INSURANCE BAD FAITH & DISCOVERY: THB POLICYHOLDBR'S PERSPECTIVE

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I. INTRODUCTION

Consumers buy insurance to protect themselves against losses if an accident occurs. For this protection, consumers pay a premium. The consumer rightly expects that if an accident occurs, his insurance company will protect him. As the Hawai`i Intermediate Court of Appeals noted, when an insured purchases insurance, he is "seeking something more than commercial advantage or a profit; the insured seeks security, protection, and peace of mind." *See Jou v. National Interstate Ins. Co. of Hawai`i,* 114 Haw. 122, 129, 157 P.3d 561, 568 (Haw. Ct. App. 2007).

In some cases, the process works. The insured makes a claim, and the insurer promptly pays or defends the claim. In other cases, however, insurers refuse to pay a legitimate claim, delay payment, refuse to defend, or shortchange and fail fully to reimburse an insured for his loss. In such circumstances, the insured is in a vulnerable position. He is worried about the accident and often faces catastrophic financial losses if the claim is not properly covered or paid. Thus, the insurer has the controlling bargaining position and may use it to its own advantage. Because of this, courts in many jurisdictions, including Hawai`i, have created a cause of action in tort against insurers who deal in "bad faith."

Before a lawsuit is filed, the insured usually knows only basic information about how the insurer handled the claim. For example, the insured knows how long

the insurer took to respond to the claim and the basis for denying the claim set forth in any letter from the insurer. However, the insured does not know other important matters such as (1) the extent to which an investigation was conducted and what it specifically entailed, (2) the individuals involved in the handling of the claim, (3) whether the claim was handled according to the insurer's written guidelines and procedures, and (4) whether the insurer treated the claim in a fair and consistent manner in comparison to other, similar claims it had processed on behalf of other insureds.

The above information is critical to support an insured's claim of bad faith. Insurers often vigorously oppose disclosure of the information. For an insured, knowing what to look for and how to obtain it through discovery become critical. This paper will discuss general concepts of bad faith and some of the key areas for discovery from the policyholders' perspective.

II. INSURANCE BAD FAITH CONCEPTS

A. Background

"[E]very contract contains an implied covenant of good faith and fair dealings (bad faith) that neither party will do anything that will deprive the other of the benefits of the agreement." *Best Place, Inc. v. Penn America Insurance Co.,* 82 Haw. 120, 123-124, 920 P.2d 334, 337-338 (1996), *quoting, Hawai`i Leasing v. Klein,* 5 Haw. App. 450, 456, 698 P.2d 309, 313 (1985). While a breach of good faith results in a cause of action under contract principles, "[w]hether a breach of this duty will give rise to a cause of action in tort, depends on the duty or duties inherent in a

contract..." *Best Place, Inc.,* 82 Haw. at 129, 920 P.2d at 343.

Hawai`i followed the California courts in recognizing a tort action for bad faith conduct by insurers. A breach of duty of good faith and fair dealing in tort was first recognized in insurance contracts dealing with third-party claims[1]. *Best place, Inc.,* 82 Haw. at 124, 920 P.2d at 338 *citing Communale v. Traders* & *Gen. Ins. Co.,* 50 Cal.2d 654, 328 P.2d 198 (1958) and *Crisci v. Security Ins. Co.,* 66 Cal.2d 425, 58 Cal.Rptr. 13, 426 P.2d 173 (1967). In *Communale* and *Crisci*, both third-party claims, the California Supreme Court characterized the insured's cause of action in tort and stated that a breach of the covenant of good faith and fair dealing may allow a plaintiff to sue in tort, as well as contract. *Best place, Inc.,* 82 Haw. at 128, 920 P.2d at 342.

