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Court of Appeals No. 38921-5-II

**IN THE SUPREME COURT
OF THE STATE OF WASHINGTON**

BRUCE CEDELL, a single man,

Plaintiff/Respondent,

v.

FARMERS INSURANCE COMPANY OF WASHINGTON,

Defendant/Appellant.

**APPEAL FROM COURT OF APPEALS DIVISION II
OF THE STATE OF WASHINGTON NO. 38921-5-II**

PETITION FOR REVIEW TO THE SUPREME COURT

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I. IDENTITY OF PETITIONER

Plaintiff, Bruce Cedell, petitions the Court for discretionary review of the Court of Appeals decision below.

II. COURT OF APPEALS DECISION

The Court of Appeals filed its decision in this case on October 21, 2010. A copy of this decision is attached as Appendix A.

III. INTRODUCTION / FACTS

Bruce Cedell owned a home at 1211 Young Street, Elma, Washington, and was the sole insured of Farmers Insurance. He had no mortgage on the home at the time of the fire. On November 25, 2006, while Bruce Cedell was in downtown Elma, his house burned down. When he left the home, his daughter, Emma was present, Melissa Ackley, Lisa Charlton and Jay Fulleton were present. When He returned home, his house was on fire.

Both Farmers expert and the Elma fire department concluded the evidence was consistent with an accidental fire as described by a witness Melissa Ackley.

Farmers adjuster estimated total damage at over \$100,000. Actual damage to the home ended up over \$115,000, not including contents.

Farmers was acutely aware that the property and contents damages were around \$100,000, and further aware that all the evidence indicated that the total damage exceeded \$100,000. Farmers hired Ryan Hall, an attorney, to participate in the investigation. He deposed Mr. Cedell and a witness to the fire. He corresponded with Mr. Cedell and after about 7 months, he drafted and had delivered a "one-time offer" of \$30,000 to Farmers' insured, Bruce Cedell. The offer indicated it was open for 10 days, and threatened denial of coverage of Mr. Cedell if not accepted. The letter claimed he made material misstatements

but did not mention what he said that was false. To date, Farmers has not provided that information to Mr. Cedell. Mr. Cedell called Mr. Hall within the 10 days but did not receive a call back.

Mr. Cedell filed suit months later and sought production of the claims file, as well as other evidence. Farmers provided the claims file with multiple redactions for claims of attorney-client privilege / work product. Mr. Cedell claimed that as a first party insured of Farmers, that Farmers owes him a duty to act as a fiduciary to treat him fairly to help them fairly resolve the claim of their own first party insured. Farmers does not deny they owe him a fiduciary duty, but refers to it as a quasi-fiduciary duty. Mr. Cedell further contends that in a first party insured bad faith case, no privilege should apply. The trial court agreed with Mr. Cedell on this issue, however, the Washington Court of Appeals, Division II reversed on this issue. Mr. Cedell contends that the appellate court's decision conflicts with the decision in *Barry vs. USAA*, 98 Wn.App. 199, a decision of Division III of the Court of Appeals.

The Washington Court of Appeals further concluded that the *in camera* review and subsequent order to compel production of the redacted portions of the claims file was error. The Court of Appeals ruled that the privilege applied and the fraud or civil fraud exception to the attorney-client privilege had not been met, i.e., that the insured failed to present a prima facie showing of bad faith, tantamount to civil fraud.

The Court of Appeals ruled that in order to justify an *in camera* inspection or disclosure, the factual showing must establish all nine elements of civil fraud.

IV. ISSUES PRESENTED FOR REVIEW

1. Should the court grant review in this case because of the decision of the Court of Appeals conflicts with the decision of the Washington Court of Appeals Division III in *Barry vs. USAA*, 98 Wn.App. 199, 989 P.2d 1172 (1999);
2. Should the court grant review in this case because the decision of the Court of Appeals involves an issue of substantial public interest that should be determined by the Supreme Court.

V. STATEMENT OF THE CASE

Bruce CedeII owned a home at 1211 Young Street, Elma, Washington and was the sole insured of Farmers Insurance. (CP 466) He had no mortgage at the time of the fire. (CP 466)

On November 25, 2006, while Bruce was downtown Elma, his house burned down.

When he returned, the house was on fire and the fire trucks were there. Dispatch records reveal that Melissa Ackley called in the fire to dispatch at 0022.

Farmers hired John Powell, a fire investigator to investigate this fire on November 30, 2006. It was his conclusion that the rendition of the fire was consistent with the acute burn patterns seen to the headboard and mattress, both in terms of the potential of the acceleration of the fire near the candle, and in the location described by Ms. Ackley relative to those patterns.

He found "no physical evidence supporting an incendiary origin". His final conclusion was that the candle Melissa Ackley described "presents a possible or even probable source of ignition that is consistent with the remaining physical evidence". The Elma Fire Department completed its investigation on November 29, 2006 and concluded their investigation with a finding that the case was considered accidental. (CP 473-476)

Mr. Cedell cooperated with both investigations.

