that Twin City had "impliedly waived" the privilege in this case. In a footnote, the Supreme Court also took aim at the notion "that any proper test of a party's assertion of ... privilege must **look to the evidentiary effect**... such claim would have on the opposing party's ability to make its case." The trial court's analysis seemed to accept that notion, finding that the privilege could be waived "to the extent necessary to ascertain the factual grounds" for an insurer's actions. The Supreme Court emphatically rejected it:

This proposed test would shift the focus from the interests of the client ... to the detrimental effect ... on the adverse party. As we explicitly stated in [*Bertelsen v. Allstate Ins. Co.*, 796 N.W.2d 685 (S.D. 2011)], **'the analysis of this issue should begin**

with a presumption in favor of preserving the privilege.' Accordingly, we reject [the] proposed test.

## Multistate Files

The Supreme Court also weighed in on another important aspect of the case. The 199 claim files from the Large Loss Initiative came from all across the United States, and the Supreme Court ruled that any future decisions about whether a privilege applicable to those files had been waived would have to be made "**pursuant to the state law governing each file.**" In each case, the governing law would be that of the state with the "most significant relationship" to the file; the court noted that this would generally be "the state where the communications took place." The court ensured, therefore, that any future wholesale assault on the privileged content of large numbers of claim files will require laborious litigation. **Don't Let This Happen to You**

In *Andrews*, plaintiff's lawyers convinced a court that the files from the Large Loss Initiative might contain admissible evidence, even though the Andrews claim had not been part of the Initiative, and even though it was, in any event, too small to have been subject to its processes. Furthermore, counsel succeeded on this issue, **without** identifying any specific act of bad faith that the Initiative was supposed to have produced—other than the bad faith alleged in *Hammonds*, which had already been **rejected** by two federal courts. With all due respect to the attorneys, it's hard to avoid the conclusion that the insurer's internal descriptions of the Large Loss Initiative played a big part in the court's decision. In those documents, the company acknowledged that it could benefit from entering into structured settlements of a significant number of long-term workers compensation claims. That observation is hardly surprising; the company might well have added that it could conclude those settlements without prejudicing the rights of claimants in any way. But **any** suggestion that a modified claims practice might "significantly impact the financial status of" an insurer opens the door to charges that the company has decided to underpay claims on a systematic basis. In this case, those charges have not resulted in any kind of liability, but they did force an insurer to incur the expense and exposure of coughing up 200 sets of claim notes and litigating privilege issues in a state Supreme Court. *Andrews* is a clear reminder, therefore, that **communications about** proposed changes to claims practices require just as much scrutiny and care as the proposed changes themselves. [1] 2015 S.D. 24 (2015).

[2] 501 F.3d 991 (8th Cir. 2007).

[3] *Bertelsen v. Allstate Ins. Co.*, 796 N.W.2d 685 (S.D. 2011). *Republished with permission by Law360 (subscription required).*

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