Subsequently, in *Gruenberg v. Aetna Ins.* Co., 9 Cal.3d 566, 108 Cal Rptr. 480, 510 P.2d 1032 (1973)[2], the California Supreme Court extended the tort of bad faith to first-party claims. The Court concluded that insurance companies owe "'an absolute duty of good faith and fair dealing to their insureds." *See also Best*

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[1] A third-party claim is one in which the insurer contracts to defend the insured against claims made by third parties and to pay any resulting liability up to a specified amount. A first-party claim refers to an insurance agreement where the insurer agrees to pay claims submitted by the insured for losses suffered by the insured. *Best Place, Inc.* 82 Haw. at 124, 920 P.2d at 338, n.4

[2] In *Gruenberg,* an insured alleged bad faith on the part of his insurance company for denying payment of three fire insurance policies and court ruled that insurance companies are obligated to act in good faith and failure to compensate an insured for a loss covered by the policy for no good reason may give rise to a cause of action in tort for breach of covenant of good faith and fair dealings. 9 Cal.3d at 574, 108 Cal Rptr. at 485, 510 P.2d at 1037.

Place, Inc., 82 Haw. at 128, 920 P.2d at 342 *citing Gruenberg,* 9 Cal.3d at 578, 108 Cal. Rptr. at 488, 510 P.2d 1040.

Citing *Gruenberg,* the Hawai`i Supreme Court held that the unique nature of an insurance contract warranted an exception allowing the imposition of tort liability on an insurer who breaches the implied covenant of good faith and fair dealings. *Best Place, Inc.,* 82 Haw. at 127-28, 920 P.2d at 341-42. The Court stated:

> Tort actions for breach of covenants implied in certain types of contractual relationships are most often recognized where the type of contract involved is one in which the plaintiff seeks something more than commercial advantage or profit from the defendant. When dealing with an...insurer, the client/ customer seeks service, security, peace of mind, protection, or some other intangible. These types of contracts create special partly noncommercial relationships, and when the provider of the service fails to provide the very item which was the implicit objective of the making of the contract, then contract damages are seldom adequate, and the cases have generally permitted the plaintiff to maintain an action in tort as well as contract.

Best Place, Inc., 82 Haw. at 133, 920 P.2d at 341-42.

Furthermore, an insured has a disadvantage because he is in a vulnerable economic position, and the insurer holds a stronger bargaining position. *Id.* Without a tort cause of action for a breach of the covenant of good faith, an insurer may not be inclined to expedite or even pay a valid claim. *Id; see also Arnold v. National County Mut. Fire Ins. Co.,* 725 S.W. 2d 165, 167 (Tex.1987); *State Farm Fire & Cas. Co. v. Nicholson,* 777 P.2d 1152, 1157 (Alaska 1989); *White v. Unigard Mut. Ins. Co.,* 112 Idaho 94, 730 P.2d 1014 (1986).

B. The Standard for Bad Faith in Tort

Following the standard in *Gruenberg,* Hawai`i courts have stated that to satisfy a claim in tort for bad faith in an insurance context, the insured need not show an awareness of wrongdoing or unjustifiable conduct, nor an evil motive or intent to harm the insured. *Best Place, Inc.* 82 Haw. at 133, 920 P.2d at 347. An unreasonable delay in payment of benefits will allow for compensatory damages. *Id.* Thus, an insured can establish bad faith by demonstrating that the insurer acted "unreasonably" in handling the claim.

Over the years, bad faith liability has grown to encompass various "unreasonable" acts by an insurer which constitute bad faith.[3] For example, the Court in *Christiansen v. First Insurance Co.,* 88 Haw. 442, 967 P.2d 639 (App. 1998), *rev'd in part on other grounds,* 88 Haw. 136, 963 P.2d 345 (Haw. 1998) noted that:

> Bad faith in the first party context can be established by evidence that the insurer unreasonably interpreted policy provisions. First party bad faith may also be shown by an insurer's unreasonably low settlement offer, or by the insurer's unreasonable conduct after the filing of the complaint in the bad faith action. . . .
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> The duty of good faith and fair dealing obliges an insurer to inform its insured of all possible benefits and coverage available under the policy and to disclose any conflicts between its interests and those of the insured. Furthermore, an insurer may

[3] *See, e.g.* Stephen S. Ashley, *Bad Faith Actions: Liability and Damages* (2d ed. 1997) at § 5:06 listing seventeen examples of unreasonable claims settlement practices including a denial of a claim with no reasonable basis, inadequate investigation, delay, deception, threats or false accusations, exploiting an insured's position, conditioning partial payment on settlement of disputed portion, and abuse of process.

