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MARTHA (MARTY) J. STREEPER
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813-983-0022
813-988-5837 Fax

LIAISON-QUARTERLY
James A. Gallagher, Jr.
Gallagher & Faller
New York, NY
jgallagher@ggfc-law.com

FDCC QUARTERLY EDITORIAL OFFICE
Marquette University Law School
Eckstein Hall, PO Box 1881
Milwaukee WI, 53201-1881
414-288-5375
414-288-5914 Fax
patricia.bradford@marquette.edu

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PUBLICATIONS
LATHA RAGHAVAN
Goldberg Segalla LLP
Albany, NY
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EDITOR-FLYER
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CLE COORDINATOR
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Defending Products Liability Suits Involving Off-Label Use: Does the Learned Intermediary Doctrine Apply?

Marisa A. Trasatti
Lindsey N. Lanzendorfer

I.
Introduction

The False Claims Act (FCA), which prohibits any person from knowingly causing the submission of false claims to the federal government for payment or approval, includes a *qui tam* provision that allows people who are not affiliated with the government to file actions on behalf of the government.[1] Several states have also created FCA statutes with *qui tam* provisions. Recently, these acts have been used to bring claims against pharmaceutical companies for marketing drugs and medical devices for off-label uses—uses other than those specified on the product labels approved by the Food and Drug Administration (FDA). As a result, many pharmaceutical companies have paid staggering claims to settle these cases. For example, Pfizer paid $430 million in 2004 to settle a claim that it encouraged physicians to prescribe the drug Neurontin to treat bipolar disorder rather than epilepsy (its FDA approved use).[2] In 2010, Elan Pharmaceuticals settled a claim of unauthorized promotion

[1] *See* False Claims Act, 31 U.S.C. §§ 3729–33 (2010). "Qui tam" is an abbreviation of the Latin phrase, "*qui tam pro domino rege quam pro se ipso in hac parte sequitur*," which means "who pursues this action on our Lord the King's behalf as well as his own." Robin Page West, Advising the Qui Tam Whistleblower: From Identifying a Case to Filing Under the False Claims Act 1 (2001).

[2] Gardiner Harris, *Shamed Drug Firm Pays Up $636m*, The Age (May 15, 2004), http://www.theage.com.au/articles/2004/05/14/1084289882827.html (last visited Nov. 2, 2011).

Marisa A. Trasatti is a Principal at Semmes, Bowen, and Semmes in the Baltimore, Maryland office. Her practice focuses primarily on civil litigation, with an emphasis on products liability, including cases involving drug and medical devices. Ms. Trasatti has served on the Board of the Maryland Defense Counsel as the Young Lawyer Liaison and is currently the Co-Chair of the Judicial Nominations Committee. She is also active in DRI, serving as the Program Vice-Chair for the 2012 Sharing Success Seminar of the Women in the Law Committee. Ms. Trasatti is a member of the Maryland bar, and she is also admitted to practice before the Superior Court of the District of Columbia, the United States District Court for the District of Maryland, the United States Court of Appeals for the Fourth Circuit, and the United States Supreme Court. She writes frequently for DRI and blogs for Maryland Defense Counsel and the Federation of Defense & Corporate Counsel.

for $214.5 million.[3] There, the company was alleged to have promoted Zonegran—another drug FDA approved to treat epilepsy—for bipolar disorder, migraine headaches, chronic daily headaches, eating disorders, and obesity.[4] As a final example, AstraZeneca agreed to pay $68.5 million in a 2011 settlement.[5] In this multi-state claim, AstraZeneca was alleged to have pushed doctors to prescribe the drug Seroquel for insomnia and Alzheimer's, even though the FDA approved the drug as an anti-psychotic.

Litigators may be wondering if these large settlements from FCA claims will translate into larger financial outcomes in personal injury tort claims arising from off-label use. This depends, in part, on whether the learned intermediary doctrine is an affirmative defense for manufacturers in these lawsuits.

The learned intermediary doctrine serves as a shield for manufacturers against consumer claims arising from allegations of failure to warn of a product's risks. Essentially, the doctrine protects manufacturers from liability if they warn physicians of the risks associated

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[3] Steven Meyerowitz, *Elan Missing As Pharmaceutical Companies Pay $214.5 Million to Settle FCA and Other Claims*, Financial Fraud Law (Dec. 16, 2010, 12:53 PM), http://www.financialfraudlaw.com/lawblog/elan-missing-pharmaceutical-companies-pay-2145-million-settle-fca-and-other-claims/1813 html (last visited Nov. 2, 2011).

[4] *Id.*

[5] Matthew Perrone, *AstraZeneca Paying $68.5M in Seroquel Settlement*, Wash. Post (Mar. 10, 2011), http://www.washingtonpost.com/wp-dyn/content/article/2011/03/10/AR2011031003328.html.

Lindsey N. Lanzendorfer was a summer associate at Semmes, Bowen, and Semmes in Baltimore, Maryland in 2011. She graduated magna cum laude from Juniata College with distinction in Politics. Ms. Lanzendorfer is currently a third-year law student at University of Maryland Francis King Carey School of Law. She is a Notes and Comments Editor for the Maryland Law Review and also a member of the National Trial Team.

with a drug or device.[6] However, physicians commonly engage in off-label use, and it is impossible for manufacturers to warn physicians of every risk associated with all uses of a medical product. Thus, the question becomes whether the learned intermediary doctrine would still insulate manufacturers when physicians prescribe drugs or devices for off-label uses. Unfortunately, court decisions that address this issue vary widely across circuits.[7] Still, analysis of these decisions offers some guidance for defense attorneys who may defend pharmaceutical companies in personal injury lawsuits.

II.
Off-Label Use of Prescription Drugs and Medical Devices

By way of background, the FDA regulates manufacturers' marketing and distribution of medical devices and prescription drugs. To market drugs and devices, the manufacturer must first obtain FDA approval for the drug or device. The FDA will only approve a prescription drug or device for the uses that the manufacturer shows are safe and effective.[8]

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[6] *See, e.g.,* Roxanne M. Wilson, *Encroachment on the Learned Intermediary Doctrine Resulting from Recent Court Decisions and Direct-to-Consumer Advertising*, 59 Fed'n Def. & Corp. Couns. Q. 223, 224 (2009).

