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Preserving and Defending an Insurance Company's Coverage and Claims Handling Decisions Through Proper File Documentation

I. Claims documentation can affect an insurer's coverage and claims handling decisions.

An insurance company's handling of a first- or third-party claim involves not just investigating the claim and making proper coverage and liability decisions, but also documenting and communicating same to the insured and other parties. An insurer's otherwise proper claims handling can be undermined if its claims notes, correspondence or other documentation are inadequate, unprofessional or otherwise suggest a lack of due diligence. A poor written record can expose the insurer to bad faith liability in many jurisdictions and can effectively prevent it from asserting otherwise legitimate coverage and liability positions.

II. Bad faith often can be proven through circumstantial evidence, such as insurer's internal claims file.

Most states do not require a claimant or insured to provide "direct evidence" of an insurance company's bad faith in order to maintain a claim for same. Instead, the claimant or insured often can prove that the insurer handled a claim or refused to pay a loss or demand in bad faith through the introduction of "circumstantial evidence." *See Nardelli v. Metropolitan Group Property and Cas. Ins. Co.*, 277 P.3d 789, 801 (Ariz. App. Ct. 2012); *Roldan v. Allstate Ins. Co.*, 149 A.D.2d 20, 37-38 (N.Y. App. Ct. 1989); *Johnson v. Allstate Ins. Co.*, 262 S.W.3d 655 (Mo App. Ct. 2008). In other words, an insurer's bad faith has been described as a "state of mind," which may be proven "by the insurer's acts and circumstances and can be proven by circumstantial and direct evidence." *Johnson*, 262 S.W.3d at 662. As the Arizona Supreme Court put it, "unless the defendant is willing to take the stand and admit its 'evil mind,' the plaintiff must prove [bad faith] with circumstantial evidence." *Hawkins v. Allstate Ins. Co.*, 733 P.2d 1073, 1081 (Ariz. 1987).

The evidentiary threshold for maintaining a bad faith claim against an insurer varies from state to state. Each particular claim is obviously fact-specific, and insurer conduct that might constitute bad faith

in one situation may not qualify as such in another. Though by no means exhaustive, factors or circumstances that courts have found sufficient to sustain a bad faith claim include the following:

- Indifference to the facts obtained during the claims investigation, *see Nardelli*, 277 P.3d at 801;

- The failure to investigate a claim, *see id.*; *Johnson*, 262 S.W.3d at 662; *O'Neill v. Gallant Ins. Co.*, 769 N.E.2d 100, 107 (Ill. App. Ct. 2002); *Besel v. Viking Ins. Co. of Wisconsin*, 146 Wash.2d 730, 737 (Wash. 2002);

- The failure to evaluate a claim, *see Johnson*, 262 S.W.3d at 662;

- The failure to recognize the severity of a claimant's injuries and the probability that a verdict would exceed policy limits, *see Johnson*, 262 S.W.3d at 662; *Phelan v. State Farm Mutual Automobile Insurance Co.*, 448 N.E.2d 579, 585 (Ill. App. Ct. 1983);

- The refusal to negotiate or consider a settlement offer, *see Johnson*, 262 S.W.3d at 662; *Cernocky v. Indemnity Insurance Co. of North America*, 69 Ill.App.2d 196, 208, 216 N.E.2d 198, 205 (Ill. 1966);

- The failure to follow the advice of the insurance company's own adjusters, *see Phelan*, 448 N.E.2d at 585;

- The failure to follow the advice of defense counsel, *see Olympia Fields Country Club v. Bankers Indemnity Insurance Co.*, 906-07 (Ill. 1945); *Kinder v. Western Pioneer Ins. Co.*, 231 Cal. App. 2d 894, 42 Cal. Rptr. 394 (Cal. App. Ct. 1965);

- The failure to communicate with the insured, particularly with respect to the claimant's willingness to settle for the policy limits, *see O'Neill*, 769 N.E.2d at 107; *Besel*, 146 Wash.2d at 737.

- The insurer's threat to take an inappropriate coverage position, such as rescission, in order to coerce a settlement, *see Fletcher v. Western National Life Ins. Co.*, 10 Cal. App. 3d 376, 392 (Cal. App. Ct. 1970);

- Accusing an insured of insurance fraud without evidence to back up the charge, *see Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 575–576, 108 Cal. Rptr. 480, 486–487, 510 P.2d 1032 (Cal. 1973);

- Harassment of an insured or witness, *see Rios v. Allstate Ins. Co.*, 68 Cal. App. 3d 811, 817, 137 Cal. Rptr. 441, 444 (Cal. App. Ct. 1977);

- An adjuster's contemptuous attitude toward an insured, *see Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 821, 169 Cal. Rptr. 691, 697, 620 P.2d 141 (Cal. 1979);

- Misrepresentation of a facts or policy coverages, *see Pistorius v. Prudential Insurance Co.*, 123 Cal. App. 3d 541, 547, 176 Cal. Rptr. 660, 664 (Cal. App. Ct. 1981);

- Unreasonable delay in paying a claim in an effort to avoid doing so, *see Richardson v. Employers Liab. Assur. Corp.*, 25 Cal. App. 3d 232, 102 Cal. Rptr. 547 (Cal. App. Ct. 1972); and

- Conduct that would demonstrate a greater concern for the insurer's monetary interest than for the insured's financial risk, *see Besel*, 146 Wash.2d at 737.

