

BAD FAITH CLAIMS AND DISCOVERY IN THE SUNSHINE STATE



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Bad faith claims in the Sunshine State can make an insurer shudder: Florida's judicial climate is not known for being particularly warm toward insurers. **Elaine Johnson James**, Partner, **Donna M. Greenspan**, Associate and **J.D. Dickenson**, Associate, of Edwards Angell Palmer & Dodge, report.

An insurer denying coverage in a Florida claim should not expect the work-product doctrine or attorney-client privilege to preclude discovery in a subsequent bad faith action. This article traces the discovery that is available in a Florida bad faith case to the historical distinction between first- and third-party bad faith claims.

Florida Bad Faith Claims – a Historical Perspective

Florida courts have long recognized a common law cause of action for third-party bad faith claims. “[T]he essence of a third-party bad faith cause of action is to remedy a situation in which an insured is exposed to an excess judgment because of the insurer’s failure to properly or promptly defend the claim.”

In *Boston Old Colony v. Gutierrez*, the Florida Supreme Court enumerated the insurer’s duties in handling a third-party claim:

An insurer, in handling the defense of claims against its insured, has a duty to use the same degree of care and diligence as a person of ordinary care and prudence should exercise in the management of his own business. For when the insured has surrendered to the insurer all control over the handling of the claim, including all decisions with regard to litigation and settlement, then the insurer must assume a duty to exercise

such control and make such decisions in good faith and with due regard for the interests of the insured. This good faith duty obligates the insurer to advise the insured of settlement opportunities, to advise as to the probable outcome of the litigation, to warn of the possibility of an excess judgment, and to advise the insured of any steps he might take to avoid same. The insurer must investigate the facts, give fair consideration to a settlement offer that is not unreasonable under the facts, and settle, if possible, where a reasonably prudent person, faced with the prospect of paying the total recovery, would do so.

A third-party bad faith action arises where the insurer allegedly violates the foregoing principles in handling the insured’s defense against claims by an injured third party.

Florida courts view an injured third party as the beneficiary of the bad faith claim, *i.e.*, the real party in interest, akin to a “judgment creditor.” Accordingly, at common law, the injured third party – as well as the insured tortfeasor -- can sue the tortfeasor’s insurer directly for third-party bad faith.

By contrast, first-party bad faith actions do not arise from the insured’s injury to a third party. In a first-party action, the insured asserts that its insurer acted in bad faith when it denied, delayed or underpaid a claim for the *insured’s* injuries or losses.

In 1982, the legislature re-enacted the Florida Insurance Code, codifying the duties enumerated in *Boston Old Colony*, and

expanding upon those duties by incorporating parts of the new Unfair Insurance Trade Practices Act into the Code. The legislature also enacted section 624.155, Florida Statutes, titled "Civil Remedy," which created a statutory cause of action for first- and third-party bad faith. The insured tortfeasor and/or the injured third party can bring a statutory third-party bad faith claim.

The Discovery Distinction between First- and Third-Party Bad Faith Claims:

A Historical Drama in Three Acts

Plaintiffs in bad faith actions invariably seek their insurers' litigation files, adjuster's notes, claims handling manuals, and training manuals. Conversely, insurers seek to protect materials that reveal how they do business.

Under Florida law, an injured third party stands in the shoes of the insured and is therefore entitled to review an insurer's claims and defense files, just as the insured is entitled to review all records relating to his representation. Thus, a plaintiff in a third-party bad faith case, seeking to review underlying claims and litigation files, can trump the insurer's assertion of the work product doctrine and attorney client privilege, even if the injured third party brings the action directly against the insurer. Until recently, however, insurers responding to discovery requests for claims files in *first-party* bad faith actions could assert the work product and attorney client privileges.

Act I – The First- vs. Third-Party Discovery Distinction Is Born

In 1989, the Florida Supreme Court distinguished between the discovery available to plaintiffs in first- versus third-party bad faith claims in *Kujawa v. Manhattan Life Ins. Co.* Reasoning that the relationship between insured and insurer in a first-party dispute is purely adversarial, the Court in *Kujawa* held that an insurer could invoke the work product doctrine and attorney client privilege in first-party bad faith litigation.

Act II – The First- vs. Third-Party Discovery Distinction Is Dead, Or Is It?

In 2005, the Florida Supreme Court "reconsidered the wisdom" of its decision in *Kujawa*. In *Allstate v. Ruiz*, the Court appeared to eviscerate the distinction between the discovery required from insurers in first-party versus third-party bad faith claims. When considering whether the work-product doctrine should protect the insurer's documents from discovery in a first-party bad faith case, the Court held:

... any distinction between first- and third-party bad faith actions with regard to discovery purposes is unjustified and without support under section 624.155 and creates an overly formalistic distinction between substantively identical claims.

Because the documents typically found in claims files are virtually the only direct evidence of how the insurer handled the insured's claim, the Court held that **all** materials created before or on the date when the underlying dispute was resolved should be produced in a first-party bad faith action, just as they are in a third-party action. Material pertaining in any way to coverage, benefits, liability, or damages is now discoverable in any bad faith action. Thus, at least with respect to the work product privilege, *Ruiz* removed the distinction between the discovery that insurers must provide in first- and third-party bad faith actions.

However, the Court was divided on this point:

In my opinion, there continue to be distinctions for purposes of discovery between first-party and third-party bad faith actions That difference is that in the claim on the policy, the insured and insurers are in an adversarial relationship, as this Court stated in *Kujawa*. The insurer must have the right to defend the claim without work product of the attorney for the insurer being subject to discovery while the claim remains pending.

Plaintiffs subsequently have used *Ruiz* to obviate the *attorney-client privilege* as well as the work product doctrine in bad faith

cases and to justify broad and burdensome discovery requests. Moreover, some federal courts have interpreted *Ruiz* broadly and held that, under Florida law, insurers may not assert the attorney-client privilege in response to discovery requests for claims files in first-party bad faith cases.

Act III - Recent Developments - The Attorney Client Privilege:

Is *Kujawa* Still Alive?

After *Ruiz*, the debate in bad faith discovery cases centered on the application of the attorney-client privilege in first-party bad faith claims. In *XL Specialty Ins. Co. v. Aircraft Holdings, LLC*, the court held that *Ruiz* related only to the work product privilege, and did not apply to attorney-client communications in first-party bad faith cases. The court noted that the attorney-client privilege was not an issue in *Ruiz* and the Court therefore could not have ruled upon the application of that privilege. The XL court painstakingly discussed *Kujawa* and concluded that *Ruiz* did not recede from *Kujawa*'s holding that an insurer may assert the attorney-client privilege in a first-party bad faith action in response to discovery requests for claims files. Finally, the XL court certified to the Florida Supreme Court the question whether, after *Ruiz*, the attorney-client privilege no longer applies to insurers in first-party bad faith actions.

Although the Court expressly receded from *Kujawa* in *Ruiz*, *XL* demonstrates that the precise parameters of the *Ruiz* opinion have not been definitively ascertained. On March 7, 2007, the Florida Supreme Court heard oral argument in *XL*, presiding over a spirited discussion of the insurers' protections against discovery in first- versus third-party bad faith claims. A decision is pending. The Court might comment on the distinction, if any, between the privileges insurers may assert in first- and third-party bad faith cases, and thereby clarify the state of Florida law. In the meantime, claims managers should not expect that their files and attorney communications will remain confidential in any bad faith litigation. GB