[7] Blain v. SmithKline Beecham Corp., 240 F.R.D. 179, 186-87 (E.D. Pa. 2007).

[8] *See* 21 U.S.C. § 355(b)(1) (2006); 21 U.S.C. § 355-1 (Supp. III. 2009).

Once approved for a particular use, the FDA historically has prohibited manufacturers from promoting their products for other uses, with limited exceptions.[9]

Physicians, however, often prescribe drugs or use medical devices off-label.[10] Physicians are free to take these actions in the exercise of good medical judgment because the FDA does not regulate individual physicians. In fact, the United States Supreme Court called off-label prescription "an accepted and necessary corollary of the FDA's mission to regulate in this area without directly interfering with the practice of medicine."[11] The federal government has made clear that its regulations do not restrict a physician's ability to prescribe products for off-label uses.[12] "Researchers have estimated that off-label uses of prescription medical products make up 25 percent to 60 percent of all prescriptions written each year."[13]

Physicians prescribe off-label for many reasons. One reason is that sometimes no drug exists to treat a particular condition. For instance, one neurologist has noted that Rituximab, which is FDA-approved for treatment of non-Hodgkin's lymphoma, is the only known treatment for "progressive encephalalomyelitis with rigidity and myoclonus."[14] If physicians did not prescribe Rituximab to treat this condition, it essentially would go untreated, and the patient could die.

Physicians may also prescribe off-label because patients respond to prescription drugs differently. Cynthia Harden, M.D., Chief of the Division of Epilepsy and Electroencephalography at Long Island Jewish Hospital, commented that drugs are not targeted for specific types of epilepsy.[15] While some seizures start in the frontal lobe, others originate in the temporal lobe.[16] As such, treating epilepsy can require doctors to prescribe the drug differently than described on the drug's label, depending on the locus of the seizure activity.

Physicians also often prescribe off-label when treating children. These off-label prescriptions occur because children do not take part in clinical tests or trials. As such, only twenty to thirty percent of FDA approved drugs are labeled for use in children.[17] If physicians were not permitted to prescribe off-label, many childhood diseases would go untreated.

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[9] See *infra* text accompanying notes 21-25 for further description on what information the FDA permits drug manufacturers to provide to physicians.

[10] Richard C. Ausness, *"There's Danger Here, Cherie!": Liability for the Promotion and Marketing of Drugs and Medical Devices for Off-Label Uses*, 73 Brook. L. Rev. 1253, 1253 (2008).

[11] Buckman Co. v. Plaintiff's Legal Comm., 531 U.S. 341, 350 (2001).

[12] Ausness, *supra* note 10, at 1259.

[13] Kevin Costello & Eric Johnston, *Manufacturer Liability for Off-Label Uses of Medical Devices*, L.A. Law., Apr. 2008, at 18, 18 (citing James M. Beck & Elizabeth D. Azari, *FDA, Off-Label Use, and Informed Consent: Debunking Myths and Misconceptions*, 53 Food & Drug L.J. 71, 80 (1998)).

[14] Tom Valeo, *A Catch 22: Neurologists Can Prescribe Off-Label, But Risk Health Insurers' Denials for Reimbursement*, Neurology Today, Apr. 7, 2011, at 28.

[15] *Id.* at 29.

[16] *Id.*

[17] *Should Your Child be in a Clinical Trial?*, U.S. Food and Drug Administration, http://www.fda.gov/ForConsumers/ConsumerUpdates/ucm048699.htm (last visited Oct. 29, 2011).

Although physicians typically prescribe off-label, manufacturers do not rush to have the FDA approve drugs or devices for these additional uses. If a manufacturer wishes to have an already marketed medical product approved for a new use, the manufacturer must go through a lengthy and expensive process to obtain FDA approval for a new use.[18] Since physicians can prescribe off-label without FDA approval, manufacturers have little incentive to obtain new approval once a product goes to market. It is easier and less costly to allow physicians to deviate from the label instructions and prescribe the approved drug or medical device for new uses.

Though physicians can engage in off-label prescribing, pharmaceutical companies are only permitted to disseminate peer-reviewed scientific information to physicians regarding off-label uses.[19] The FDA allows this dissemination for several reasons. For one, if an off-label use is common enough that it becomes the standard of care, a physician may commit medical malpractice if he fails to prescribe the drug or device for that off-label use. Additionally, if physicians are aware of these off-label uses, they will advance public health by prescribing off-label to properly treat patients.[20]

The FDA provides strict guidance on the types of information that manufacturers can distribute to physicians and how they issue the information. The guidelines have changed slightly over the years, but they are currently found under the "Good Reprint Practices for the Distribution of Medical Journal Articles and Medical or Scientific Reference Publications on Unapproved New Uses of Approved Drugs and Approved or Cleared Medical Devices."[21] The guidelines suggest that any reprints or articles that drug companies provide to physicians be scientific or medical journals. These journals should be peer-reviewed and not funded by the manufacturer.[22] The journals should also state the risks associated with the off-label use.[23] The FDA guidelines also suggest that the journals be unabridged reprints with no markings or highlights by the manufacturer and that they should be distributed separately from promotional material.[24] Finally, the guidelines encourage manufacturers to include a statement disclosing that the uses described have not been FDA approved and identifying the manufacturer's financial interest in the drug or device.[25]

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[18] Mark Herrmann & Pearson Bownas, *Keeping the Label Out of the Case*, 103 Nw. U. L. Rev. Colloquy 477, 483–484 (2009).

[19] Aaron S. Kesselheim, *Off-Label Drug Use and Promotion: Balancing Public Health Goals and Commercial Speech*, 37 Am. J. L. & Med 225, 226–228 (2011).

[20] U.S. Food and Drug Administration, Good Reprint Practices for the Distribution of Medical Journal Articles and Medical or Scientific Reference Publications on Unapproved New Uses of Approved Drugs and Approved or Cleared Medical Devices, [hereinafter Good Reprint Practices] *available at* http://www.fda.gov/oc/op/goodreprint.html.