> be subject to a bad faith action even though it has paid the policy limits without delay when, for the purpose of protecting its own interests, it acts improperly to impede the insured's recovery of the uninsured portion of the loss.

88 Haw. at 449, 967 P.2d at 646, n.9, *citing* W. Shernoff, S.Gage and S.Levine, *Insurance Bad Faith §* 5.02 [1] (1997).

An insurer's potential liability is not restricted to common-law bad faith tort actions. Statutory restrictions on an insurer also serve as a source for potential liability. For example, Hawai`i Revised Statutes § 431: 13-103 outlines specific examples that constitute unfair claims handling practices by an insurer. These include the failure to respond to a communication from an insured within 15 business days, misrepresenting the benefits of an insurance policy in advertising, and not attempting in good faith to effectuate prompt, fair and equitable settlement of claims in which liability has become relatively clear, among others.

Although there is no private right of action under this chapter,[4] the United States District Court ruled that a claimant may refer to this statute in order to establish bad faith in a tort action. *Wailua Associates v. Aetna Casualty* & *Surety Co.,* 27 F.Supp.2d 1211, 1221 (D. Haw. 2001)("[V]iolations of the unfair settlement provision, §431:13-103(a), may be used as evidence to indicate bad faith in accordance with the guidelines of *Best Place.*").

Lastly, punitive damages can also be awarded in bad faith tort cases. *Best Place,* 82 Haw. at 134, 920 P.2d at 348. However, for punitive damages, the

[4] The Hawai'i Insurance Commissioner has the exclusive power to address violations of this Chapter.

insured must prove more than "unreasonable conduct." The insured must present evidence that "the defendant acted wantonly, oppressively or with such malice as implies a spirit of mischief or criminal indifference to civil obligations, or where there has been some wilful misconduct or that entire want of care which would raise the presumption of a conscious indifference to consequences." *Id.*

III. DISCOVERY

The following is information which policyholders may want to obtain in bad faith actions.

A. Underwriting files

Underwriters are involved in the process of considering and approving applications for insurance, communicating with agents and brokers, and determining premium rates. They also have knowledge of how policy provisions have been interpreted in the past. Arthur, Randy; Houser, Douglas G., *The Role of the Insurance Underwriter in Claims Disputes,* 31 Tort & Insurance L. J.573, 575 (Spring 1996).

Underwriting files can be relevant because they may contain an insurer's position on coverage, claims and relations with policyholders. *See Hoechst Celanese Corporation v. National Union Fire Insurance Company of Pittsburgh, Pennsylvania,* 623 A.2d 1099, 1107 (Del. Super. 1991). In *Hoechst Celanese Corporation,* the insured sought explanatory and interpretive materials, such as underwriting files, pertaining to the relevant policies. *Id* at 1104-1105. The insurer claimed that this information was not relevant to the case. *Id* at 1104. The court allowed discovery of underwriting files and reinsurance materials, reasoning that

they were relevant because they may provide evidence as to how the insurance company intended to interpret and apply the insurance policy. *Id* at 1107.

In *Open Software Foundation Inc. v. United States Fidelity & Guaranty* Co., 191 F.R.D 325 (D. Mass. 2000) , the insured sued the insurer for failing to defend the insured in litigation involving claims of antitrust violations, unfair competition, and interference with business relations. *Id.* at 325-26. The plaintiffs requested production of underwriting files and claims files. While the underwriting file was lost and not subject to production, the court stated that an insurer is obligated to produce such documents if they were non-privileged. *Id.* at 328.

In *Nestle Foods Corp. v. Aetna Casualty and Surety* Co., 135 F.R.D. 101 (D.N.J. 1990), the court ordered the insurer to produce certain underwriting files. The insured filed a declaratory action against the insurer seeking a determination of coverage after a series of environmental claims were brought against the insured. *Id* at 103. The insured served extensive discovery requests which were opposed by the insurer. *Id.* The court ruled that the underwriting files were discoverable and relevant because they may help with interpreting the polices and the intent of the drafters. *Id.*

B. The Claims File

The law is clear that an insured may obtain the claims file maintained by the insurer. *See Terrell v. Western Casualty Ins.* Co., 427 S.W.2d 825, 828 (Ky. Ct. App. 1979); *Hoechst Celanese Corporation,* 623 A.2d at 1107.