As far as Mr. Cedell knows, these are the only two fire investigations that were ever conducted and both concluded that this fire was accidental and that there was absolutely no physical evidence of an incendiary origin. (CF 473-484) Farmers interrogatory supplemental answer signed February 26th 2009 makes it clear that Farmers does not contend (1) that Mr. Cedell set this fire; (2) or was even present in home when fire broke out; or (3) conspired with anyone else to set this fire. And they admitted they have no physical evidence that this fire has anything other than accidental. (CF 325-330)

On January 4, 2007, Laurie Oleary estimated exposure on building to be \$70,000 plus \$35,000 cleaning and storage contents. (CP 124)

Seven months post-accident, Farmers wrote a letter to Bruce Cedell on July 3, 2007, saying that the fire had been determined to be of unknown origin and that there was "a possibility" that it was intentionally set. Farmers

threatened to deny coverage to Mr. Cedell at that time. Farmers then went on to make a "one time only" offer to settle Mr. Cedell's claim in its entirety for a "one time total sum of \$30,000". Farmers allowed this offer to be open for a period of ten business days from the date of its letter signed by Ryan Hall. Bruce Cedell attempted to contact Mr. Hall during the ten day period and was told that he was unavailable and on vacation. Mr. Hall did not contact Mr. Cedell when he returned. (CP 466-471)

Farmers has alleged numerous, misstatements of Melissa Ackley (not an insured party) and contended that the policy excludes intentional acts. Farmers was aware of the fact that their own policy exclusion applies to coverages A, B and C, section 6 reads: "*Excludes intentional acts of an insured.*" They are further aware that Ms. Ackley is not an insured under the definition of their policy. (CP 378-475, at 387, 391 and 392) Further, their policy excludes coverage only for an insured "*who has intentionally concealed or misrepresented any material fact or circumstance*" relating to this insurance before or after the loss. (CP 398) Mr. Cedell has challenged Farmers to identify any material false statements that he made, but they have not done so to date. (CP 466-471)

On November 5, 2007, a summons and complaint was filed by Bruce Cedell against Farmers Insurance Company of Washington, seeking damages, and alleging among other things that Farmers engaged in unfair

and deceptive acts or practices. Mr. Cedell contends that Farmers Insurance' conduct in this case amounts to bad faith. (CP 336-340)

First Interrogatories and Second Requests were sent out on the 30th day of April, 2008. (CP 9-17) A motion to compel was filed on January 27, 2009. (CP 1-8) The motion requested that Farmers be required to fully answer the interrogatories and to produce the entire claims file including the redacted portion of which Farmers claimed attorney-client privilege and work product, or in the alternative, to have the Court conduct an *in camera* inspection of the records.

The motion to compel was heard and the court entered findings and conclusions, holding that the objections by Farmers were not well founded and that the refusal to answer certain of the interrogatories constituted the epitome of faith and violations of CR 11 and CR 26. (CP 490-496) The court ordered an *in camera* evaluation of the redacted portions of the record findings that the plaintiff had made a sufficient showing to justify the examination, making findings that:

1. Bruce Cedell owned a home at 1211 Young Street, Elma, Washington, and that he owned the home for 20 years.
2. That Mr. Cedell had insured the home with Farmers for over 20 years.

3. That he had not filed a single claim against Farmers during the entire time he owned the property until a fire broke out on November 25, 2006.

4. That at the time of the fire Mr. Cedell was not present at the home but was in downtown Elma.

5. That the City of Elm Fire Department concluded the fire was accidental.

6. That Farmers investigator John Powell submitted a report to Farmers indicating the fire was consistent with the accidental burning of a candle as described by Melissa Ackley. It also found that there was no evidence of incendiary origin,

7. Farmers was aware of the fact that their insured Bruce Cedell did not have a home after the fire because of the extensive damage to it.

8. Five months, after the fire, Farmers sent in Joe Mendoza to estimate the damage to the residence and concluded the damage was \$56,498.84 replacement value.

9. Records created by Rebecca Sealy, a Farmers adjuster, on 01-11-2007, indicated it appeared that Farmers exposure would be approximately \$70,000 in the building and perhaps \$35,000 in contents clean up and storage.

10. On July 3, 2007, Mr. Hall from Farmers sent a letter to Mr. Cedell making a "one-time only" offer of \$30,000 to him. They threatened him with denying coverage and alleged that he had misrepresented material information but did not state what material information he misstated. The offer was stated to be open for 10 days.

11. When Mr. Cedell called Mr. Hall, he was told he was out of the office. They told him that he would call him when he returned, however he did not call back.

12. Farmers has not filed anything to indicate that they have any information or any evidence to indicate that this fire was anything other than accidental and Farmers has presented no proof that Mr. Cedell was even present or near the fire when it started.

13. That the damage to the house was eventually determined to be \$115,000 plus \$16,000 code updates in the appraisal process.

From the above, the court found that there was an adequate basis to justify an *in camera* review of the entire claims file. The court also ordered Farmers to answer the interrogatories, and imposed sanctions based upon CR 26 and CR 11. (CP 490-496)

The trial court noted that this case involves a first-party insured where an "insurer owes the insured a heightened duty-a fiduciary duty, which by its nature is not, and should not be adversarial. The Court concluded that in a first-party insured situation the insured is entitled to discover the entire claims file kept by the insurer, without exceptions to the claims of attorney-client privilege or work product." The Court concluded that the nature of the issues in a first-party insured case automatically establishes the substantial need for discovery for the claims file, citing Barry V. USAA, 98 Wn.App. 199, 989 P.2d 1172 (1999) and Escalante v. Sentry Insurance Company, 49 Wn. App. 375, 743 P.2d 832 (1987)¹.

After reviewing the entire claims file, and considering Farmers responses to interrogatories and the requests for production, including the redacted portions, the court indicated that the entire claims file should be provided to Mr. Cedell without redactions.

VI. ARGUMENT WHY REVIEW SHOULD BE ACCEPTED

¹ See Ellwein vs. Hartford Co., 142 Wn.2d 766, 779, 15 P.3d 640, where the court noted that the relationship between a UIM insurer and its insured "is by nature adversarial and at arms' length."