[21] *Id.*

[22] *Id.*

[23] *Id.*

[24] *Id.*

[25] *Id.*

If manufacturers provide more information than the FDA guidelines permit, they are considered to have engaged in unauthorized promotion. This unauthorized promotion is against the law and is referred to as misbranding.[26] In 2010 *qui tam* actions brought on behalf of the government under the False Claims Act or similar state laws, at least six manufacturers settled charges pertaining to off-label marketing.[27] The following chart outlines these six settlements. It includes the name of the manufacturer, the related drug, the approved use of the drug, a non-exhaustive list of the off-label use the company was alleged to have promoted illegally, and the settlement amount.

Company Name	**Drug**	**Approved Use(s)**	**Off-label Use(s) Allegedly Promoted**	**Settlement Amount**
AstraZeneca[28]	Quetiapine (Seroquel)	Schizophrenia and manic episodes in bipolar disorder	Alzheimer's disease, anger management, anxiety, attention deficit hyperactivity disorder, dementia, depression, and post-traumatic stress disorder	$520 million
Ortho-McNeil-Janssen[29]	Topiramate (Topamax)	Epilepsy and prevention of migraines	Alcohol dependence	$81 million
Novartis[30]	Tobramycin (TOBI)	Cystic Fibrosis in adults	Cystic Fibrosis in patients under the age of six	$72.5 million
Forest[31]	Citalopram (Celexal) and Escitalopram (Lexapro)	Antidepressant for adults	Antidepressant for children and adolescents	$313 million
Allergen[32]	OnabotulinumtoxinA (Botox)	Blepharospasm (spasm of the eyelids), Cervical Dystonia (severe neck muscle spasms), and severe Primary Axillary Hyperhydrosis (excess sweating)	Headache, pain, and juvenile cerebral palsy.	$600 million
Novartis[33]	Oxcarbazepine (Trileptal)	Epilepsy	Bipolar disorder and neuropathic pain	$422.5 million

III.
The Learned Intermediary Doctrine

Although the chart in the previous section refers to actions involving misbranding in violation of the FCA or similar state laws, off-label use may also create civil liability for manufacturers based on consumer injuries allegedly sustained because of that use. When a patient claims an injury from a prescription drug or medical device, he or she usually sues both the physician and the drug or device manufacturer. In such products liability lawsuits, plaintiffs include claims for either or both negligence or strict liability against the product manufacturers for failure to warn of the potential risks of a particular drug or device.[34] In most cases, however, the learned intermediary doctrine protects manufacturers from liability; it has been found to apply in negligence and strict liability claims, including design defect, misbranding, and breach of implied warranty claims.[35]

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[26] *See* 21 U.S.C. § 331(b) (2006 & Supp. III 2009). *See also* 21 U.S.C. § 352(f) (2006) and 21 U.S.C. § 333 (2006 & Supp. III 2009), which address usage directions on drug labels and penalties for violation of § 331, respectively.

[27] Molly Cohen, *Study: Whistleblower Cases Involving Off-Label Promotion Pervade Industry*, 10 Drug Indus. Daily, Apr. 11, 2011, *available at* 2011 WLNR 6945190.

[28] Press Release, The Department of Justice Office of Public Affairs, Pharmaceutical Giant AstraZeneca to Pay $520 Million for Off-label Drug Marketing (Apr. 27, 2010), *available at* http://www.justice.gov/opa/pr/2010/April/10-civ-487.html

[29] Press Release, The Department of Justice Office of Public Affairs, Two Johnson & Johnson Subsidiaries to Pay Over $81 Million to Resolve Allegations of Off-Label Promotion of Topamax (Apr. 29, 2010), *available at* http://www.justice.gov/opa/pr/2010/April/10-civ-500.html.

[30] Press Release, The Department of Justice Office of Public Affairs, Novartis Vaccines & Diagnostics to Pay More Than $72 Million to Resolve False Claims Act Allegations Concerning TOBI (May 4, 2010), *available at* http://www.justice.gov/opa/pr/2010/May/10-civ-522.html.

[31] Press Release, The Department of Justice Office of Public Affairs, Drug Maker Forest Pleads Guilty;To Pay More Than $313 Million to Resolve Criminal Charges and False Claims Act Allegations (Sept. 15, 2010), *available at* http://www.justice.gov/opa/pr/2010/September/10-civ-1028.html.

[32] Press Release, The Department of Justice Office of Public Affairs, Allegan Agrees to Plead Guilty and Pay $600 Million to Resolve Allegations of Off-Label Promotion of Botox® (Sept. 1, 2010), *available at* http://www.justice.gov/opa/pr/2010/September/10-civ-988.html.

[33] Press Release, The Department of Justice Office of Public Affairs, Novartis Pharmaceuticals Corp. to Pay More Than $420 Million to Resolve Off-label Promotion and Kickback Allegations (Sept. 30, 2010), *available at* http://www.justice.gov/opa/pr/2010/September/10-civ-1102.html.

[34] Restatement (Third) of Torts: Products Liability § 2(c), cmt. d (1998) ("If the plaintiff introduces expert testimony to establish that a reasonable alternative design could practically have been adopted, a [factfinder] may conclude that the product was defective notwithstanding that such a design was not adopted by any manufacturer, or even considered for commercial use, at the time of sale.").

[35] *See, e.g.*, Fellows v. USV Pharm. Corp., 502 F. Supp. 297, 299–301 (D. Md. 1980).

To help readers better understand how courts have applied the learned intermediary doctrine in cases involving off-label use, this section provides a general overview of the learned intermediary doctrine. Under the learned intermediary doctrine, when a manufacturer provides a treating physician with adequate notice of a product's possible risks, the manufacturer has no additional duty to warn the end consumer.[36] This doctrine exists because physicians, as learned intermediaries, are in the best position to weigh the risks and benefits of a particular drug or device based on patient selection, needs, and conditions.[37] Essentially, a manufacturer's duty to warn extends only to the prescribing physician, who then assumes responsibility for advising patients of the risks associated with the drug or device.