In *Terrell,* the insured alleged that the insurer committed bad faith and

fraud because the insurer had refused to negotiate a fair settlement. 427 S.W. 2d at 828 . On appeal, the court stated: "The insurer must not abuse the power it has to negotiate and make settlements and refuse to settle within the limits of the policy if the damage to the insured is reasonably certain ... Finally it is within the proper scope of discovery to inquire into and demand the production of all documents and material pertaining to any negotiations or offers of settlement." *Id.*

While claim files, in general, may be discoverable, certain documents may be protected under the work product doctrine: "For general guidance purposes only, the Court notes that the work product doctrine provides a qualified protection from discovery in a civil action when the documents materials are (1) document and tangible things otherwise discoverable, (2) prepared in anticipation of litigation, and (3) by or for another party or by that other party's representative. *American Savings Bank v. Painewebber. Inc.,* 210 F.R.D. 721, 723 (D. Haw. 2001). To satisfy the second element of the work product doctrine, there must be some threat of litigation, and the document must have been generated after that threat had materialized. *Id.*

A minority of courts holds that an insurance company's investigation of a claim is almost always done in anticipation of litigation .[5] However, in *Pete*

[5] *See Fireman's Fund Ins.* Co. *v. McAlpine,* 120 R.I. 744, 391 A.2d 84 (1978)(court ruled that statements taken during investigation were done so in preparation of trial). *But cf., Langdon v. Champion,* 752 P.2d 999, 1006 (Alaska l999)(Because a substantial part of an insurance company's business is to investigate claims made by an insured, it must be presumed that such investigations are part of the normal business activity and witness statements compiled by or on behalf of the insurer in the course of such investigations are ordinary business records as distinguished from trial preparation materials).

Rinaldi's Fast Foods, Inc., v. Great American Insurance Co., 123 F.R.D. 198, 202 (M.D.N.C. 1988), the court stated that "[a]n insurance company cannot reasonably argue that the entirety of its claims files are accumulated in anticipation of litigation when it has a duty to investigate, evaluate and make a decision with respect to claims made on it by its insured." The court noted that it is an insurance company's duty in their ordinary course of business to investigate the insureds' claims. Thus, the claims files containing such documents cannot be entitled to work doctrine protection. *Id.* Furthermore, even if documents are considered work product, the material may still be discoverable upon a showing of good cause, undue hardship, and need. *National Farmer's Union Property & Casualty Co. v. District Court,* 718 P.2d 1044, 1047 (Colo. 1986).

C. Other Claims Files

Claims files of other insureds can be discoverable because they are relevant in interpreting policy provisions and determining how the insurance company analyzes its policies' provisions. *National Union Fire Insurance Company of Pittsburgh, PA v. Stauffer Chemical Co.,* 558 A.2d 1091, 1093-1096 (Del. Super. 1989); *Nestle Foods* Corp.,135 F.R.D. at 106-107.

In *National Union,* the court allowed discovery of claims files of non-party insureds because they were relevant in clearing up an ambiguity in certain policy provisions. 558 A.2d at 1093-1096. Moreover, in *Nestle Foods Corp.,* the court

allowed discovery of claims files of other insureds "since it may show that identical language has been afforded various interpretations by the insurer." 135 F.R.D. at 106-107.