- A. This Court should accept review of this case because the Court of Appeals' decision conflicts with the opinion in *Barry vs. USAA*, 98 Wn. App. 199, a decision of Division III of the Court of Appeals.**
- B. The Court of Appeals declined to follow the ruling in *Barry vs. USAA* 98 Wn. App. 199, at 204, which held that the attorney-client privilege is inapplicable in a first party insured case.**

It is a well-established principal 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. *Barry*, 98 Wn. App. at 204.

It is clear that *Barry* dealt with the issue of what is and what is not privileged in first-party insurance bad faith actions. *Barry vs. USAA*, 98 Wn.App., 199 *supra*, discussed these issues. In this regard, the court, in *Barry vs. USAA*, 98 Wn.App. 199, 204-205, 989 P.2d 1172 (1999), stated as follows:

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 his. 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."

We have good reason to treat first-party bad faith claims involving the processing of UIM claims differently, however. UIM carriers stand in the shoes of the underinsured motorist/tortfeasor to the extent of the carrier's policy limits. Dayton v. Farmers Ins. Group, 124 Wn. 2d 277, 281, 876 P.2d 896 (1994). Consequently, the UIM carrier is entitled to pursue all the defenses against the UIM claimant that could have been asserted by the tortfeasor. See id (the UIM carrier is not compelled to pay if the same recovery could not be obtained from the tortfeasor). Because the provision of UIM Coverage is by nature adversarial, an inevitable conflict exists between the UIM carrier and the UIM insured. Fisher v. Allstate Ins. Co., 136 Wn. 2d 240, 249, 961 P.2d 330 (1998). The friction between this adversarial relationship and the traditional fiduciary relationship of an insured and an insurer is - difficult to resolve.

In Silva vs. Fire Ins Exchange, 112 F.R.D. 699 (D.Mont. 1986) the court dealt with a first party insured bad faith claim and a request for the complete claims file. The insurance company claimed attorney-client privilege for 52 items. In holding that the entire claims file was discoverable, the court, in Silva vs. Fire Ins. Exchange, 112 F.R.D. 699, stated at p.699:

This court has recently ruled that a plaintiff in a first-party bad faith action is entitled to discover the entire claims file kept by the insurer. In re Bergeson, et al., 112 F.R.D. 692, 697 (1986). Under ordinary circumstances, a first party bad faith claim can be proved only by showing the manner in which the claim was processed, and the claims file contains the sole source of much of the needed information. See Brown

v. Superior court in and for Maricopa County, 137 Ariz, 327, 670 P.2d 725, 734 (1983).

The Silva case was based upon the reasoning set forth in *In re Bergeson*, 112 F.R.D. 692 (D.Mont. 1986). The Bergeson case was, once again, a first party insurance bad faith claim. The court in *In re Bergeson*, supra, set forth the criteria that an insurance company is supposed to consider when failing to pay a claim to its insured, when no third party is involved. In this regard, the court in Bergeson, stated at p.697:

Obviously, several of the six factors are irrelevant in a case challenging the insurance company's failure to pay a claim to its insured where no third party is involved. On the other hand, both situations arise out of "first-party" bad faith, an action by the insured against the insurer. In any first party bad faith action, the pivotal inquiry is the manner in which the insurance company processed the claim involving its insured.

In a first party bad faith case such as this, where the insurance company has refused to pay benefits claimed under the policy, the critical issue is whether the company had a good faith basis for its decision. This in turn requires a number of other inquiries, including the substance of any investigations conducted by the insurer, the information available to the company at the time its decision was made, and the manner in which the company arrived at its decision, including reliance on advice of counsel. The insurance company's claims file constitutes the only source of this information. Clearly, it is "relevant to the subject matter involved in the pending action" and "reasonably calculated to lead to the discovery of admissible evidence." Fed.R.Civ.P. 26(b)(1).

Bad faith actions against an insurer, like actions by client against attorney, patient against doctor, can only be

proved by showing exactly how the company processed the claim, how thoroughly it was considered and why the company took the action it did. The claims file is a unique, contemporaneously prepared history of the company's handling of the claim; in an action such as this the need for information in the file is not only substantial, but overwhelming.

Brown, 670 P.2d at 734.

The Court, in *In re Bergeson, Supra*, made it clear that the critical issue in a first party bad faith claim is whether the company had a good faith basis for its decision. It further made it clear that the insurance company is supposed to exercise good faith in dealing with its insured. The investigations conducted by any attorney/agent are pertinent upon whether the insurance company acted in good faith or not. This situation is not supposed to be an adversarial one. The insurance company is supposed to act on behalf of its insured as well as themselves.

The Court of Appeals cited *Escalante vs. Sentry Insurance Company*, 49 Wn.App. 375, 743 P.2d 832, a case that was decided in 1987, twelve years earlier. *Escalante* was also a UIM motorist case. The case in *Barry vs. USAA, Supra*, makes it clear that unlike normal first party insurance actions where the relationship is supposed to be non-adversarial, UIM cases become adversarial when the insured requests underinsurance coverage. At that point, the insured is allowed to step into the shoes of the underinsured motorist/tortfeasor and assert any defenses that he may have against their own UIM claimant. The court noted that this situation was fraught with conflict of interest unlike what is supposed to exist in normal first-party insurance

situations. The Court in *Barry* was careful to point out that USAA's attorney was only involved in Ms. Barry's UIM claim. They were careful to point out that USAA's attorney only acted as an attorney against Ms. Barry in her UIM claim against them. He took no action on her behalf against the tortfeasor and therefore had no conflict of interest. This is unlike the present case where Farmers attorney was actually deposing witnesses and conducting an investigation. An investigation that should be conducted by someone protecting the interest of Mr. Cedell.