For the doctrine to apply, however, the physician must be aware of the product's risks.[38] The manufacturer has a duty to warn the physician, but even if a manufacturer's warning is inadequate, the doctrine will still apply if the physician has been sufficiently warned from other sources.[39] In essence, the learned intermediary doctrine encompasses the physician's entire field of knowledge.[40]

Every state in the country has some precedent concerning the learned intermediary defense.[41] In thirty-six states and the District of Columbia, the jurisdiction's highest court or the legislature has adopted the learned intermediary doctrine. These jurisdictions include Alabama,[42] Alaska,[43] Arkansas,[44] California,[45] Connecticut,[46] Delaware,[47] the District of Co-

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[36] Richard B. Goetz & Karen R. Growden, *A Defense of the Learned Intermediary Doctrine*, 63 Food & Drug L.J. 421, 421 (2008).

[37] Lee v. Baxter Healthcare Corp., 721 F. Supp. 89, 95 (D. Md. 1989).

[38] Chambers v. G.D. Searle & Co., 441 F. Supp. 377, 379 (D. Md. 1975).

[39] *See, e.g.*, Dean v. Eli Lilly & Co., 387 F. Appx. 28, 30 (2d Cir. 2010) (holding that the learned intermediary doctrine applied because the doctor had actual knowledge of the warning that the plaintiff alleged that the manufacturer should have given); Sita v. Danek Med., Inc., 43 F. Supp. 2d 245, 259–260 (E.D.N.Y. 1999) (holding that the learned intermediary doctrine applied because the doctor was aware of the risks that the plaintiff claimed should have been included in the manufacturer's warning).

[40] Ames v. Apothecon, Inc., 431 F. Supp. 2d 566, 572 (D. Md. 2006).

[41] For an extensive list of the relevant case law, see *The Closing of the Learned Intermediary Frontier*, Drug and Device Law (June 2, 2011), http://druganddevicelaw.blogspot.com/2011/06/closing-of-learned-intermediary.html.

[42] *See* Stone v. Smith, Kline & French Labs., 447 So. 2d 1301, 1304–05 (Ala. 1984).

[43] *See* Shanks v. Upjohn Co., 835 P.2d 1189, 1200, 1200 n.17 (Alaska 1992).

[44] *See* West v. Searle & Co., 806 S.W.2d 608, 613 (Ark. 1991).

[45] *See, e.g.*, Carlin v. Superior Court, 920 P.2d 1347, 1354 (Cal. 1996).

[46] *See, e.g.*, Hurley v. Heart Physicians, P.C., 3 A.3d 892, 899–900 (Conn. 2010).

[47] *See* Lacy v. G.D. Searle & Co., 567 A.2d 398, 400–01 (Del. 1989).

lumbia,[48] Florida,[49] Georgia,[50] Hawaii,[51] Idaho,[52] Illinois,[53] Kansas,[54] Kentucky,[55] Maryland,[56] Massachusetts,[57] Michigan,[58] Minnesota,[59] Mississippi,[60] Missouri,[61] Montana,[62] Nebraska,[63] Nevada,[64] New Jersey,[65] New York,[66] North Carolina,[67] Ohio,[68] Oklahoma,[69] Oregon,[70] Pennsylvania,[71] South Carolina,[72] Tennessee,[73] Texas,[74] Utah,[75] Virginia,[76] Washington,[77] and Wyoming.[78]

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[48] *See, e.g.*, Mampe v. Ayerst Labs., 548 A.2d 798, 801, 802 n.6 (D.C. 1988).

[49] *See, e.g.*, E.R. Squibb & Sons, Inc. v. Farnes, 697 So. 2d 825, 827 (Fla. 1997).

[50] *See, e.g.*, McCombs v. Synthes (U.S.A.), 587 S.E.2d 594, 595 (Ga. 2003).

[51] *See* Craft v. Peebles, 893 P.2d 138, 154–55 (Haw. 1995).

[52] *See* Silman v. Aluminum Co. of Am., 731 P.2d 1267, 1270–72 (Idaho 1986).

[53] *See, e.g.*, Happel v. Wal-Mart Stores, Inc., 766 N.E.2d 1118, 1126–28 (Ill. 2002).

[54] *See, e.g.*, Savina v. Sterling Drug, Inc., 795 P.2d 915, 928–29 (Kan. 1990).

[55] *See, e.g.*, Hyman & Armstrong, P.S.C. v. Gunderson, 279 S.W.3d 93, 109–12 (Ky. 2008).

[56] *See, e.g.*, Rite Aid Corp. v. Levy-Gray, 894 A.2d 563, 577–79 (Md. 2006).

[57] *See, e.g.*, Coombes v. Florio, 877 N.E.2d 567, 577 n.1 (Mass. 2007).

[58] *See, e.g.*, Smith v. E.R. Squibb & Sons, Inc., 273 N.W.2d 476, 479 (Mich. 1979).

[59] *See, e.g.*, Mulder v. Parke Davis & Co., 181 N.W.2d 882, 885 n.1 (Minn. 1970).

[60] *See, e.g.*, Janssen Pharmaceutica, Inc. v. Bailey, 878 So. 2d 31, 57 (Miss. 2004).

[61] *See, e.g.*, Krug v. Sterling Drug, Inc., 416 S.W.2d 143, 146–47 (Mo. 1967).

[62] *See, e.g.*, Stevens v. Novartis Pharm. Corp., 247 P.3d 244, 257–60 (Mont. 2010).

[63] *See, e.g.*, Freeman v. Hoffman-La Roche, Inc., 618 N.W.2d 827, 841–42 (Neb. 2000).

[64] *See, e.g.*, Allison v. Merck & Co., 878 P.2d 948, 957–58 (Nev. 1994); *see also id*. at 969 (Young, J., concurring & dissenting).

[65] *See, e.g.*, Perez v. Wyeth Lab., Inc., 734 A.2d 1245, 1257 (N.J. 1999).

[66] *See, e.g.*, Spensieri v. Lasky, 723 N.E.2d 544, 549 (N.Y. 1999).

[67] *See, e.g.*, N.C. Gen. Stat. § 99B-5(c) (2009).

