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COURT OF APPEALS
DIVISION II

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NO. 38921-5-II

STATE OF WASHINGTON
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COURT OF APPEALS STATE OF WASHINGTON
DIVISION II

BRUCE CEDELL, a single man,

Plaintiff/Respondent,

v.

FARMERS INSURANCE COMPANY OF WASHINGTON,

Defendant/Appellant.

APPELLANT'S REPLY BRIEF

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TABLE OF CONTENTS

	Page
I. INTRODUCTION	1
II. ARGUMENT	2
A. Respondent's arguments regarding Farmers' failure to produce the non-privileged portions of its claim file are immaterial to this appeal.....	2
B. Respondent concedes that an insurer is entitled to assert the attorney-client privilege absent an applicable exception to the privilege.....	4
C. Respondent concedes that Washington's only two cases (Barry and Escalante) regarding application of the attorney-client privilege in insurance bad faith litigation do not support the superior court's order	5
D. Respondent concedes that the superior court applied incorrectly the fraud exception to the attorney-client privilege.....	9
E. Respondent's reliance on <i>In re Bergeson</i> is misplaced	11
F. Respondent's arguments regarding sanctions are limited to discovery disputes involving non-privileged matters, which are immaterial to the current appeal.....	13
III. CONCLUSION	14

TABLE OF AUTHORITIES

Page

Washington State Cases

<i>Barry v. USAA</i> , 98 Wn. App. 199, 989 P.2d 1172 (1999).....	1, 5, 6, 7, 8, 9, 12
<i>DeHeer v. Post-Intelligencer</i> , 60 Wn.2d 122, 126, 372 P.2d 193 (1962).....	4
<i>Escalante v. Sentry Ins. Co.</i> , 49 Wn. App. 375, 743 P.2d 832 (1987).....	1, 5, 6, 9, 12

Non-Washington State Cases

<i>Baker v. CNA Ins. Co.</i> , 123 F.R.D. 322, 326 (D. Mont. 1988).....	6
<i>Haines</i> , 975 F.2d 81, 95-96 (3rd Cir. 1992)	9
<i>In re Bergeson</i> , 112 F.R.D. 692 (D. Mont. 1986).....	8, 11, 12
<i>Silva v. Fire Ins. Exch.</i> , 112 F.R.D. 699 (D. Mont. 1986).....	1, 6, 8

Rules and Regulations

CP 509-14.....	10
RCW 5.60.060(2).....	4

I. INTRODUCTION

In this case, respondent (like the superior court below) lifts a single sentence out of context from two Washington cases: *Barry v. USAA*, 98 Wn. App. 199, 989 P.2d 1172 (1999) and *Escalante v. Sentry Ins. Co.*, 49 Wn. App. 375, 743 P.2d 832 (1987).

It is a well established principle in bad faith actions brought by an insured against an insurer under the terms of an insurance contract that communications between the insurer and the attorney are not privileged with respect to the insured.

Respondent's Response Brief at 14 (quoting *Barry* at 204). The above sentence was quoted *in dicta* from a Montana case¹, and does not stand for a blanket exception to the attorney-client privilege as they hope. What the respondent and the superior court have failed to comprehend is that the "attorney" referred to in this single sentence refers, not to the insurer's coverage counsel, but to the insured's counsel retained by the insurer.

In the present appeal, the superior court's orders to invade the attorney-client privilege protecting communications between the

¹ *Silva v. Fire Ins. Exch.*, 112 F.R.D. 699 (D. Mont. 1986).

insurer (Farmers) and its coverage counsel should be reversed, because (1) Washington law continues to recognize the attorney-client privilege between an insurer and its coverage counsel; and (2) no exception to the privilege was applicable to the facts of this case.

II. ARGUMENT

A. Respondent's arguments regarding Farmers' failure to produce the non-privileged portions of its claim file are immaterial to this appeal.²

Respondent dedicates a significant portion of his Response Brief to the non-privileged aspects of the underlying discovery dispute and the superior court's orders and sanctions that followed. *See* Response to Appellant's Brief Re Discretionary Review at 6-7, 9, 12, 24-29 ("Response"). However, Farmers advised this Court repeatedly in its Motion for Discretionary Review and its Appellant's Opening Brief that the decisions of the superior court with respect to the non-privileged aspects of the underlying discovery dispute are not at issue in this appeal. *See, e.g.*, Appellant's Opening Brief at 13 ("[T]he portion of the sanctions that were imposed due to the redactions of the "reserve" information is

² Appellant does not respond to these arguments of Respondent – not because appellant concedes these points – but because they are immaterial in this appeal.

not at issue in this appeal.” “For purposes of this appeal only, Farmers does not contest the superior court’s order with respect to the non-privileged aspects of plaintiff’s discovery requests.”).