The Supreme Court should take review of this case to review and resolve the apparent conflict between *Barry vs. USAA*, 98 Wn. App. 199, 989 P.2d 1172 and the Court of Appeals' decision in the present case. Further, the Supreme Court should take review of this case as an issue concerning the correct rule to be applied concerning what the nature of the privilege should be in a first-party insured case versus other more adversarial situations. This is an important matter that involved the insurance industry and the public at large. Issues concerning conflicts of interest of lawyers and proper treatment by the insurance companies and the duties owed to their insureds are important considerations that need to be addressed and clarified by the Supreme Court. The Court should determine whether an insurance company can hide behind the cloak of the name "insurance coverage lawyer".

C. The Supreme Court should accept review of this case even if the court concludes that a privilege exists in first-party insurance bad faith cases because the Court of Appeals decision conflicts with existing law regarding what is necessary to justify an *in camera*

inspection, and the subsequent disclosure utilizing the civil fraud exception. In the present case, the appellate court now requires a showing of all nine elements of civil fraud prior to allowing an *in camera* review or disclosure.

**VII. ARGUMENT RE: MISAPPLICATION OF CIVIL FRAUD
EXCEPTIONS ANNOUNCED IN OPINION**

A) The Court Has Misapprehended The Two-Step Test Articulated In Escalante For Applying The Civil Fraud Exception To The Attorney-Client Privilege, By Replacing The "Good Faith Belief"/"Foundation In Fact" Prongs With An All-Encompassing Actual Fraud Requirement.

The court has misapprehended the two-step test established in *Escalante* for applying the civil fraud exception to attorney-client and work produce privilege claims when invoked by insurers in bad faith litigation.³ Under *Escalante*, a trial court first determines whether the party seeking discovery has made a factual showing "adequate to support a good faith belief by a reasonable person that wrongful conduct sufficient to invoke the ... fraud exception ... has occurred." 49 Wn.App. at 394 (quoting *Caldwell v. District Court*, 644 P.2d 26, 33 (Colo. 1982)). The threshold showing deemed necessary by *Escalante* to justify *in camera* review does not require the court to find conclusively that wrongful conduct occurred (let alone that the conduct constituted actual fraud); in

recognition of "the proof problems inherent in requiring a prima facie showing at the discovery stage." See 49 Wn.App. at 394 (adopting reasoning of *Caldwell*): "[T]he trial court may conduct an *in camera* review of the allegedly privileged documents without first requiring a prima facie showing if it determines that this would aid its assessment of the privilege's applicability." *Caldwell*, 644 P.2d at 32. The evidence need only be sufficient to create a legitimate question about whether invocation of the attorney-client or work product privilege serves to mask wrongful conduct involving the lawyer.²

If this threshold requirement is met, the trial court has discretion to conduct an *in camera* review to determine whether there is a "foundation in fact" for applying the civil fraud exception. See *Escalante*, 49 Wn.App. at 394. The foundation in fact is assessed after *in*

² While the civil fraud exception usually arises in the context of the attorney-client privilege, it should apply equally to the work product privilege. See *Caldwell v. District Court*, 644 P.2d 26, 34 (Colo. 1982) (noting "[B]ut as the attorney-client privilege may not be abused as a shield for ongoing or future illegal activity, so the privilege created for an attorney's work product cannot be allowed to protect the perpetuation of wrongful conduct"). As discussed above, *Caldwell* is cited with approval in *Escalante*, 49 Wn.App. at 394. Consequently, the analysis here is also relevant to work product privilege claims. In an employment discrimination case, this Division stated that it would decline to follow *Caldwell*. See *Whetstone v. Olson*, 46 Wn.App. 308, 311-12, 732 P.2d 159 (1986). The court appears to have read *Caldwell* differently than *Escalante*: namely, that *Caldwell* permits *in camera* review based on "a bare allegation of fraud." *Whetstone* at 311. Nonetheless, *Whetstone* adopted the "good faith belief standard for *in camera* review, 46 Wn.App. at 311-12, which is indistinguishable from *Escalante* at 394 (and *Caldwell* at 33).

camera inspection of the relevant materials. See *Id.* As with the first step in the analysis, this second step does not require, the court to find conclusive evidence of wrongful conduct. It is still a "lesser quantum of proof" than a "prima facie case" because, as with the first step, "[r]equiring a strict prima facie case may not be possible at the discovery stage, and would result in an overzealous protection of the attorney-client privilege in a context where the rationale for that privilege may be inapplicable." *Caldwell* at 33; accord *Escalante* at 394 (recognizing "proof problems inherent in requiring a prima facie showing," as expressed in *Caldwell*).

While actual fraud would be sufficient to satisfy *Escalante's* two-step test, actual fraud is not necessary to satisfy either prong of the test. Until this court's opinion, no Washington authority has limited the test to cases of actual fraud. To the contrary, *Escalante* contemplates that tortious conduct such as insurance bad faith may satisfy the test, given its reliance on *United Servs. Auto Ass'n v. Werley*, 526 P.2d 28 (Alaska 1974). See *Escalante* at 394. *Werley* involved alleged claims mishandling in an uninsured motorist context, and the court had little difficulty extending the civil fraud exception to insurance bad faith situations:

When an insurer *through its attorney* engages in a bad faith attempt to defeat, or at least reduce, the rightful claim of its insured, invocation of the attorney-client privilege for communications pertaining to such bad faith dealing seems clearly inappropriate. We thus find that the tortious activity alleged by Werley satisfies the 'civil fraud' requirement of the exception to the attorney-client privilege.