[68] *See, e.g.*, Ohio Rev. Code Ann. § 2307.76(c) (LexisNexis 2010).

[69] *See, e.g.*, McKee v. Moore, 648 P.2d 21, 24 (Okla. 1982).

[70] *See, e.g.*, Oksenholt v. Lederle Lab., 656 P.2d 293, 296–98 (Or. 1982).

[71] *See, e.g.*, Baldino v. Castagna, 478 A.2d 807, 812 (Pa. 1984).

[72] *See, e.g.*, Madison v. Am. Home Prod. Corp., 595 S.E.2d 493, 496 (S.C. 2004).

[73] *See, e.g.*, Pittman v. Upjohn Co., 890 S.W.2d 425, 429 (Tenn. 1994).

[74] *See, e.g.*, Humble Sand & Gravel, Inc. v. Gomez, 146 S.W.3d 170, 190–91 (Tex. 2004).

[75] *See, e.g.*, Downing v. Hyland Pharmacy, 194 P.3d 944, 946–47 (Utah 2008).

[76] *See, e.g.*, Pfizer, Inc. v. Jones, 272 S.E.2d 43, 44–45 (Va. 1980).

[77] *See, e.g.*, Wash. State Physicians Ins. Exch. & Ass'n v. Fisons Corp., 858 P.2d 1054, 1061 (Wash. 1993).

[78] *See, e.g.*, Rohde v. Smiths Med., 165 P.3d 433, 436 n. 5, 440–42 (Wyo. 2007).

Intermediate appellate courts in five states have applied the rule: Arizona,[79] Colorado,[80] Indiana,[81] Louisiana,[82] and New Mexico.[83] In six states, federal courts applying state law have assumed the state would adopt the doctrine. These states include Iowa,[84] Maine,[85] New Hampshire,[86] North Dakota,[87] South Dakota,[88] and Wisconsin.[89] In Vermont, only a trial court has applied the rule.[90] Rhode Island has neither accepted nor rejected the doctrine.[91] Finally, West Virginia's highest court, the Supreme Court of Appeals, is the only court to have rejected the learned intermediary doctrine.[92]

IV.
Applying the Learned Intermediary Doctrine to Claims Involving Off-Label Use

Personal injury claims increasingly allege injury from off-label use of medical products. These claims create a dilemma for pharmaceutical companies: the learned intermediary doctrine applies when physicians are aware of the risks associated with drug or device, but manufacturers are only required to warn physicians of risks associated with on-label uses

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[79] *See, e.g.*, Piper v. Bear Med. Sys., Inc., 883 P.2d 407, 415 (Ariz. Ct. App. 1993).

[80] *See, e.g.*, Hamilton v. Hardy, 549 P.2d 1099, 1110 (Colo. App. 1976).

[81] *See, e.g.*, Allberry v. Parkmor Drug, Inc., 834 N.E.2d 199, 202–03 (Ind. Ct. App. 2005).

[82] *See, e.g.*, Kampmann v. Mason, 921 So. 2d 1093, 1094 (La. Ct. App. 2006).

[83] *See, e.g.*, Serna v. Roche Labs., Div. of Hoffman-LaRoche, Inc., 684 P.2d 1187, 1189 (N.M. Ct. App. 1984).

[84] *See, e.g.*, Petty v. United States, 740 F.2d 1428, 1440 (8th Cir. 1984).

[85] *See, e.g.*, Violette v. Smith & Nephew Dyonics, Inc., 62 F.3d 8, 13 (1st Cir. 1995).

[86] *See, e.g.*, Brochu v. Ortho Pharm. Corp., 642 F.2d 652, 656 (1st Cir. 1981).

[87] *See, e.g.*, Ehlis v. Shire Richwood, Inc., 367 F.3d 1013, 1017 (8th Cir. 2004).

[88] *See, e.g.*, McElhaney v. Eli Lilly & Co., 575 F. Supp. 228, 231 (D.S.D. 1983), *aff'd*, 739 F.2d 340 (8th Cir. 1984).

[89] *See, e.g.*, Menges v. Depuy Motech, Inc., 61 F. Supp. 2d 817, 829–30 (N.D. Ind. 1999).

[90] *See* Estate of Baker v. Univ. of Vt., No. 233-10-03 Oscv., 2005 WL 6280644, at *12–14 (Vt. Super. May 4, 2005).

[91] *See* Ingram v. Davol, Inc., C.A. No. PC 07-4701, 2011 R.I. Super. LEXIS 17, at *5 (R.I. Super. Ct. Feb. 9, 2011). However, in *Hogan v. Novartis Pharmaceuticals Corp*., the district court indicated that if the Rhode Island Supreme Court were to adopt the learned intermediary doctrine, its product liability jurisprudence indicates that the court would probably adopt the version in the Restatement 3rd of Products Liability. 06 CV 260, slip op. at 15–18 (E.D.N.Y. filed April 24, 2011). In *Hogan*, the district court did not have to determine whether the Rhode Island Supreme Court would adopt or reject the learned intermediary doctrine in order to rule on the motion before it. *Id*. at 16.

[92] *See* State *ex rel.* Johnson & Johnson Corp. v. Karl, 647 S.E.2d 899, 912–14 (W. Va. 2007).

and cannot know of all of the possible off-label uses of a medical product and the risks associated with those uses. In turn, this dilemma has resulted in substantial differences among state court decisions regarding a manufacturer's liability for failure to warn claims involving off-label use.