Instead, the issues on this appeal are limited to those matters addressed in Appellant’s Assignment of Errors. *See* Appellant’s Brief at 1-3; *see also* Respondent’s Response Brief (identifying no Assignments of Error). Specifically, the issues raised on this appeal are whether an insurer is entitled to assert the attorney-client privilege in bad faith litigation involving first party insurance coverage; whether the fraud exception to the attorney-client privilege applied in the present case; whether the superior court erred in its application of the fraud exception; whether the superior court erred by ordering the disclosure of attorney-client information contained in Farmers’ claim file; and whether the superior court erred by sanctioning Farmers arising from its assertion of the attorney-client privilege.

B. Respondent concedes that an insurer is entitled to assert the attorney-client privilege absent an applicable exception to the privilege.

Both parties concede that the superior court concluded that the attorney-client privilege is inapplicable in all bad faith litigation involving first party coverage. *See* Response Brief at 13 (“The court held that the attorney-client privilege ... [was] inapplicable in a first party insurance bad faith action.”). Indeed, the respondent attempts to reach the same conclusion. *See* Response Brief at 18 (“[P]laintiff contends that in first party insurance situations involving bad faith, the attorney-client privilege ... [is] inapplicable.”). However, the respondent failed to cite to a single Washington case that has ever held that insurers are always stripped of the attorney-client privilege in bad faith litigation involving first party coverage disputes. Where no authorities are cited, the court may assume that counsel, after diligent search, has found none. *DeHeer v. Post-Intelligencer*, 60 Wn.2d 122, 126, 372 P.2d 193 (1962).

Respondent did, however, acknowledge the existence of the attorney-client privilege, which may be subject to certain exceptions. *See* Respondent’s Response Brief at 17 (citing RCW 5.60.060(2)).

Accordingly, respondent tacitly concedes that an insurer may assert the attorney-client privilege absent an applicable exception. Since neither respondent nor any Washington case has identified any such blanket exception, Farmers was entitled to assert the privilege, and the superior court's conclusion to the contrary constitutes an abuse of discretion.

C. Respondent concedes that Washington's only two cases (*Barry* and *Escalante*) regarding application of the attorney-client privilege in insurance bad faith litigation do not support the superior court's order.

Both parties concede that the superior court relied on *Barry* and *Escalante* in reaching its conclusion that no insurer is ever entitled to assert the attorney-client privilege in bad faith litigation involving a first party coverage dispute. *See* Appellant's Brief at 16; Response Brief at 10, 13. Farmers, however, argued that neither *Barry* nor *Escalante* support the superior court's conclusion, because (1) those cases did not hold that an insurer in bad faith litigation is barred from asserting the attorney-client privilege; and (2) even if it did, the *Barry* case is clearly distinguishable. *See* Appellant's Brief at 16-19. Respondent did not dispute these arguments in his

Response. *See, generally*, Response at 13-14; *see also* at 17 (“This is not like the situation presented in *Barry v. USAA*[.]”). Indeed, respondent’s discussion of the *Barry* case supports Farmers’ position that *Barry* does not support the superior court’s order.

We first ask whether any of the materials in Ms. Barry’s claims file would be privileged.

Typically, in the insured-insurer relationship, the attorney is engaged and paid by the carrier to defend the insured and therefore operates on behalf of two clients. *Baker v. CNA Ins. Co.*, 123 F.R.D. 322, 326 (D. Mont. 1988). According to *Baker*, 123 F.D.R. at 326, it is a well established principle in bad faith actions brought by an insured against an insurer under the terms of an insurance contract that communications between the insurer and the attorney are not privileged with respect to the insured. *See also Silva v. Fire Ins. Exch.*, 112 F.R.D. 699 (D. Mont. 1986), *cited in Escalante*, 49 Wn. App. at 394. As explained in *Silva*, 112 F.R.D. at 699-700, “The time-worn claims of work product and attorney-client privilege cannot be invoked to the insurance company’s benefit where the only issue in the case is whether the company breached its duty of good faith in processing the insured’s claim.”