526 P.2d at 33 (*footnote omitted; emphasis added*). Such conduct is "tantamount to civil fraud." See *Escalante* at 394.

The *Escalante* test has been recognized in subsequent Washington cases. See *Seattle Northwest v. SDG Holding Co.*, 61 Wn.App. 725, 740-41, 812 P.2d 488 (1991) (contract-based claim, recognizing test and remanding for further proceedings); *Barry v. USAA*, 98 Wn.App. 199, 206-07, 989 P.2d 1172 (1999) (insurance bad faith claim against underinsured motorist insurer, recognizing test but upholding trial court decision that evidence wanting); *of. Soter v. Cowles Publ'g Co.*, 131 Wn.App. 882, 894-95 (2006) (public disclosure request, recognizing test but finding *Escalante* "bad faith" exception inapplicable), *aff'd*, 162 Wn.2d 716, 174 P.3d 60 (2007). While the superior court recognized and applied the *Escalante* test below, this court has misread *Escalante* as imposing a much more onerous standard of proof in order for a trial court to subject disputed materials to in camera review or thereafter require their disclosure.

The Supreme Court should address the proper standard to be applied in the two-step analysis set forth in *Escalante*, as the Court's

opinion in the present case conflicts with the standard set forth in *Escalante vs. Sentry Insurance*, 49 Wn.App. at 394.

In addition to the conflict that exists between the Court of Appeals' decision and the present case, the Court should grant discretionary review. The new test that has been enlisted by the Court in the present case imposes an unduly burdensome proof requirement on the insureds, and the insurance bad faith litigation context, especially when there are indications in the record that the insurer's legal counsel was involved in performing an adjustor-type function in the claims handling process. Insurance is a matter of "public interest". RCW 48.01.030. Unlike traditional contracts, insurance policies "abound with public policy considerations." See *Oregon Auto. Ins. Co. vs. Salzberg*, 85 Wn.2d 372, 376, 535 P.2d 816 (1975). First-party insurers have quasi-fiduciary obligations to their insureds, requiring an insurer to give equal consideration to its insured in all matters. See *Tank vs. State Farm Fire & Cas. Co.*, 105 Wn.2d, 381, 385-86, 715 P.2d 1133 (1986); *Farmers Br.* At 16 n.3.

Here, Cedell challenges whether Farmers exercised good faith in the claims handling process, questioning, among other things, the direct involvement of Farmers' lawyer in attempts to adjust the claim. See *Cedell Br.* at 11, 23 (describing the role of Farmers' legal counsel in claims handling process). In the course of its analysis, the trial court noted that Farmers' legal counsel was actively involved in the claims handling process "with primary responsibility for communicating with the insured for several months before the insured retained counsel". CP 488. Notwithstanding the Court's stated concern about limitations on an

insurer's lawyer's role in the claims handling process, it appears the significance of Farmers' lawyer's involvement in this case is left unexamined in light of the Court's conclusion that actual fraud must be proven before the civil fraud exception applies.

Imposition of such an onerous requirement on insureds will all but eliminate any *in camera* inquiry into the insurer's lawyer's role in the claims handling process absent egregious circumstances where fraud is otherwise manifest. Under the court's analysis, evidence of potential lawyer misconduct supporting liability for insurance bad faith will only surface in cases of outright fraud, at which point any such evidence will be largely cumulative. This view of the civil fraud exception is analytically unsound, and at odds with the public policy that is unique to the world of insurance law.

Secondly, the Supreme Court should accept review in this case because it involves issues of substantial public interest involving the insurance industry and the public and the protection of insureds from fraudulent conduct. The proper test for when an *in camera* review and discovery of redacted materials involves issues of substantial public interest that the Supreme Court should decide.

VIII. CONCLUSION

For the reasons set forth herein, the Court should accept review of the issues set forth herein.

RESPECTFULLY SUBMITTED on November 18, 2010.


OLSON, ZABRISKIE & CAMPBELL INC.
Attorney for Plaintiff/Respondent

APPENDIX "A"

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

BRUCE CEDELL,

Respondent,

v.

FARMERS INSURANCE
COMPANY OF WASHINGTON,

Appellant.

No. 38921-5-II

ORDER DENYING MOTION FOR
RECONSIDERATION

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DIVISION II

RESPONDENT moves for reconsideration of the Court's **August 3, 2010** opinion.

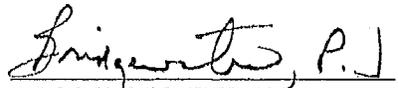
Upon consideration, the Court denies the motion. Accordingly, it is

SO ORDERED.

PANEL: Jj. Bridgewater, Armstrong, Quinn-Brintnall

DATED this 21st day of October, 2010.

FOR THE COURT:


PRESIDING JUDGE

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FACTS

This case arose from a claim for accidental fire damage to Cedell's home under a Farmers' policy. A year after the fire, Farmers had still not paid Cedell's claim so he filed suit, alleging that Farmers (1) failed to acknowledge pertinent communications; (2) failed to conduct a prompt investigation of his claim; (3) failed to act promptly, fairly, and equitably; (4) engaged in unfair and/or deceptive acts or practices; (5) effectively denied his claim by delaying action; and (6) acted unreasonably in denying his claim for coverage and/or payment of benefits.¹ Farmers had hired Ryan Hall, an attorney, to assist it making a coverage determination.