This section contains a survey of cases that involved off-label uses of drugs and medical devices and the learned intermediary defense. This survey is not exhaustive, but merely provides examples of how some jurisdictions have approached the issue. Additionally, this survey does not address the causation defense: that any failure to warn did not cause the plaintiff's injuries. For instance, the failure to warn cannot cause a plaintiff's injuries when the physician was aware of the off-label risks from a different source or when the physician would have prescribed the drug or device regardless of whether he knew of the risks—both of which turn on the facts of an individual case.[93]

A. *The Learned Intermediary Doctrine Always Insulates Manufacturers from Liability for Off-Label Use*

1. Maryland

The United States District Court for the District of Maryland, applying Maryland law, addressed the learned intermediary doctrine and off-label use in *Robak v. Abbott Laboratories*.[94] There, the plaintiff, Robak, argued that the manufacturer had a duty to warn physicians of the risks associated with Omniflox when used for sinusitis (an off-label use).[95] The court rejected this argument, reasoning that the physician, as a learned intermediary, made the decision to prescribe the drug for that off-label use, not Abbott Laboratories, the manufacturer.[96] In fact, the court found that the learned intermediary doctrine applies in every case where the patient suffered injuries resulting from an off-label use of a drug.[97]

2. Louisiana

In *Bell v. Danek Medical, Inc.*,[98] an unreported opinion, the United States District Court for the Eastern District of Louisiana held that the learned intermediary doctrine always protects drug manufacturers from liability for off-label use injuries. In that case, the plaintiff,

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[93] *See, e.g.*, Alexander v. Smith & Nephew, P.L.C., 98 F. Supp. 2d 1310, 1321 (N.D. Okla. 2000). The *Alexander* court reasoned that where a physician testified that he was "fully informed as to the FDA statutes of the [medical device], knew of its risks, did not rely on the [defendant manufacturer's] information materials, and exercised his independent judgment based on the standards of care and [the patent's] situation in recommending the surgery," the plaintiff had failed to establish a claim for any injury resulting from the defendant's failure to warn the physician. *Id.*

[94] 797 F. Supp. 475 (D. Md. 1992).

[95] *Id.* at 475–476.

[96] *Id.* at 476.

[97] *Id.*

[98] No. CIV. A. 96-1393, 1999 WL 335612 (E.D. La. May 24, 1999).

Bell, alleged that a Texas-Scottish Rite Hospital Spinal System, which was implanted in her spine and included pedicle screws, caused her extreme lower back pain, numbness, charley horses, and cramps.[99] Her physician's placement of pedicle screws into her spine was an off-label use of the screws given that the FDA had approved the screws for some bones but not for the spine.[100] Bell filed a lawsuit, naming the manufacturer, Danek Medical Incorporated, as one of the defendants, contending that Danek failed to warn her physician adequately of the risks associated with this off-label use.[101] Specifically, she alleged that Danek promoted the off-label use and therefore had a duty to warn the physician of its risks.[102] The court found that Danek's over-promotion did not affect the learned intermediary doctrine because Bell failed to provide any case law from Louisiana for her contention that over-promotion defeats the doctrine.[103]

B. *The Learned Intermediary Doctrine Only Insulates Manufacturers Who Warn of the Risks Associated with Off-Label Use*

In *Upjohn Company v. MacMurdo*,[104] the Florida Supreme Court held that Upjohn Company, a manufacturer of Depo-Provera, had a duty to warn physicians of the risks associated with the off-label use of the drug.[105] In *MacMurdo,* a physician prescribed Depo-Provera to MacMurdo for contraceptive purposes even though at that time the drug was labeled for endometrial carcinoma.[106] After her second injection, MacMurdo experienced excessive and continuous menstrual bleeding which only stopped after her doctor performed a hysterectomy.[107] A jury found that Upjohn "negligently failed to adequately warn [MacMurdo's physician] of the potential consequences of the use of the drug" and returned a verdict assessing damages.[108] When the case was eventually appealed to the Florida Supreme Court, Upjohn argued that it could not be held liable because the package insert for Depo-Provera warned physicians that Depo-Provera had not been approved for contraceptive use.[109] But the court decided that since there was medical evidence that physicians can properly prescribe drugs for off-label uses, "the more crucial question [was] whether the warnings [on the label] were adequate to warn a physician of the possibility that Depo-Provera might

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[99] *Id.* at *1.

[100] *Id.* at *4.

[101] *Id.* at *3.

[102] *Id.* at *3–4.

[103] *Id.* at *4.

[104] 562 So. 2d 680 (Fla. 1990).

[105] *Id.* at 683.

[106] *Id.* at 682.

[107] *Id.*

[108] *Id.* at 681.

[109] *Id.* at 682.

be causing the condition experienced by MacMurdo."[110] Since MacMurdo's injury did not involve an obvious situation and MacMurdo did not produce medical expert testimony that the package insert was insufficient to put a doctor on notice that Depo-Provera might be causing MacMurdo's symptoms, the court held that the trial court should have ruled that Upjohn's warning to physicians was adequate as a matter of law.[111] The court remanded the case to the trial court with directions to enter a judgment for Upjohn.[112]

C. *The Learned Intermediary Doctrine Does Not Insulate Manufacturers Who Have Knowledge of the Off-Label Use*

1. New Jersey

The United States District Court for the Eastern District of Pennsylvania applied New Jersey law in *Knipe v. SmithKline Beecham*.[113] The court held that a drug manufacturer has a duty to warn of the risks associated with known drug uses "as soon as reasonably feasible upon actual or constructive knowledge of the danger."[114] There, Knipe alleged that despite having evidence of an increased suicide risk in younger patients taking Paxil, the manufacturer, GlaxoSmithKline, failed to warn physicians of this finding.[115] The court rejected GlaxoSmithKline's argument that it did not have a duty to warn of risks associated with off-label uses of a drug, finding that its knowledge of the suicide risks rebutted any use of the learned intermediary defense.[116]

2. Ohio

In *Krumpelbeck v. Breg, Inc.*,[117] the United States District Court for the Southern District of Ohio applied Ohio law and found that a manufacturer does not have a duty to warn until it knows or should know of the risks associated with a particular off-label use.[118] In this case, Krumpelbeck alleged that she developed chondrolysis from a prescribed and implanted

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[110] *Id*. at 683.

[111] *Id.*

[112] *Id.*

[113] 583 F. Supp. 2d 602 (E.D. Pa. 2008).

[114] *Id.* at 628.

[115] *Id.* at 609, 613.

[116] *Id.* at 628–29. *But see* Davenport v. Medtronic, Inc., 302 F. Supp. 2d 419, 440 (E.D. Pa 2004) (holding that medical device manufacturers do not have a duty to prevent off-label uses of their products by physicians even if the manufacturer knows that the off-label use is occurring).

[117] 759 F. Supp. 2d 958 (S.D. Ohio 2010).