To prove one or more of these circumstances or factors, claimants and insureds will often try to obtain an insurance company's internal documentation of a claim, particularly its claims diary notes. An Arizona appellate court summarized well why an insurer's claims notes often become the focus in bad faith litigation:

> Continental conceded at oral argument that the claims file contains a "blow-by-blow" diary of the insurer's investigation and decision-making process with regard to Brown's loss of earnings claim. The tort of bad faith arises when an insurance company intentionally denies, fails to process, or fails to pay a claim without a reasonable basis for such action….The portions of the claims file which explained how the company processed and considered Brown's claim and why it rejected the claim are certainly relevant to these issues. Further, 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 the information in the file is not only substantial, but overwhelming.

Brown v. Superior Court, 670 P.2d 725, 734 (Ariz. App. Ct. 1983).

III. An insurance company's internal claims documentation often is discoverable.

Of course, any correspondence or communications that an insurance company may have with third parties are likely discoverable. The discoverability of internal communications and materials, however, such as claims diary notes, e-mails or memoranda, will vary widely from jurisdiction to jurisdiction. Insurers often will take the position that these internal materials are immune from discovery under the work product doctrine, which generally protects materials created by a party in anticipation of litigation. Some states take a very narrow view of the work product doctrine, however, and protect only the mental impressions of the insurance company's attorneys. *See Waste Management, Inc. v. International Surplus Lines Insurance Co.,* 144 Ill.2d 178, 196 (1991).

Other states take a broader view of the work product doctrine generally but nonetheless require production of internal insurance company materials under a variety of theories. For example, some states require production of these materials in bad faith litigation under the view that the insurer's internal documentation is "at issue" in the suit. *See Tackett v. State Farm Fire and Cas.*, 558 A.2d 1098, 1104 (Del. App. Ct. 1988). Other states allow production under the theory that the claimant or insured may have a "substantial need" for these materials. *See Brown v. Superior Court*, 137 Ariz. 327, 670 P.2d 725, 734 (Ariz. App. Ct. 1983); *Vesta Fire Ins. Corp. v. Figueroa*, 821 So.2d 1233, 1236 (Fla. Ap. Ct. 2002). Still other states require production under the view that the insured is entitled to her liability claims file, much like a client

is entitled to the file created by her attorney. *See Grewell v. State Farm Mut. Auto Ins. Co, Inc.*, 102 S.W.3d 33 (Mo. 2003). Another set of states holds that an insurance company may waive any privilege or protection of certain of its claims materials should it contest an allegation of bad faith or otherwise reference advice of counsel in its decision-making. *See Boone v. Vanliner Ins. Co.*, 744 N.E.2d 154, 158 (Ohio 2001).

No matter the theory, the reality is that internal communications and materials created by an insurance company with respect to a given claim may very well be subject to discovery in any subsequent insurance coverage or bad faith litigation.

IV. Suggestions for claims notes and internal documentation.

With this reality in mind, it is helpful for insurance companies to consider how the documentation of their claims handling may affect their ability to assert their otherwise legitimate insurance coverage and liability decisions. An insurer's claims documentation should show that the company is diligently investigating all necessary issues in a claim, is conducting its investigation in a prompt and professional manner, is trying to arrive at a claims or coverage decision that fairly takes into account the facts and circumstances of the claim, and is communicating the status of its investigation and claims handling to the insured in an accurate and timely manner.

In order to do so, claims documentation should strive at all times to:

- Be Professional.
- Indicate the source of information and its context.
- Stay away from uncommon abbreviations.
- Clearly label as coverage information as such or bifurcate the file.
- Accurately document insurer actions.
- Accurately document status of the claim.
- Support the insurance company's position.
- Outline next steps and actions.
- Document the insurer's work on a file to avoid lengthy gaps in the record.
- Avoid criticisms of colleagues and management.
- Leave out derogatory remarks.
- Stay away from unnecessary commentary.

- Avoid unnecessary references to race, religion, gender or ethnicity.

- Make sure the insurer shows that it is putting the insured's interests first.

Claims notes and documentation that fail to meet one or more of these points can make the insurer's handling of a claim look unprofessional, confused, slow, biased or worse. They can expose an insurer to potential bad faith liability and can actually discourage the carrier from asserting its otherwise legitimate coverage or claims decisions for fear of triggering a bad faith claim.

When an insurer's claims notes meet all of these attributes, however, the company can better preserve its insurance coverage defenses and explain its claims handling decisions should any subsequent insurance litigation arise. When claims notes and other internal documentation accurately and professionally reflect the insurance company's investigative and decision-making process, the focus in any subsequent insurance litigation will shift from improper documentation to the actual merits of the claim and the insurer's response to it.