In *Aetna Casualty & Surety Co. v. Haas,* 422 S.W.2d 316 (Mo. 1968), the court found the previous payment by the insurer of a claim by the insured similar to the one in dispute to be of "great weight" in determining the meaning of the exclusion at issue: "That practical construction of coverage under the policy is and should be binding upon [the insurance company]." *Id.* at 320. *See also Independent Petrochemical Corp. v. Aetna Casualty & Surety Co.,* 117 F.R.D. 283, 287 (D. D.C. 1986) (ordering production of other dioxin claims involving the spraying of the chemical on land or releases into waterways against other policyholders during years in which plaintiff was insured); *Owens-Coming Fiberglass Corp. v. Allstate Ins. Co.,* 74 Ohio Misc. 2d 174, 660 N.E.2d 765 (1993) (ordering production of "material from any lawsuits or arbitrations that defendants have had concerning asbestos coverage."); *Carey-Canada, Inc. v. California Union Ins. Co.,* 118 F.R.D. 242, 243 (D.D.C. 1986)(finding "meritless" the insurers argument that claims files related to asbestosis claims against other insureds were irrelevant and non-discoverable); *Potomac Electric Power Company v. California Union Ins. Co.,* 136 F.R.D. 1 (D.D.C. 1990) (ordering production of "information on third party claims that were either litigated or ultimately paid, and which were filed under similar policies for incidents of PCB contamination that occurred during the effective dates of Pepco's policies with defendants.").

Insurers opposing discovery of the claims files for non-party insureds often argue that production of such documents can be burdensome. However, courts have offset that burden by limiting and tailoring the discovery: "[T]he burden can be limited by tailoring the discovery order. The discovery may be limited to a particular number of claim files and a limit may be placed on time and geography." *National Union,* 558 A.2d at 1093-1096.

D. Claims, Policy, and Procedure Manuals

In *Glenfed Development Corp. v. the Superior Court,* 53 Cal. App. 4th 1113, 1116, 62 Cal. Rptr. 2d 195, 196 (1997), the insured filed petition for writ of mandate, seeking order directing the insurer to produce its claims manual. *Id.* The insured attempted to determine if subcontractor's defective work was covered under real estate developer's excess liability policy. The Court noted, "our courts have for years recognized that claims manual are admissible in coverage dispute litigation ... If claims manuals are admissible, it follows (as the courts of other states with similar discovery statutes have held) that they are discoverable." *Id .,* 53 Cal. App. 4th at 1117, 62 Cal. Rptr. at 197-198. Accordingly, the Court held that the claims manuals were discoverable because policy terms were emphasized in the manuals. *Id.*

In *Nestle Foods Corp.,* the insurer sought a protective order, prohibiting the disclosure of claims and underwriting manuals. The insurer argued that these documents were confidential because they contained proprietary business information and their disclosure could lead to a competitive disadvantage. 129

F.R.D. at 484. The Magistrate Judge ruled that there was no showing of good cause to protect these documents. *Id.* The court found that the documents were not highly confidential because the insurer was open in sharing the allegedly confidential information with competitors. *Id.; See also Hoechst Celanese Corporation,* 623 A.2d at 1107 (underwriting and claims manuals are discoverable because they may help establish an insurance company's official position on coverage and claims); *Adams v. Allstate Insurance Co.,* 189 F.R.D. 331, 332-333 (E.D.P.A. 1999)(claims manuals are discoverable).

E. Attorney Case Files

Insurers often object to production of information based on the attorney-client/work product privilege. They argue that since an attorney (in many instances in-house counsel) reviewed the reservation of rights or denial letter, his drafts, memoranda, and communications are non-discoverable. There are several ways to attack this insurer strategy.

First, some cases hold that in bad faith cases, the attorney client privilege does not apply to actions taken by the insurer before the denial of coverage. *See Boone v. Vanliner Insurance Co.,* 91 Ohio St.3d 209, 2 13-214, 744 N.E.2d 154, 158 (2001). In *Boone,* the insured filed a declaratory judgment action against his insurer seeking a determination that his policy provided a certain amount of motorist coverage. The plaintiff also included a bad faith claim, alleging that the insurer lacked justification for the denial of coverage. To support the bad faith claim, the insured sought discovery to insurer's claims file. 91 Ohio St.3d at 210,

744 N .E.2d at 155.

The insurer sought a protective order stating that several documents were protected by the attorney-client privilege and work product doctrine. *Id.* The Court rejected the insurer's argument. In allowing discovery of claims files created prior to the denial of coverage, the court ruled that the files may show a lack of good faith and are unworthy of protection even though the files contained attorney-client and work product privileged information. 91 Ohio St.3d at 212, 744 N.E.2d at 157.