Cedell sent Farmers interrogatories and a request for production of documents, including Farmers' case file on Cedell's claim. Farmers responded by providing a heavily redacted copy of the case file and included a privilege log, which cited attorney-client privilege and work product as the basis for over 200 redactions and withholdings.² In addition, Farmers declined to answer multiple interrogatories because of attorney-client privilege and work product. Cedell then filed a motion to compel, arguing that attorney-client privilege and work product did not apply in bad faith litigations.

¹ Cedell appears to allege violations of WAC 284-30-330 (enumerated unfair claims settlement practices); RCW 48.30.010 (insurance unfair practices); and the Consumer Protection Act, RCW 19.86.170.

² Farmers also redacted certain information as irrelevant. The trial court found this improper and imposed up to \$2,500 in attorney fees and \$5,000 in sanctions payable to the court. Farmers does not seek review of the trial court's ruling on its failure to disclose other, non-privileged material. Thus, we do not address Cedell's arguments on this issue.

Farmers responded, arguing that it had a right to the protections of attorney-client privilege and work product even when a plaintiff alleged bad faith. It also sought a protective order preventing discovery of all privileged communications.

The trial court found that (1) Cedell was not home at the time of the fire, (2) the fire department and Farmers' fire investigator concluded the fire was accidental, (3) Farmers knew the fire left Cedell homeless, (4) a Farmers' adjuster appraised the value at \$56,498.84, (5) another adjuster estimated the damage at \$70,000 in building and \$35,000 in contents, (6) Farmers made a one-time offer of \$30,000 with an acceptance period that fell when Hall was out of town, (7) Farmers threatened to deny Cedell coverage and claimed he misrepresented material information without explanation, and (8) the damage to the house was eventually valued at over \$115,000 and more than \$16,000 in code updates. Citing *Escalante v. Sentry Ins. Co.*, 49 Wn. App. 375, 393, 743 P.2d 832 (1987), *review denied*, 109 Wn.2d 1025 (1988), *overruled on other grounds by Ellwein v. Hartford Accident & Indem. Co.*, 142 Wn.2d 766, 15 P.3d 640 (2001), the trial court found these facts adequate to support a good faith belief that Farmers engaged in wrongful conduct sufficient to invoke the fraud exception to the attorney-client privilege. The trial court ordered an *in-camera* review of Farmers' redacted documents.

After conducting an *in-camera* review, the trial court found that

In the context of a claim arising from a residential fire, the insurer owes the insured a heightened duty—a fiduciary duty, which by its nature is not, and should not be adversarial.³ Under such circumstances, the insured is entitled to discover the entire claims file kept by the insured without exceptions for any claims of attorney-client privilege.

³ This language mirrors that found in *Barry v. USAA*, 98 Wn. App. 199, 205, 989 P.2d 1172 (1999), which is discussed in section I.A.

CP at 487. The trial court found Farmers' claims of attorney-client privilege without merit. The trial court also found that Cedell was entitled to Farmers' work product. The trial court ordered Farmers to provide Cedell with all documents that it withheld and/or redacted based on attorney-client privilege and work product. The trial court also imposed sanctions and awarded Cedell attorney fees for Farmers' failure to provide the information.

We granted Farmers' motion for discretionary review and an emergency stay.

ANALYSIS

I. ATTORNEY-CLIENT PRIVILEGE

Farmers argues that the trial court abused its discretion by ordering the disclosure of confidential and privileged information with no basis to invoke the fraud exception to the attorney-client privilege.

In the attorney-client privilege context, we review the trial court's determination to permit or deny discovery for abuse of discretion. *Barry v. USAA*, 98 Wn. App. 199, 204, 989 P.2d 1172 (1999). But we review de novo the trial court's interpretation of the privilege statute. *Drewett v. Rainier Sch.*, 60 Wn. App. 728, 731, 806 P.2d 1260, *review denied*, 117 Wn.2d 1003 (1991).

Parties may obtain discovery regarding any matter, not privileged, relevant to the subject matter of the pending action. CR 26(b)(1). A party may serve on another party a request to produce documents that constitute or contain matters within the scope of CR 26(b) and that are in the possession, custody, or control of the party on whom the request is served. CR 34(a)(1). If a party disagrees with the scope of production requested during discovery, it must move for a

protective order and cannot withhold discoverable materials. *Wash. State Physicians Ins. Exch. & Ass'n v. Fisons Corp.*, 122 Wn.2d 299, 354, 858 P.2d 1054 (1993).

The attorney-client privilege, codified in RCW 5.60.060(2), provides that an attorney or counselor shall not, without the consent of his or her client, be examined as to any communication made by the client to him or her, or his or her advice given in the course of professional employment. Former RCW 5.60.060(2)(a) (2007). In general, this privilege protects confidential attorney-client communications from discovery or public disclosure so that clients will not hesitate to speak freely and fully inform their attorneys of all relevant facts. *Escalante*, 49 Wn. App. at 393.

A. Insurance Companies are Entitled to Attorney-Client Privilege in a Bad Faith Action

Cedell argues that there is no right to attorney-client privilege in a first-party-insured bad faith claim because it is not supposed to be an adversarial situation and because information about the insurance company's reasoning and claim handling is central to a bad faith claim.

