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Revisiting The Litigation Privilege And Its Application In Bad-Faith Cases

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Commentary

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Introduction

Over the last 25 years, courts have wrestled with the issue of whether to apply an absolute privilege to preclude bad-faith lawsuits based on an insurance company's conduct during the litigation of an underlying first-party or third-party claim. Some courts still refuse to recognize a bad-faith claim against an insurance company based upon its post-litigation conduct.[1] However, the prevailing trend seems to suggest that courts will find that some of the insurer's conduct remains relevant and admissible, while the conduct of the insurer's attorneys in defending the claim remains privileged.[2]

History of the Litigation Privilege

The litigation privilege generally shields judges, counsel, witnesses, and parties from liability for conduct during the course of a judicial proceeding as long as the conduct relates to the subject of inquiry.[3] In a recent Florida Supreme Court opinion, *DelMonico v. Traynor*, the court outlined the history and development of the litigation privilege in the context of a subsequent defamation suit. At issue were certain out-of-court comments made by a defendant's counsel to a third-party witness while investigating the claim. The court noted that Florida's long-standing application of an absolute privilege provided protections through contempt of court and providing the court with wide discretion to determine which statements were pertinent to the pending litigation.[4] The absolute privilege was premised on a concern that the initial litigation would devolve into a second trial and that the absence of the privilege would have a potential chilling effect on litigants seeking to redress their injuries.[5]

Since its inception, Florida courts have applied the litigation privilege by balancing two competing interests - the public interest in allowing litigants and counsel to zealously advocate for their cause versus protecting individuals from tortious actions.[6] Where the balance fell often depended upon whether the formalized judicial process provided adequate safeguards to prevent abuse of the privilege.[7] In the context of the *DelMonico* case, the court found that the statements made by counsel were both out-of-court and outside of the formal discovery process and only a qualified privilege would apply.[8]

Recent Applications of the Litigation Privilege to Bad-Faith Actions

The reasoning of the Florida Supreme Court in the recent *DelMonico* opinion, albeit not in a bad-faith context, remains consistent with the trend among courts across the nation addressing bad-faith concerns. Beginning with the California case of *White v. Western Title Ins. Co.*, courts have considered whether an insurer's litigation conduct can provide an additional basis to prove bad faith.[9] While some jurisdictions refuse to consider litigation conduct in a subsequent bad-faith claim, many others have admitted evidence of the

insurance company's conduct occurring after litigation as relevant.[10] Since the *White* decision, California limited its application and, generally, prohibited evidence of litigation conduct, including litigation techniques and strategies.[11]

Third-Party Cases

The Kentucky Supreme Court addressed these issues in its 2006 decision in *Knotts v. Zurich Ins. Co.* and attempted to define the limitations that litigation conduct would be admissible and relevant in a subsequent bad-faith action.[12] In *Knotts*, a third-party claimant (a self-employed construction contractor) was injured while working at the insured's warehouse. The claimant filed a tort suit against the insured's company. At trial, a jury rendered a verdict in favor or the claimant. The claimant subsequently filed a bad-faith claim against the insured's commercial general liability carrier. The claimant argued that the insurer violated the Kentucky's Unfair Claims Settlement Practices Act (UCSPA) in the course of litigating the underlying tort case. The lower courts rejected the bad-faith claim on the grounds that the UCSPA did not apply to the insurer's conduct after the commencement of the underlying tort action.[13] The Supreme Court reversed, noting that absolute privilege had "some instinctive appeal," but the UCSPA continued to apply during litigation.

The court noted that the filing of the underlying complaint did not change the nature of what the claimant sought.[14] If the UCSPA were not applicable during litigation, then insurers would have a "perverse incentive" to encourage claimants to litigate, thereby shielding insurers from bad-faith claims.[15]

The court discussed whether it should permit evidence of the insurance company's settlement behavior only, or also permit evidence of litigation tactics, strategies, and techniques employed on behalf of the insurance company.[16] Ultimately, the court held that only the insurance company's settlement behavior, including refusals to settle and low offers, should be permitted.[17] The court stated that permitting evidence of litigation strategies and tactics would impede the insurer's access to the courts and right to defend and make them reluctant to contest coverage of questionable claims.[18] The court reasoned that the rules of civil procedure provide sufficient safeguards against improper behavior.[19]

While evidence of the limited litigation conduct may be relevant, the court must still weigh its probativeness against its potential to prejudice a jury.[20]

In another third-party bad-faith case, *Barefield v. DPIC*, the West Virginia Supreme Court of Appeals held that the insurance company cannot be held liable for bad faith, under its state statutory provision, for the misconduct of the defense counsel for the insured, unless the insurance company knowingly encouraged, directed, participate in, relied upon, or ratified that behavior.[21] The *Barefield* court noted:

