Defending the Bad Faith Claim: Discovery

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Bad faith claims can be about more than just whether the insurer handled and evaluated the insured's claim in a reasonable matter. Increasingly, plaintiffs seek to expand the case to include claims that the insurer's business practices are designed to reduce claim payouts to benefit the insurer. This approach can result in substantial compensatory and punitive damages. Controlling discovery on these issues is critical to the defense of the insurer. This article will explore typical discovery requests and how to limit discovery responses to those that are relevant or reasonably calculated to lead to the discovery of admissible evidence.

1. Claim File

Under Arizona law, the insurer's claim file generally is discoverable in a bad faith case because it provides evidence of the insurer's subjective thought process. *Brown v. Superior Court*, 137 Ariz. 327, 670 P.2d 725 (1983). The attorney-client privilege still applies to legal advice rendered in connection with the claim. However, if the company defends the claim by asserting that its claims decisions were subjectively reasonable, the court may imply a waiver of the attorney-client privilege, and the documents will be discoverable. *State Farm Mutual Automobile Insurance Co. v. Lee*, 199 Ariz. 52, 13 P.3d 1169 (2000). It is important to carefully evaluate whether to assert subjective bad faith if legal advice was given but not followed or the insurer's attorney provided adverse legal opinions generally or in connection with similar claims.

2. Company Policies and Procedures

Plaintiffs usually request all claims manuals, procedures, guides, homeowner's claims handling memos, and guidelines utilized by the adjusters, which generally are discoverable in bad faith cases. However, these document requests can be overly broad in terms of both subject matter and time. Courts have limited discovery or admissibility of these types of documents to the specific issues in the case. Courts have denied overbroad requests, ordering production of those materials relevant to the time frame of the claim.

Most bad faith claims will involve the production of some of the insurer's documents addressing claims handling practices and procedures. If these documents are proprietary, they should only be produced pursuant to a protective order. The federal and Arizona versions of civil procedure rule 26(c)(7), provide that the court can enter orders that confidential commercial information be disclosed only in a certain way. Many courts have recognized internal insurance claims handling and training documents contain confidential business information and have ordered them produced under confidentiality orders. If the insurer cannot obtain a stipulated protective order, the insurer must be prepared to submit affidavits demonstrating that the documents are unique to the company and were developed at considerable expense and that the company has policies restricting dissemination of the material outside of the company.

3. Other Claim Files

Insureds typically seek production of other claim files with similar issues as a predicate to arguing that the insurer has a "pattern and practice" of poor claims handling. Such a request may be objectionable because the files are not relevant or reasonably calculated to lead to the discovery of admissible evidence, the request is overly broad and unduly burdensome, and production would violate the confidentiality of the insureds' claim files.

The Arizona Supreme Court has held evidence of the insurer's conduct on other claims may be admissible only where the insured

can show that the other claims are substantially similar. *Hawkins v. Allstate*, 152 Ariz. 490, 733 P.2d 1073 (1987). However, *Hawkins* should be limited to its facts, because it involved a routine practice of processing claims for auto property damage. The court permitted former Allstate employees to testify about Allstate's practice of deducting $35 from every claim as a "cleaning fee" regardless of the cleanliness of the vehicle. The court held evidence of prior, similar acts was relevant to the issue of intent required for bad faith and punitive damages. *See id.* at 498, 733 P.2d at 1081. A subsequent Arizona Court of Appeals decision affirmed the trial court's decision to exclude evidence of other claims where the insured was unable to prove the other claims were substantially similar to his claim. *Miel v. State Farm Mut. Auto. Ins. Co.*, 185 Ariz. 104, 108-09, 912 P.2d 1333, 1337-38 (App. 1995); *see also Knoell v. Metropolitan Life Ins. Co.*, 163 F.Supp.2d 1072 (D. Ariz. 2001) (pattern and practice evidence inadmissible in bad faith claim); *Montoya Lopez v. Allstate Ins. Co.*, 282 F.Supp.2d 1095 (D. Ariz. 2003) (same).

4. <u>Personnel Files</u>.

Plaintiffs usually request production of the personnel files of adjusters and managers involved with the claims decisions in order to find information about performance evaluations and compensation. These requests may be objectionable on the grounds they are not relevant or reasonably likely to lead to the discovery of admissible evidence and they violate non-party expectations of privacy.

