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Pre-Denial Work Product Limitation Applies to Insurers and Not Policyholders

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New York law unequivocally empowers policyholders to demand discovery of nearly all documents and communications authored by insurers or their consultants before a denial of coverage by prohibiting insurers from claiming work-product protection over such material.

While Insurers routinely contend that this prohibition applies equally to policyholders in discovery disputes, a recent decision by Judge Jesse Furman in the Southern District of New York clarifies that this limitation on the scope of work product "applies to insurers … and not to insureds." *Tower 570 v. Affiliated FM Insurance,* No. 20-CV-0799 (JMF), 2021 WL 1222438, at *4 (S.D.N.Y. Apr. 1, 2021) (emphasis original). This means that policyholders can seek discovery into insurers' pre-denial claims adjustment without opening the door to disclosure of their own sensitive and privileged coverage analysis.

In *Tower 570*, a first-party property coverage action, the policyholder engaged an electrical engineer and public adjuster within days of an electrical incident that resulted in significant property damage, to evaluate its cause and origin. The electrical engineer prepared a report expressing his opinion on the cause of loss, the final version of which was eventually provided to the insurer. However, draft copies of the report were also shared with the public adjuster and policyholder's legal counsel. The insurer sought to compel these draft reports as well as communications among the electrical engineer, policyholder employees, the public adjuster, and counsel—all of which were authored within days of the loss but months prior to the insurer's eventual denial of coverage. Citing to cases restricting insurers' work-product claims, the insurer argued that "[i]n the insurance context, it is generally recognized that an 'anticipation of litigation' privilege is deemed triggered when a determination has been made to reject overage," (citing *Bombard v. Amica Mutual Insurance,* 11 A.D.3d 647, 648, 783 N.Y.S.2d 85, 86 (2nd Dep't 2004)). The Southern District, however, rejected the insurer's argument, making express that "[t]he payment or rejection of claims is a part of the regular business of an insurance company" only, (emphasis original) (quoting *Bombard,* 11 A.D.3d at 648). Thus, although insurers may not assert work-product protection prior to the denial of coverage, a New York policyholder most certainly can.

From a practical standpoint, this means that policyholders are free to seek discovery of all pre-denial claims adjustment activity, including any communications with, or reports authored by, consultants, independent adjusters, or "experts" engaged by insurers to investigate the loss or evaluate coverage. Absent a decision to deny coverage (which Insurers all too often delay under the guide of "investigation"), an insurer may not assert "work-product" protection over such material. Even more significant is that for policyholders, this means they can pursue pre-denial discovery without fear of weakening their own work-product claims respecting material generated prior

to receiving a formal denial of coverage from their carrier.

Quite often, documents from this pre-denial period—when an insurance company formulates its coverage opinion or calculates the quantum of loss—can provide policyholders with unique and powerful evidence to establish key elements of their claim. Discovery of insurers' claims handling practices during this period can also allow an insured to assess the reasonableness of the insurer's conduct (or misconduct) and evaluate whether an insurer breached their duty of good faith and fair dealing by engaging in unreasonable claims adjustment practices or unjustified delay.

Take for instance documents reflecting an insurance adjuster's uncertainty as to the meaning of terms in a policy, or the application of an exclusion to the specific incident at hand—even an insurer's decision to confer with consultants to determine coverage—all such documents may provide circumstantial evidence of policy ambiguity, which under bedrock New York law, must be construed against the insurer and in favor of coverage. Similarly, internal acknowledgments of coverage (including partial coverage) that do not result in prompt payment may provide evidence of breaches of cooperation provisions in policies, or worse, evidence that the implied covenant of good faith and fair dealing has been violated. Indeed, insurers may breach this covenant by taking too long to adjust a claim, thereby exposing themselves to liability for extracontractual consequential damages. Even where an insurer ultimately refuses coverage, their failure to adjust the claim expediently and commit to payment or denial can still breach the implied covenant of good faith and fair dealing. See *D.K. Property v. National Union Fire Insurance Co. of Pittsburgh*, 168 A.D.3d 505, 506 (1st Dep't 2019). Discovery into what an insurer knew, when, and what its representatives did with that knowledge, is invaluable to a policyholder trying to prove its claim.

And while an outright rejection of coverage by an insurance company is an obvious cutoff point after which insurers may assert work-product, policyholders (and courts) may scrutinize when an insurance company made the actual decision to deny. Policyholders should be aware that an insurer's mere reservation of rights is insufficient to end the claims-adjustment period when work product protection is unavailable. For example, in *Bombard*, the insurer claimed that the decision to deny coverage had been made as of its initial reservation of rights letter. However, the language of that letter and other evidence showed that the insurer's "investigation of the incident … was ongoing" and, as a consequence, the court rejected the insurer's attempts to assert work-product protection prior to the actual denial of coverage months later. *Bombard,* 11 A.D.3d at 649. In complex coverage cases, it is not unusual for the adjustment of a claim to continue for months or even years after the receipt of a reservation of rights letter. Since the party withholding discovery bears the burden of demonstrating that its material is privileged, the insurer (and not the insured) must prove that it already made the decision to deny coverage to assert work product. This can prove a precarious balancing act for insurers, who, on the one hand, want to assert an early denial in order to cloak their claims adjustment process in the work product doctrine, and on the other hand, often seek to delay issuing denials of coverage. Sometimes insurers wish to allow their adjustment process to play out, but, in some instances, a denial is delayed so an insurer may preserve arguments that an insured's coverage litigation is not ripe.

Either way, policyholders should know that thanks to *Tower 570*, they can pursue claim adjustment discovery without the fear of losing protection over their own pre-denial analyses.

And, insurers should know they cannot have their cake and eat it, too.

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