Even if the privilege is generally recognized, it only applies to an attorney furnishing legal advice. In other words, if the attorney is simply functioning as an adjustor, the privilege may not apply. *See National Fanner's Union Property & Casualty Co. v. District Court,* 718 P.2d 1044 (Colo. 1986). In *National Fanner's Union,* the insurer sought to avoid producing a memorandum prepared by outside counsel. The memorandum contained results of an investigation as to the facts regarding the issuance of an insurance policy and conclusions regarding whether a claim under the policy should be paid. *Id.*

The court found that the work product of the attorney, who was hired to investigate the claim, did not constitute legal advice but was work that was a normal part of the insurer 's business. *Id* at 1047- 1048. Moreover, the work was not prepared in anticipation of litigation because at the time of the investigation, no lawsuit had been filed nor was there any indication that any litigation was imminent. *Id.* at 1048. The court stated that the attorneys performed the same work as a claims adjuster and, therefore, the resulting work was a business record

and was discoverable. *Id. See also Hawkins v. District Court,* 638 P.2d 1372, 1378 (Colo. 1982)(An insurance company's business is to investigate claims. Thus the investigative work is presumed to be ordinary business records).

It is also clear that if an insurer raises the "advice of counsel" defense, it waives the attorney-client privilege. *See State Farm Mutual Auto Ins. Co. v. Lee,* 199 Ariz. 52, 13 P.3d 1169, 1184 (2000)(affirming trial's court grant of policyholder's motion to compel discovery, rejecting the insurer's attorney-client privilege claim) because insurer implicitly asserted the advice of counsel defense).

Another exception to the attorney-client privilege is the crime-fraud exception. *See Freedom Trust v. Chubb Group of Insurance Companies,* 38 F. Supp. 2d 1170, 1171 (C. D. Cal. 1999). The crime-fraud exception states that there is no attorney-client privilege if the services of the lawyer were used in order to perpetuate a crime or fraud. *Id.*

In *United Services Auto Ass'n v. Werley,* 526 P.2d 28 (Alaska, 1974), the court reviewed a discovery order directing the production of various documents. The insurer claimed that the documents were protected under the attorney- client privilege. *Id* at 29. The insured claimed that the documents fell within the "civil fraud" exception to the attorney-client privilege. *Id.* at 33. The court concluded that the insurer's bad faith was enough to satisfy the "civil fraud" exception to the attorney-client privilege. *Id.*

F. Discovery of Reserves

In a bad faith claim, access to the reserves file may prove vital for the insured. The reserves file may be relevant to establish a bad faith claim. "Loss reserves ... represent the amount anticipated to be sufficient to pay all obligations for which the insurer may be responsible under the policy with respect to a particular claim. That amount necessarily includes expenses that are likely to be incurred in connection with the settlement or adjustment of the claim, as well as the legal fees and other costs required to defend the insured." *Lipton v. Superior Court,* 48 Cal. App. 4th 1599, 1614 (Cal. App. 2d 1996).

In *Lipton,* the court ruled that an insured is entitled to the loss reserve information unless the trial court can conclude that the information is irrelevant and that it would not lead to any admissible evidence in the bad faith action. *Id.* Furthermore, while addressing the importance and relevancy of the loss reserves files, the court said: "[S]uch evidence may or may not be relevant in a subsequent bad faith action, depending on the issues presented. For example, in a case where the insurer has denied coverage and refused a defense, the *fact* that a reserve had been set by the insurer might well be relevant to show that the insurer must have had some knowledge that a *potential* for coverage existed." *Id* at 1614.