Courts have held personnel files, including performance evaluations, are private non-party records, contain self-critical analysis, and are not ordinarily subject to discovery. *See In re Sunrise Sec. Litigation*, 130 F.R.D. 560, 580 (E.D. Pa. 1989); *In re Del-Val Corp. Sec. Litig.*, 158 F.R.D. 275 (S.D.N.Y. 1994); *In re One Bancorp Securities Litigation*, 134 F.R.D. 4 (D. Me. 1991); *New York Stock Exchange v. Sloan*, Fed. Sec. L. Rep. P 95, 774 (S.D.N.Y. 1976); *Kaufman v. Nationwide Mut. Ins. Co.*, 1997 WL 703175 (E.D. Pa. 1997); *Carlucci av. Maryland Cas. Co.*, 2000 WL 298925 (E.D. Pa. 2000) (same). Personnel files are not discoverable unless plaintiff demonstrates that the records are: "(1) clearly relevant, and (2) the need for discovery is compelling because the information sought is not otherwise readily available." *See In re Sunrise Sec. Litigation*, 130 F.R.D. at 580; *see also Del-Val Corp.*, 158 F.R.D. 275. Many courts require a "heightened standard of relevance" before compelling discovery of information contained in personnel files. *See Kaufman*, 1997 WL 703175; *see also Sloan*, Fed. Sec. L. Rep. P 95, 774 (requiring a showing of "exceptional necessity"). To show personnel files are "clearly relevant," plaintiff must "make specific allegations or some initial showing, based on deposition testimony or other evidence," the employment records will support plaintiff's bad faith claims in the case at issue. *See Sunrise*, 130 F.R.D. at 580.

Furthermore, strong public policy precludes discovery of personnel files. Like a patient's sense of privacy regarding medical records, employees have a strong sense of privacy about their personnel files, which extends to performance evaluations. *See Sloan*, Fed. Sec. L. Rep. P 95, 774. Personnel files often contain private information employees do not expect to have disclosed, such as personal or family problems, health problems, and personality conflicts that can affect their work. The adjusters involved in the insured's claim should not have to face abuse, harassment, and embarrassment over matters that have nothing to do with their handling of the particular claim. Additionally, requiring employers to produce personnel files as a matter of course would have chilling effect on performance reviews because firms would cease to "criticize and rate their own performance, for fear that any written evaluations they make might be used against them or their employees in a lawsuit." *See Sloan*, Fed. Sec. L. Rep. P 95, 774.

5. <u>Employee Compensation</u>.

Insureds seek evidence of employee and management compensation, particularly performance bonuses, in order to argue that the employees had a personal financial stake in denying or underpaying a claim. *See Zilisch v. State Farm Mutual Automobile Insurance Co.*, 196 Ariz. 234, 995 P.2d 276 (2000). These discovery requests can be

objectionable if performance bonuses are not tied to claim payment goals. *See Knoell v. Metropolitan Life Ins. Co.* 163 F.Supp.2d 1072 (D. Ariz.2001) (company practices are not relevant unless they affect the claim at issue); *Montoya Lopez v. Allstate Ins. Co.*, 282 F.Supp.2d 1095 (D. Ariz. 2003).

6. Company Representative Depositions.

Insureds sometimes attempt to depose high level company representatives, such as the branch claim manager, regional managers, and corporate officers. Unless the representative has personal knowledge of the claim, such attempts can be resisted. The law provides high level company representatives with a certain level of protection from unnecessary depositions in cases in which they have no personal knowledge, particularly where the party can obtain the same information through less intrusive means and/or where the executive does not have unique knowledge pertinent to the issues in the case. *See, e.g., Cardenas v. The Prudential Ins Co.*, 2003 WL 21293757 (D. Minn. 2003); *Thomas v. IBM*, 48 F.2d 478 (10th Cir. 1995); *Blaine v. General Motors Corp.*, 141 F.R.D. 332 (M.D. Ala. 1991).

7. Electronic Discovery.

Some plaintiffs will request all information stored electronically on the company computer hard drives. Some requests go so far as to demand forensic examination of the company's computer system. Such requests are objectionable and may be the subject of a protective order. Rule 26(b)(2) imposes limitations on discovery using practicality and proportionality tests, which are applicable to electronic discovery requests. The court has the power to prohibit the requested discovery if it is unreasonably duplicative or cumulative of documents already produced in the case or if it will be unduly expensive and burdensome, given the importance of the requested information, the needs of the case, and the amount in controversy.

A party is not required to produce documents in electronic form because that is the opposing party's preferred format. *See Northern Crossarm Co. Inc. v. Chemical Specialties, Inc.,* 2004 WL 635606, *1 (W.D. Wis. 2004). Rule 34 simply requires a party to produce documents as they are kept in the usual course of business, which permits a party to produce its electronic information in a hard copy format.

Courts do not permit a party to search its opponent's computer systems and computer records unless the moving party can show the documents they seek actually exist and are being unlawfully withheld. Mere suspicion that a party has failed to respond to document requests fully and completely does not justify compelled inspection of its computer systems. The courts also consider the burden and expense of such discovery. *Bethea v. Comcast*, 218 F.R.D. 328, 329-30 (D.D.C. 2003); *Fennell v. First Step Designs, Ltd.*, 83 F.3d 526, 532 (1st Cir. 1996); *Medical Billing Consultants, Inc. v. Intelligent Medical Objects, Inc.*, 2003 WL 1809465, *2 (N.D. Ill 2003); *Stallings-Daniel v. The Northern Trust Co.*, 2002 WL 385566 (N.D. Ill 2002); *Wright v. AmSouth Bancorporation*, 320 F.3d 1198, 1205 (11th Cir. 2003).

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