[118] *Id.* at 975; *see also* Monroe v. Zimmer US Inc., 766 F. Supp. 2d 1012, 1033 (E.D. Cal. 2011) ("Accordingly, plaintiff must provide evidence that demonstrates defendants failed to give adequate warning of a risk associated with their product that defendants knew or should have known about at the time the product was distributed.").

catheter of a Breg Pain Care infusion pump.[119] The court granted summary judgment in favor of Breg Incorporated, the manufacturer, on this issue because Krumpelbeck did not show that Breg knew or should have known of the off-label risks associated with the product.[120]

3. Georgia

In *Medics Pharmaceutical Corp. v. Newman*,[121] the Georgia intermediate appellate court held that a manufacturer has a duty to warn of risks associated with foreseeable off-label uses.[122] In this case, a physician prescribed Diastyl to Newman's mother to prevent a possible miscarriage.[123] Years later, Newman developed genital cancer.[124] She sued Medics for negligence and alleged that her cancer was a risk inherent in the off-label use of Diastyl to prevent miscarriages.[125] The court concluded that whether the manufacturer could have foreseen the use of Diastyl for the prevention of miscarriages was a question for the jury.[126] Importantly, the court found that if the use was foreseeable, Medics would have had a duty to use reasonable care to determine if the drug was safe for that use.[127]

4. Indiana

In *Meharg v. I-Flow Corp.*,[128] the United States District Court for the Southern District of Indiana found, in an unreported opinion, that under Indiana law, if a manufacturer does not promote an off-label use, the manufacturer does not have a duty to warn of the risks unless it knows (1) "that the off-label use is occurring" and (2) that "the off-label use carries with it the risk of the harm at issue."[129] In that case, Meharg developed chondrolysis after receiving bupivacaine through a pain pump.[130] Bupivacaine was a pain reliever, but it was not approved to be used with pain pumps.[131] Thus, Meharg's physician prescribed the

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[119] *Krumpelbeck,* 759 F. Supp. 2d at 960.

[120] *Id.* at 975.

[121] 378 S.E.2d 487 (Ga. Ct. App. 1989).

[122] *Id.* at 488–89; s*ee also* Woodbury v. Janssen Pharm., Inc., No. 93 C 7118, 1997 WL 201571, at *8–9 (N.D. Ill. Apr. 10, 1997) (holding manufacturer who should reasonably know of dangers associated with an off-label use has a duty to warn physicians of those dangers under Illinois law).

[123] *Newman,* 378 S.E.2d at 488.

[124] *Id.*

[125] *Id.*

[126] *Id.* at 488–89.

[127] *Id.* at 489.

[128] No. 1:08-cv-184-WTL-TAB, 2010 WL 711317 (S.D. Ind. Mar. 1, 2010).

[129] *Id.* at *2.

[130] *Id.* at *1.

[131] *Id.*

pain pump as an off-label use.[132] Meharg alleged in her product liability suit that the manufacturer, AstraZeneca, had a duty to warn the physician of the risk of chondrolysis.[133] The court pointed out that the line between having or not having a duty to warn of a particular risk often is hard to draw.[134] On the facts at hand, however, the court refused to assume the manufacturer had knowledge of the risks merely because experts in the relevant field had such knowledge.[135] Accordingly, the court granted summary judgment for AstraZeneca because the company did not have a duty to warn Meharg's physician.[136]

D. *The Learned Intermediary Doctrine Does Not Shield Manufacturers Who Receive a Large Volume of Sales from Off-Label Use*

1. California

In *Miles Laboratories, Inc. v. Superior Court*,[137] a California intermediate appellate court ruled that a manufacturer could be liable for failure to warn when it profited from an off-label use of a medical product because, in that instance, the manufacturer knew or should have known the product was being used for an off-label use.[138] The plaintiff, Fisher, alleged that as a result of exposure to diethylstilbestrol (DES), a drug prescribed for miscarriages, she was required to undergo surgical removal of her female reproductive organs. The plaintiff alleged that although Miles Laboratories did not sell DES as a miscarriage preventative, it was common knowledge that other manufacturers sold DES for that purpose and that pharmacists prescribed whatever brand of the drug they had on hand, including Miles Laboratories' brand.[139] The court found that Miles Laboratories knew or should have known that its brand of DES was being used for an off-label use because it profited from that use. Thus, it had a duty to warn physicians of the possible risks associated with the use.[140] In other words, the physician was not a learned intermediary because Miles Laboratories did not warn the physician of the risks, so the doctrine did not apply.

2. Texas

In *McNeil v. Wyeth*,[141] the Fifth Circuit Court of Appeals, applying Texas law, found that manufacturers who substantially profit from off-label uses of their products must warn

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[132] *Id.*

[133] *Id.* at *2.

[134] *Id.* at *3.

[135] *Id.*

[136] *Id.* at *4.

[137] 184 Cal. Rptr. 98 (Ct. App. 1982).

[138] *Id.* at 103.

[139] *Id.* at 102.

[140] *Id.* at 103.

[141] 462 F.3d 364 (5th Cir. 2006).

physicians of the risks associated with those off-label uses.[142] There, McNeil allegedly developed Tardive Dyskinesia, a severe neurological disease, from taking the prescription Reglan.[143] Reglan was approved to speed up the digestive system.[144] Prescribing Reglan for longer than twelve weeks, however, was considered an off-label use.[145] The court held that Wyeth had a duty to warn physicians of the risks associated with this prolonged use because Wyeth knew physicians were prescribing Reglan for longer than twelve-week cycles as a majority of its sales came from these extended prescriptions.[146]

E. *The Learned Intermediary Doctrine Does Not Shield Manufacturers Who Engage in Unauthorized Promotion of the Off-Label Use*

1. Illinois

In *Proctor v. Davis*,[147] the Illinois Appellate Court, an intermediate appellate court, found that the learned intermediary doctrine did not apply when a manufacturer openly promoted the off-label use. In that case, a physician injected a corticosteroid, Depo-Medro, into a patient's eye, disfiguring the eye.[148] The drug was not approved for eye injections.[149] The court found that Depo-Medro's manufacturer, Upjohn Company, was liable because it actively encouraged physicians to use the drug for eye injections.[150] Indeed, Upjohn had paid a physician to experiment with the drug, and when the physician reported that all of his animal experiments were "very unsatisfactory," Upjohn did not include these findings in an article it sent to practicing physicians.[151] This failure to include the findings, in turn, falsely promoted the off-label use and diminished any warnings of risks associated with

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[142] *Id.* at 371.