In *Escalante*, the plaintiffs sued Sentry Insurance for bad faith, among other claims, for failure to pay an underinsured motorist (UIM) claim. *Escalante*, 49 Wn. App. at 379-80. The Escalantes sent interrogatory requests that sought, relevantly, general information and materials related to Sentry's evaluation of the Escalantes's claim. *Escalante*, 49 Wn. App. at 393. Sentry objected based on the attorney-client privilege and work product. *Escalante*, 49 Wn. App. at 393. The trial court denied the Escalantes's motion to compel. *Escalante*, 49 Wn. App. at 381. On appeal, the Escalantes argued that the attorney-client privilege did not protect information relevant to a bad faith claim. *Escalante*, 49 Wn. App. at 393.

First, the *Escalante* court recognized the general attorney-client privilege rule codified by RCW 5.60.060(2). *Escalante*, 49 Wn. App. at 393. The court then acknowledged the “fraud” or “civil fraud” exception to the privilege. *Escalante*, 49 Wn. App. at 394. The court held that the fraud or civil fraud exception could be invoked only when the insured presented a prima facie showing of bad faith tantamount to civil fraud. *Escalante*, 49 Wn. App. at 394. The court did not hold, however, that there was no attorney-client privilege in a bad faith lawsuit.

In *Barry*, an insured sued her insurance company, USAA, for bad faith for failure to pay a UIM claim. *Barry*, 98 Wn. App. at 202. During discovery, she requested documents including reports from the claims adjuster and correspondence from the attorney who handled the UIM claim. *Barry*, 98 Wn. App. at 202. When USAA did not comply, Barry moved to compel production. *Barry*, 98 Wn. App. at 203. The trial court found that Barry failed to establish sufficient wrongful conduct to invoke the fraud exception to the attorney-client privilege and declined to inspect the claims file. *Barry*, 98 Wn. App. at 202-03.

On appeal, the court first examined whether Barry had sought any privileged materials. *Barry*, 98 Wn. App. at 204. The court held that “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.” *Barry*, 98 Wn. App. at 204 (citing *Baker v. CNA Ins. Co.*, 123 F.R.D. 322, 326 (D. Mont. 1988); *Silva v. Fire Ins. Exch.*, 112 F.R.D. 699 (D. Mont. 1986); *Escalante*, 49 Wn. App. K

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at 394). The court agreed with the *Silva*⁴ court: “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.” *Barry*, 98 Wn. App. at 204 (quoting *Silva*, 112 F.R.D. at 699-700).

But the *Barry* court distinguished first party insured disputes from its case. *Barry*, 98 Wn. App. at 204-05. The court held that in UIM claims, UIM carriers stand in the shoes of the underinsured motorist/tortfeasor and are entitled to pursue all defenses against the UIM claimant that the tortfeasor possessed. *Barry*, 98 Wn. App. at 205. “Because the provision of UIM coverage is by nature adversarial, an inevitable conflict exists between the UIM carrier and the UIM insured.” *Barry*, 98 Wn. App. at 205. The friction of that relationship entitled USAA to the protections of attorney-client privilege. *See Barry*, 98 Wn. App. at 205.

We reject Cedell’s argument that an insurance company does not have any right to attorney-client privilege in a bad faith claim. *Escalante* did not hold that an insurance company has no right to assert attorney-client privilege in a bad faith action. It recognized the existence of the privilege and then determined whether the fraud or civil fraud exception applied. *Escalante*, 49 Wn. App. at 393-94. Additionally, the issue in *Barry* was whether an attorney-client privilege existed in the UIM context, not in first party insured claims. *Barry*, 98 Wn. App. at 204, 205. We agree with Farmers that, to the extent that *Barry* can be read to remove any attorney-client privilege in a first party bad faith claim, it is dicta and we decline to follow it.

⁴ *Silva* involved a bad faith insurance claim that arose out of a house fire. *Silva*, 112 F.R.D. at 699. That court unequivocally held that “a plaintiff in a first-party bad faith action is entitled to discover the entire claims file kept by the insurer.” *Silva*, 112 F.R.D. at 699.

An insurance company does not lose attorney-client privilege protection simply because its litigation opponent raises an issue where advice of counsel may be relevant. While an attorney's impressions may be relevant to a bad faith claim, an automatic removal of attorney-client privilege would frustrate the purpose of the attorney-client privilege without cause. The fraud exception discussed below provides a litigant with sufficient means to discover relevant attorney-client communications. We note, however, that an insurance company may not hire an attorney as a claims adjuster just to fall within the attorney client privilege. A claims adjuster's conduct is not privileged simply because the claims adjuster happens to be a lawyer. Accordingly, only information, investigation, and advice Hall gave Farmers in his capacity as an attorney is subject to the privilege.

We next determine whether the fraud or civil fraud exception to the privilege applies here. The trial court erred by finding that an insurance company has no attorney-client privilege in a bad faith action as a matter of law.

B. Prima Facie Showing of Fraud Not Made

Farmers argues that the trial court abused its discretion by ordering an *in-camera* review of the claim file without a sufficient factual basis related to the fraud exception to the attorney-client privilege. Farmers contends that the alleged inconsistency between its valuation of Cedell's damaged property in the context of a disputed, suspicious claim, and the short time limit placed on the offer to settle is an insufficient factual basis to support *in-camera* review. We agree.

Even privileged communications may be discoverable if the fraud exception applies. *Escalante*, 49 Wn. App. at 394.⁵ Generally, the exception is invoked only when the insured presents a prima facie showing of bad faith tantamount to civil fraud. *Escalante*, 49 Wn. App. at 394. To strip a communication of the attorney-client privilege, the party seeking discovery must show that (1) its opponent 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. *Barry*, 98 Wn. App. at 205. *Escalante* established a two-step analysis for determining whether fraudulent conduct exists that is sufficient to overcome the privilege. *Barry*, 98 Wn. App. at 205.