While loss reserves may be relevant in a bad faith claim, there are instances when they are not and thus not open to discovery. See *In re Couch,* 80 B.R. 512, 518 (Bankr. S.D. Cal. 1987)(court ruled that, because reserve policy is established

by legislature and Insurance Commissioner, it cannot be fairly equated with an admission of liability or the value of any particular claim). Other courts have ruled that if the reserves files were established as part of an attorney's work or in expectation of litigation, then the reserves files would be protected by the attorney-client privilege or work product doctrine. *Simon v. G.D. Searle* & Co., 816 F.2d 397, 401 (8th Cir. 1987). Likewise, if the burden of producing the reserves files is greater than the benefit received, discovery will be denied. *Champion Int'l Corp. v. Liberty Mut. Ins.* Co., 128 F.R.D. 608, 612 (S.D.N.Y 1999).

G. Reinsurance

"Reinsurance occurs when one insurer (the 'ceding insurer' or 'reinsured') 'cedes' all or part of the risk it underwrites, pursuant to a policy or a group of policies, to another insurer. The reinsurer agrees to indemnify the ceding insurer on the risk transferred. The purpose of reinsurance is to diversify the risk of loss, and to reduce required capital reserves. *Lipton,* 48 Cal. App. 4th 1599 at 1617. The purpose of reinsurance is to allow the ceding company to reduce its statutory reserve requirements for existing policies and thereby undertake additional risks by issuing policies to a greater number of insureds. *Id.*

Depending on the specific facts of the case, reinsurance information may be relevant in a bad faith claim. In *Fireman's Fund Ins.* Co. *v. Superior Court,* 233 Cal. App. 3d 1138, 1141 (Cal. App. 1991), the court ruled that the reinsurance documents may be relevant in the bad faith claim and decided that, before ruling on the relevancy of the documents, it would review the documents *in camera* to

determine if any documents should be withheld from disclosure.

However, in *Lipton,* the court stated that because the reinsurance contract does not alter the original contract between the insurer and insured, an argument can be made that reinsurance documents have no relevance and are unlikely to lead to the discovery of admissible information. 48 Cal. App. 4th at 1617. The court went on to say that correspondence between insurer and reinsurer that is not privileged and which talks about liability exposure, may be relevant and discoverable. *Id.* Similarly in *Leksi, Inc. v. Federal Ins. Co.,* 129 F.R.D. 99, 106 (D. N. J. 1987), the court stated that "[r]einsurance involves a company's attempt to spread the burden of indemnification and [i]t is a decision based on business considerations and not questions of policy interpretation. I conclude, therefore, that its relevance is very tenuous and its production is not compelled at this juncture except insofar as an insurer has 'lost' Leksi's policy." While courts have differed on the matter, ultimately, whether or not reinsurance documents are discoverable depends on their relevancy.

H. Other Bad Faith Actions

> [A] plaintiff may establish a claim by showing either that the acts that harmed him were knowingly committed or were engaged in **with such frequency as to indicate a general business practice**. While proof of a knowing violation will make plaintiff's job that much easier, in cases where a knowing violation is difficult to establish, knowledge can be proved circumstantially. **Discovery aimed at determining the frequency of alleged unfair settlement practices is therefore likely to produce evidence directly relevant to the action** …

Colonial Life & Accident Ins. Co. v. Superior Court, 31 Cal.3d 785, 791-92, 647 P.2d 86, 90 (Cal. 1982). *See also J&M Assoc. v. Nat'l. Union Fire Ins. Co.,* 2008 U.S.

Dist. LEXIS 16855 at *14 (S.D. Cal., Mar. 14, 2008)(following *Colonial Life* and finding that in a bad faith claim alleging unreasonable withholding of benefits, "discovery regarding other claims handled by [the insurer] is relevant to [the insured's] claims . . . insofar as the requests seek information pertaining to the same type of policy at issue in this case").