> An insurance company is not like the average citizen or business defending their assets against a lawsuit; an insurance company exists to pay valid claims, and charges premiums that provide sufficient resources to pay those claims. . . . [To] then allow an insurance company to increase its underwriting profit by unreasonably defending claims, while still charging the same premiums, violates the public policy underlying the premium-rate statutes.[22]

The court also noted the "disparaging economic bargaining power between insurance companies and the average litigant."[23] The court reasoned that to hold otherwise would reward obstinacy and "provide a disturbing incentive" for insurance companies to push meritorious claims into litigation.[24]

In contrast, once the insurance company retains counsel for the insured, the counsel's duty is to defend the insured. Further, under ethical rules, the attorney cannot represent both the insured and the insurance company.[25] This ethical obligation requires the attorney to maintain his independent professional judgment and the insurance company cannot control the details of his performance or his strategy and tactics.[26]

First-Party Cases

The U.S. District Court in Colorado has issued two opinions over the last year discussing these issues.[27] In *Rabin v. Fidelity Nat'l*, the plaintiff made a claim for damaged real and personal property related to a fire. The insurance carrier tendered payments for a portion of the personal property loss and requested appraisal of the remainder of the personal property loss.[28] The

plaintiff then brought suit for breach of contract and bad faith against the homeowners' insurance carrier.[29] The appraisal process was completed after suit had been filed, resulting in additional payments from the insurance company. During discovery, the insurance company received information that its counsel believed supported a counterclaim. Counsel moved to assert claims for declaratory judgment, breach of good faith and fair dealing, and unjust enrichment against the insured plaintiff. The motion to amend was denied as untimely.[30]

The insurance company then filed several motions, including a motion to determine whether the duty of good faith and fair dealing was suspended upon the filing of the action and for summary judgment on the bad-faith claim based upon the litigation privilege.[31]

The court noted that the "duty of good faith and fair dealing continues unabated during the life of an insurer-insured relationship, including through a lawsuit or arbitration between the insured and the insurer."[32] However, the court also noted that "collateral circumstances" could suspend any obligation to negotiate.[33] These collateral circumstances include situations where the insurer and insured have a genuine disagreement as to the amount of compensable damages and where an adversarial proceeding has been filed.[34] As a result, the court held that the insurance company's duty to negotiate had, in fact, been suspended once the insured filed suit.

The absence of the duty to negotiate did not resolve the issue of whether the insurer could be found in bad faith for its attempts to assert the counterclaims. As with the duty of good faith and fair dealing, bad faith may encompass an entire course of conduct and can be cumulative.[35] Evidence of bad-faith conduct occurring after the filing of a complaint may be admissible as a "continuation of the same difficulties that preceded the filing of the complaint."[36]

However, the court noted that attorney conduct during litigation was subject to a different rule and its relevance may be limited.[37] The court noted a prior decision that held that the attorneys' conduct could be admissible as evidence of bad faith "if the risks of unfair prejudice, confusion of the issues, or misleading the jury, and consideration of undue delay, waste of time, or the presentation of unnecessary cumulative evidence are substantially outweighed by the probative value of the evidence.[38] The court ultimately held that the attempt to assert the counterclaims were benign and lacked the necessary probative value to show bad faith.[39] The court noted whether the counterclaims demonstrated bad faith would require a delving into their respective merits, as a meritorious counterclaim would not be in bad faith.[40] The court additionally noted that the decision to assert the counterclaim was "attorney litigation conduct," and not the insurer's conduct, in the same manner as the assertion of defenses and denial of allegations.[41]

In *Etherton v. Owners Ins. Co.*, an insurer filed a motion in limine to exclude evidence of post-filing conduct.[42] The plaintiff challenged the motion, arguing that to show that the insurer's investigation of the plaintiff's underinsured motorist claim was unreasonable, he would need to contrast the insurer's investigation before and after plaintiff filed suit.[43] The court stated that admitting the insurer's litigation strategy as evidence of bad faith could create potential conflicts with the attorney's litigation privilege, result in ethical dilemmas for attorneys representing insurance companies, or involve attempts to obtain or introduce information protected by the attorney-client privilege and work-product doctrine.[44] Additionally, it could deter insurers from conducting a vigorous defense.[45]

Conclusion

It appears that courts will continue the trend of allowing limited evidence of the insurance company's actions post-litigation as evidence of bad faith. Insurers can still argue that such evidence is irrelevant and more prejudicial than probative. If the bad- faith claim is premised on the insurer's knowledge and belief during the time the claim is being reviewed, then the relevance of the litigation conduct is diminished.[46] However, the decisions, tactics, and strategies of defense counsel will remain protected by the litigation privilege except in the instances where the plaintiff can establish that the insurer knowingly controlled or participated in that litigation strategy. As most courts hold that the insurance company has a continuing duty of good faith to its insured, that extends through litigation, an insurance company should exercise caution to ensure that the

claims and defenses asserted on its behalf have a justifiable basis or risk their decisions being challenged in a subsequent action.