See Response at 13-14 (quoting *Barry* at 204). It should be obvious from the respondent’s quotation of the *Barry* case that the attorney to which the court refers is not the insurer’s coverage counsel, but, rather counsel retained by the insurer to represent the insured.

Barry, 98 Wn. App. at 204 (“in the insured-insurer relationship, the attorney is engaged and paid by the carrier to defend the insured and therefore operates on behalf of two clients. ... [C]ommunications between the insurer and the attorney are not privileged with respect to the insured.”)

It is important to note that in *Barry* (which involved an insured’s claim for bad faith against her insurer), the Court of Appeals did not strip the insurer of the attorney-client privilege. Instead, it found that the insurer was entitled to assert the privilege. *Id.* at 205. Nor did the Court of Appeals find an insurer is not entitled to the protections afforded by the attorney-client privilege in any bad faith litigation. *Id.* In fact, no Washington case has ever done so.

Instead, the *Barry* case explicitly recognized an insurer’s right to assert the attorney-client privilege – even in bad faith litigation with its insured. *Id.* at 205. Not surprisingly, the respondent’s quote of the *Barry* case stops just short of this recognition. Immediately following the respondent’s quoted portion of the *Barry* case, the opinion holds as follows:

Considering the fact that [the insurer's] attorney was only involved in [the insured's] UIM claim, it follows that communications between [the insurer] and its attorney concerning the UIM claim are privileged for the purposes of [the insured's] bad faith insurance suit.

Id. Thus, *Barry* stands for the proposition that an insurer is entitled to the protections afforded by the attorney-client privilege – not only in UIM claims – but in any first party coverage dispute where the interests of the insurer and insured are not precisely aligned and the insurer's attorney is retained solely to represent the insurer. That is precisely the situation here.

Thus, the single sentence from *Barry*, which was quoted *in dicta* from a Montana case (*Silva v. Fire Ins. Exch.*, 112 F.R.D. 699 (D. Mont. 1986)³, does not support the superior court's orders. Because its orders were contrary to Washington law, they are untenable and constitute an abuse of discretion.

³ In its Appellant's Opening Brief, Farmers argued that the two-page *Silva* ruling neither refers to nor relies on any law or case in support of its conclusion. Instead, the *Silva* court fabricates its rule out of whole cloth. Respondent argues that the *Silva* case relied on *In re Bergeson*, 112 F.R.D. 692 (D. Mont. 1986), another Montana case. Yet, the *Silva* court relied on that case – not for the conclusion that an exception to the privilege applies in all bad faith litigation – but for the proposition that a claims file is generally discoverable in bad faith litigation. In any event, even if the *Silva* court relied on *In re Bergeson* as respondent suggests, it does not support respondent's position here. See §III.E. *infra*.

D. Respondent concedes that the superior court applied incorrectly the fraud exception to the attorney-client privilege.

Both parties concede that under *Escalante*, Washington law protects confidential communications between an insurer and its counsel unless an insured can establish that they are subject to the fraud exception. *See* Response at 18-19 (quoting *Escalante*, 49 Wn. App. at 394). Generally, the exception is invoked only when the insured presents a prima facie showing of bad faith tantamount to civil fraud. *See* Response at 19 (quoting *Escalante*, 49 Wn. App. at 394). To strip a communication of the attorney-client privilege, the insured must show that (1) the insurer was engaged in or planning a fraud at the time the privileged communication was made, and (2) the communication was made in furtherance of that activity. *Id.*; *see also Barry*, 98 Wn. App. at 205 (citing *Haines*, 975 F.2d 81, 95-96 (3rd Cir. 1992)).

After acknowledging this to be the law, the respondent then fails to argue – much less even allege – that the superior court properly followed this procedure. The superior court found neither that the insurer was engaged in or planning a fraud at the time the

privileged communication was made nor that any such communications was made in furtherance of that activity. CP 509-14. Indeed, the superior court did not even find that the fraud exception to the attorney-client privilege applied. *Id.* Instead, the superior court found that the privilege simply does not apply -- ever. *Id.*

Respondent attempts to gloss over the error by conflating the attorney-client privilege with the work product doctrine. *See* Response at 20-24. The respondent attempts to defend the superior court's error by arguing that an insurance claim file is not protected by virtue of the work product doctrine. *See id.* However, this argument is completely immaterial to this appeal. In its Appellant's Opening Brief, Farmers never once argued that the privileged communications were protected from discovery because of the work product doctrine. Instead, it argued that they were protected under the attorney-client privilege, and the only way to invade the privilege was through a correct application of the "fraud" or "civil fraud" exception.