First, the trial court determines whether there is a factual showing adequate to show that wrongful conduct sufficient to evoke the fraud exception has occurred. *Escalante*, 49 Wn. App. at 394. Second, if so, the court conducts an *in-camera* inspection of the documents to determine whether there is a foundation in fact to overcome the privilege based on civil fraud. *Escalante*, 49 Wn. App. at 394. The *in-camera* inspection is a matter of trial court discretion. *Escalante*, 49 Wn. App. at 394. A court abuses its discretion if its decision is manifestly unreasonable or based on untenable grounds. *State ex rel. Carroll v. Junker*, 79 Wn.2d 12, 26, 482 P.2d 775 (1971).

To establish fraud, a litigant must show:

(1) a representation of an existing fact, (2) its materiality, (3) its falsity, (4) the speaker's knowledge of its falsity or ignorance of its truth, (5) [the speaker's] intent that [the fact] should be acted upon by the person to whom it is made, (6) ignorance of [the fact's] falsity on the part of the person to whom it is made, (7) the latter's reliance on the truth of the representation, (8) [the right of the person] to rely on it, and (9) [the person's] consequent damage.

⁵ Farmers seems to argue that Cedell implicitly conceded that an attorney-client privilege exists because he cited RCW 5.60.060(2). Farmers argues that Cedell conceded that attorney-client privilege exists unless an exception is shown because Cedell cited language to that effect. Cedell may argue in the alternative without waiving an argument.

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Lambert v. State Farm Mut. Auto. Ins. Co., 2 Wn. App. 136, 141, 467 P.2d 214, *review denied*, 78 Wn.2d 993 (1970). Contrary to Cedell's argument, proving fraud is different from proving bad faith. A bad faith claim is proven by conduct such as:

(2) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies.

(3) Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies.

(4) Refusing to pay claims without conducting a reasonable investigation.

(5) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed.

(7) Compelling insureds to institute or submit to litigation, arbitration, or appraisal to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in such actions or proceedings.

(8) Attempting to settle a claim for less than the amount to which a reasonable [person] would have believed he [or she] was entitled by reference to written or printed advertising material accompanying or made part of an application.

(13) Failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement.

Former WAC 284-30-330 (1987); *see also Indus. Indem. Co. of the Nw., Inc. v. Kallevig*, 114 Wn.2d 907, 923, 792 P.2d 520 (1990) (insurer's violations of former WAC 284-30-330 constitute a violation of RCW 48.30.010(1) and thus a violation of RCW 19.86.170). The elements of bad faith and fraud are thus separate and distinct. To qualify for the fraud exception to attorney-client privilege, the plaintiff must show fraud, as opposed to just bad faith.

The trial court found that (1) Farmers made a one-time offer of \$30,000 with an acceptance period that fell when Hall was out of town, (2) Farmers threatened to deny Cedell

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coverage without explanation, and (3) the damage to the house was eventually determined to be far more than Farmers' \$30,000 offer. Such conduct might constitute a violation of former WAC 284-30-330. But these facts are not adequate to support a finding of fraud. There is no evidence, for example, that Farmers knowingly misrepresented a material fact or that Cedell justifiably relied on a misrepresented material fact to his detriment. While the trial court found a factual showing of bad faith, it did not find a factual showing of fraud. The trial court therefore abused its discretion by ordering an *in-camera* review on the evidence presented.

C. No Factual Basis Finding

The trial court also abused its discretion by ordering disclosure and production of the information without finding a foundation in fact for a claim of civil fraud. Farmers correctly notes that the trial court's only finding was that it was not entitled to the attorney-client privilege at all. As we stated above, Farmers is entitled to attorney-client privilege unless some exception applies. Accordingly, we vacate the order compelling discovery and remand.

II. ATTORNEY FEES

Because of our holding that there were no facts to support a finding of fraud, we vacate the attorney fees award. We do not examine the calculation method. Additionally, we vacate the sanctions imposed under CR 26(g) and CR 37. The *Silva* theory regarding attorney-client privileges had never been applied in Washington and is not the law; thus, an award under either CR 26(g) or CR 37 is inappropriate.

In conclusion, alleging bad faith on the part of an insurer does not do away with the attorney-client privilege. Instead, the plaintiff must still show an exception to the attorney-client

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privilege, such as the fraud exception. That exception requires a showing of actual fraud, not just bad faith. Discovery sanctions are inappropriate in this case.

We reverse and remand for further proceedings consistent with this opinion before a different trial court judge with instructions to vacate the order compelling discovery, awarding attorney fees, and imposing sanctions.

Bridgewater P.J.

Bridgewater, P.J.

We concur:

Armstrong, J.

Armstrong, J.

Quinn-Brintnall, J.

Quinn-Brintnall, J.

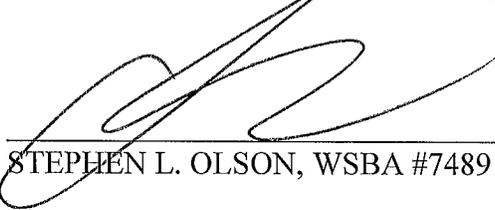
Certificate of Service by Mailing

I declare under penalty of perjury under the laws of the State of Washington that on November 18th, 2010, I deposited a true and correct copy of Petition to Review to the Supreme Court into the United States Mail, proper postage affixed thereto, to :

Court of Appeals Division II
950 Broadway, Suite 300
Tacoma, WA 98402

Curt Feig
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Dated Nov 18th, 2010, at Montesano, Washington.


STEPHEN L. OLSON, WSBA #7489

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