Endnotes

1. *See* Andres v. Oklahoma Farm Bureau Mut. Ins. Co., 290 P.3d 15,17 (Okla. Civ. App. 2012).

2. *See, e.g.*. Rabin v. Fidelity Nat'l Prop. & Cas. Ins. Co., 863 F. Supp. 2d 1107, 1116 (D. Colo. 2012); Knotts v. Zurich Ins. Co., 197 S.W.3d 512 (Ky. 2006).

3. DelMonico v. Traynor, No. SC10-1397, 2013 WL 535451 at *4 (Fla. Feb. 14, 2013).

4. *Id.* at *6.

5. *Id.* at *7.

6. *Id.* at *10. In the context of this article, the tortious conduct would be the alleged bad faith conduct of the insurance company towards its insured.

7. *Id.* at *10.

8. *Id.* at *11.

9. White v. Western Title Ins. Co., 710 P.2d 309 (Cal. 1985). For a further review of the development of the litigation privilege in the context of first-party bad-faith cases, *see* Brian D. Webb, *Applying The Litigation Privilege In Bad-Faith Cases*, MEALEY'S LITIGATION REPORT: INSURANCE BAD FAITH, Vol. 25, #8 (Aug. 25, 2011).

10. *See* Parker v. Southern Farm Bureau Cas. Ins. Co. 935 S.W.2d 556, 562 (Ark. 1996)(excluding all post litigation conduct), *but see* T.D.S. Inc. v. Shelby Mut. Ins. Co., 760 F.2d 1520 (11th Cir. 1985)(evidence of litigation conduct relevant to the claim that the insurance company acted dishonestly toward the insured).

11. *See* California Physician's Service v. Superior Court, 12 Cal. Rpt. 2d 95, 100 (Cal. Ct. App. 1992). This court held:Defensive pleading, including the assertion of affirmative defenses, is communication protected by the absolute litigation privilege. Such pleading, even though allegedly false, interposed in bad faith, or even asserted for inappropriate purposes, cannot be used as the basis for allegations of ongoing bad faith. No complaint can be grounded upon such pleading.

12. Knotts v. Zurich Ins. Co., 197 S.W.3d 512 (Ky. 2006).

13. *Id.* at 514.

14. *Id.* at 517.

15. *Id.* at 517.

16. *Id.* at 518.

17. *Id.* at 523.

18. *Id.* at 521.

19. *Id.* at 522.

20. *Id.* at 523.

21. Barefield v. DPIC Companies, Inc., 600 S.E.2d 256, 271 (W. Va. 2004).

22. *Id.* at 267.

23. *Id.* at 267.

24. *Id.* at 267.

25. *Id.* at 269.

26. *Id.* at 270.

27. *See* Rabin v. Fidelity Nat'l Prop. & Cas. Ins. Co., 863 F. Supp. 2d 1107 (D. Colo. 2012); Etherton v. Owners Ins. Co., No. 10-cv-00892, 2013 WL 68702 (D. Colo. Jan. 7, 2013).

28. *Id.* at 1109.

29. *Id.*

30. *Id.* at 1109.

31. *Id.* at 1109.

32. *Id.* at 1112 *citing* Sanderson v. American Family Mut. Ins. Co., 251 P.3d 1213, 1217 (Colo. App. 2010).

33. *Id.* at 1113, *citing* Bucholtz v. Safeco Ins. Co. of America, 773 P.2d 590 (Colo. App. 1988).

34. *Id.* at 1113.

35. *Id.* at 1116 *citing* Vaccaro v. American Family Ins. Group, 275 P.3d 750, 756 (Colo. App. 2012).

36. *Id.* at 1116. *See also* Southerland v. Argonaut Ins. Co., 794 P.2d 1102, 1106 (Colo. App. 1990).

37. *Id.* at 1116.

38. *Id.* at 1116-7, *discussing* Parsons v. Allstate Ins. Co., 165 P.3d 809 (Colo. App. 2006).

39. *Id.* at 1117.

40. *Id.* at 1118.

41. *Id.* at 1118.

42. 2013 WL 68702 at *5.

43. *Id.* at *5.

44. *Id.* at *6, *citing* Parsons, *supra* note 38.

45. *Id.*

46. *See* Dakota, Minnesota & Eastern RR Corp. v. Acuity, 771 N.W. 623, 635-6 (S.D. 2009) *citing* Timberlake Constr. Co. v. U.S. Fid. & Guar. Co. 71 F.3d 335, 340 (10th Cir. 1995). ■

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