Because neither the respondent nor the superior court even attempted to make the required showing to invoke the fraud exception, the superior court's order to disclose confidential communications constituted an abuse of discretion.

E. Respondent's reliance on *In re Bergeson* is misplaced.

Respondent relies almost exclusively on a case from a federal district court in Montana (*In re Bergeson*, 112 F.R.D. 692 (D. Mont. 1986)) for his argument that Washington should abandon its long standing recognition of the attorney-client privilege in bad faith litigation. Respondent's reliance on this case is misplaced, because the Montana case is contrary to Washington law and holds limited value of precedence.

In *In Re Bergeson*, a bankruptcy trustee filed an action against the debtors' insurer after the insurer denied a tender for payment under the "business interruption" clause of the policy. *Id.* at 693-94. The complaint sought damages on behalf of the debtors' estate for breach of the policy, **actual fraud**, **constructive fraud**, and bad faith, as well as punitive damages for the insurer's alleged willful, wanton and oppressive conduct. *Id.* at 694.

Unlike the present case here, the insured in *In re Bergeson* alleged, and presumably had facts sufficient to support such allegations, that the insurer had engaged in a civil fraud. If this case had been decided in Washington and if sufficient facts existed to support such allegations of fraud, then Washington's "fraud exception" to the attorney-client privilege may have been triggered. Unfortunately, this district court opinion provides virtually no facts regarding the insurer's conduct regarding its handling of the insured's claim. It is impossible to determine to what degree the insurer's conduct in this case may or may not have risen to the level of "fraud" or "civil fraud" to trigger Washington's fraud exception to the attorney-client privilege in bad faith litigation. Without these facts from the *In re Bergeson* case, it holds little, if any, precedence to Washington cases.

In any event, the case is contrary to Washington law. Both *Barry* and *Escalante* were decided after *In re Bergeson*. Despite the existence of *In re Bergeson* at the time *Barry* and *Escalante* were decided, Washington courts have recognized an insurer's right to assert the attorney-client privilege unless the insured can present

facts sufficient to trigger the fraud exception thereto. *Escalante* controls here; *In re Bergeson* does not. Under *Escalante*, because the superior court failed to find sufficient evidence to invoke the fraud exception, its orders to disclose confidential communications constituted an abuse of discretion.

F. Respondent’s arguments regarding sanctions are limited to discovery disputes involving non-privileged matters, which are immaterial to the current appeal.

As noted in its prior briefing, Farmers has repeatedly stated that the superior court’s award of sanctions regarding non-privileged matters is not at issue in this appeal. *See* Appellant’s Opening Brief at 13, fn. 2. Instead, Farmers argued that the sanctions imposed by the superior court purportedly as a result of Farmers’ “failure” to produce communications protected by the attorney-client privilege were erroneous, because (1) the sanctions were excessive and not based on a *Lodestar* calculation; and (2) the superior court did not find (and was unable to find) that Farmers violated any court order. *See* Appellant’s Brief at 24-28.

Respondent provided no response whatsoever to these arguments. Therefore, he tacitly concedes that the sanctions were erroneous on these bases.

Respondent's arguments regarding sanctions were limited solely to the discovery disputes involving non-privileged matters, which is wholly immaterial to the appeal. Respondent attempts to imply that Farmers' conduct related to non-privileged matters in the course of the underlying discovery disputes justifies the erroneous sanctions that were imposed with respect to the discovery disputes related to privileged matters. *See* Respondent's Response Brief at 24-29. Nonetheless, respondent cites no authority for this argument.

In any event, although Farmers does not agree with respondent's allegations regarding the non-privileged discovery disputes, it is not at issue in this appeal.

III. CONCLUSION

This Court should reverse the superior court's Findings and Order, dated March 2, 2009, and Order Re: In Camera Review of Claim File, dated March 2, 2009, as they each relate to the issues addressed herein.

RESPECTFULLY SUBMITTED this 6th day of November,
2009.

NICOLL BLACK & FEIG

By: 
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CERTIFICATE

The undersigned certifies under penalty of perjury under the laws of the State of Washington, that on November 6th, 2009, I caused service of the foregoing pleading on each and every attorney of record herein:

Stephen L. Olson (via overnight mail)
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DATED this 6th day of November, 2009, in Seattle, Washington.

Denise M. Wolfard
Denise M. Wolfard

STATE OF WASHINGTON
BY Denise M. Wolfard
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