In *Mauna Kea Beach Hotel Corp. v. Affiliated FM Insurance Co.,* 2009 U.S.Dist. LEXIS 38078 (D. Haw. May 1, 2009), the court disallowed discovery of bad faith claims by other policyholders. However, the court in *Mauna Kea* addressed only conduct, which violated the Hawai`i Insurance Code. *Mauna Kea* at *10-13. The court reasoned that insurance codes from other states could have different requirements. *Id.* In cases in which the policyholders are not relying exclusively on the insurer's violations of the Hawai`i Insurance Code, the reasoning of *Mauna Kea* should not apply . As noted above, an insurer commits bad faith if it acts unreasonably. *Best Place, supra.* Violating the Insurance Code may be one way of acting unreasonably, but it is not the only way. In fact, in addressing the bases for insurer bad faith, the Court in *Best Place* specifically discussed "case law" separately from the "statutory provisions" of the Insurance Code. 82 Haw. at 125-26, 920 P.2d at 339-40. In *State of Hawaii, Department of Transportation v. American Home Assurance Co. et al.*, Civ. No. 10-1-0598093 (JHC), the Court declined to follow *Mauna Kea* and affirmed the discovery master's order, compelling the insurers to produce bad faith lawsuits and administrative complaints within the past 3 years. *See 4/24/14* Order Denying Defendants' Motion to Appeal Discovery

Master's Order Dated February 10, 2014.

Courts in other jurisdictions similarly recognize that bad faith claims and lawsuits brought by other insureds are discoverable in bad faith actions. For example, in *Ex parte O'Neal*, 713 So.2d 956 (Ala. 1998), the court upheld an order requiring the insurer to respond to an interrogatory asking for detailed information concerning lawsuits filed in the past five years against the insurer for bad faith or fraud. *See also Paul Revere Life Ins. Co. v. Dibari,* 2010 U.S. Dist. LEXIS 42820 at *8 (D. Conn., May 3, 2010)(ordering insurer to identify "any verdict, judgment or arbitration award against it in any declaratory judgment action that it had commenced from January 2004 to December 31, 2008 for bad faith liability relating to the appropriate care question.").

In *Miller v. Mutual of Omaha Insurance Company,* 1977 U.S. Dist. Lexis 16349 (D. Kan., Apr. 15, 1977), the court noted that, "[c]ertainly, a plaintiffs claim for 'bad faith', outrage, and punitive damages is strengthened if he can show more than the single denial of his individual claim. If he can demonstrate a pattern of activity evidencing a scheme and intent, his chances of recovery greatly increase." (emphasis added)(compelling answers to interrogatories - (1) "Has any lawsuit substantially similar to the instant suit been filed against you by any policyholder or claimant whose claim you denied or resisted under circumstances substantially similar to your position herein within [a two year period]" and (2) a subsequent interrogatory seeking "relevant details concerning any such lawsuit.").

I. Discovery into the Financial Condition of the Insurer

An insurer's financial condition is considered to be relevant as it relates to punitive damages. In *Caruso v. Coleman Co.,* 157 F.R.D. 344, 349 (E.D. Pa. 1994), the court stated that "since relevancy governs the standard of discoverability and the very purpose of discovery is to locate evidence, it would be difficult and illogical to require plaintiff to show entitlement to punitive damages before completion of discovery." *Id.; see also Vollert v. Summa Corp.,* 389 F. Supp. 1348, 1351 (D. Haw. 1975)(stating that because liability and damages go to the jury together, it must be assumed that the jury will receive proper instructions as to when and how to decide the issue of punitive damages, therefore it was not premature for plaintiff to demand discovery of any financial information) . Additionally, some courts, to protect the privacy of defendant whose financial information is being disclosed, have required that financial documents be revealed only to counsel for the discovering party or to counsel's representative, and that, once the financial information is revealed, it may only be used for that pending dispute. *Richards v. Superior Court,* 86 Cal. App. 3d 265, 272, 150 Cal. Rptr. 77, 81 (Cal. App. 2d Dist. 1978).

IV. CONCLUSION

Litigating coverage and bad faith cases against insurers can be daunting. Insurers have seemingly limitless resources to defend the case and often take aggressive positions on all issues, including discovery. To be successful, policyholders' counsel must be thoroughly familiar with the coverage issues and the

various ways in which the insurer may have acted in bad faith. Counsel must also vigorously pursue discovery of information which might establish (1) that the insurer's position in the coverage action is inconsistent with its own internal documents or its handling of similar claims filed by other insureds and/or (2) the insurer's actions represent a pattern of unreasonable behavior in handling claims.