[143] *Id.* at 367.

[144] *Id.* at 366.

[145] *Id.* at 371.

[146] *See id.*; *see also* O'Neal v. Smithkline Beecham Corp., No. CIV S-06-1063 FCD/DAD, 2008 WL 1721891, at *3 (E.D. Cal. Apr. 10, 2008) ("In *McNeil*, the court determined the drug's extensive off-label use created the duty to warn; here, there was simply no evidence proffered by plaintiffs that prescriptions of Paxil to pediatric patients made up the majority of Paxil sales. Thus, there would be no basis to invoke the McNeil court's duty to warn.").

[147] 682 N.E.2d 1203 (Ill. Ct. App. 1997).

[148] *Id.* at 1210–11.

[149] *Id.* at 1206.

[150] *Id.* at 1215.

[151] *Id.* at 1207.

using the drug for eye injections.[152] As a result, physicians could not properly weigh the risks and benefits of the drug. Therefore, the learned intermediary doctrine did not shield Upjohn from liability.[153]

2. North Carolina

In *Dellinger v. Pfizer, Inc.*,[154] the United States District Court for the Western District of North Carolina found, in an unreported opinion, that under North Carolina law, a manufacturer cannot be liable for a plaintiff's resulting injuries unless the manufacturer acted unreasonably in failing to warn physicians of the risks associated with using the product that caused the injuries.[155] In that case, Dellinger's physician prescribed him Neurontin as a pain reliever.[156] Dellinger subsequently became very ill and was hospitalized.[157] After reading that Pfizer Incorporated had been found to have illegally promoted Neurontin for an off-label use, Dellinger brought a claim against Pfizer for his injuries.[158] The court found that Pfizer had unreasonably failed to warn physicians of Neurontin's off-label risks associated with an off-label use that Pfizer had fraudulently promoted.[159] Specifically, the learned intermediary doctrine did not protect Pfizer because Pfizer was aware of the off-label use dangers (because it promoted the use) but did not warn physicians of the dangers of the off-label use.[160]

3. Tennessee

In *Smith v. Pfizer, Inc.*,[161] the United States District Court for the Middle District of Tennessee found that a manufacturer who actively promotes an off-label use must warn physicians of risks associated with that use. There, in another case involving Neurontin, a widow alleged that Neurontin caused her husband to commit suicide.[162] She brought a claim against Pfizer alleging that it had failed to warn physicians of the risks related to using Neurontin as a pain reliever, an off-label use.[163] She alleged that Pfizer's unauthorized off-label promotion of Neurontin showed that Pfizer should have adequately tested the drug

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[152] *Id.* at 1212–13.

[153] *Id.* at 1214–15.

[154] No. 5:03CV95, 2006 WL 2057654 (W.D.N.C. July 19, 2006).

[155] *Id.* at *6.

[156] *Id.* at *1.

[157] *Id.* at *2.

[158] *Id.* at *2–3.

[159] *Id.* at *6.

[160] *Id.*

[161] 714 F. Supp. 2d 845 (M.D. Tenn. 2010).

[162] *Id.* at 848.

[163] *Id.* ("Although Neutrontin has been approved by the FDA to treat epilepsy and post-herpetic neuralgia, doctors frequently prescribe it for the "off-label" usage of treating pain.").

as a pain reliever because it knew physicians were prescribing the drug for that use.[164] Consequently, the plaintiff argued, Pfizer did not adequately test the drug and warn physicians of the risks.[165] Pfizer argued that because plaintiff did not show that Smith's doctor relied on any off-label promotion, it was irrelevant.[166] The district court applied Tennessee law and disagreed.[167] The court determined that Pfizer's unauthorized promotion of Neurontin for off-label uses made it more likely that the use was foreseeable. Thus, Pfizer was required to adequately test the drug and warn physicians of the risks associated with the use.[168]

V.
Conclusion

The law regarding the learned intermediary doctrine and off-label use is conflicting. These conflicts create difficulty in determining the best way to defend drug manufacturers in cases involving off-label use. In some jurisdictions, whether the learned intermediary doctrine applies depends on the manufacturer's knowledge or the foreseeability of the off-label use. In other jurisdictions, the learned intermediary doctrine's application depends on the manufacturer's promotion of an off-label use. In still other jurisdictions, courts have assumed that manufacturers always have a duty to warn and have not applied the doctrine in the absence of warnings. Finally, courts in some jurisdictions have found that the learned intermediary doctrine applies in all cases because physicians use their entire knowledge base and training to determine what is best for the patient. Given these varied approaches, the foregoing survey of case law may help those who defend drug and device manufacturers predict whether a court will recognize and apply the learned intermediary doctrine in a situation where the plaintiff alleges that her injury occurred because a medical provider prescribed a treatment involving off-label use of the manufacturer's product.

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[164] *Id.* at 854.

[165] *Id.*

[166] *Id.* at 853–54.

[167] *Id.* at 854.

[168] *See id.*; *see also* Ebel v. Eli Lilly and Co., 536 F. Supp. 2d 767, 775–76 (S.D. Tex. 1999) (explaining that Texas statutory law specifies that promotion of off-label use rebuts the presumption that warnings are adequate).

Navigating Through Insurer Bad Faith Set-ups: Proactive, Preventative, and Responsive Measures to Preserve Insurance Policy Limits†

Paul S. White

I.
Introduction

> *It seems to me that attorneys who handle policy claims against insurance companies are no longer interested in collecting on those claims, but spend their wits and energies trying to maneuver the insurers into committing acts which the insureds can later trot out as evidence of bad faith.*[1]

Courts in numerous jurisdictions have held that, in certain circumstances, an insurer who wrongfully fails to defend its policyholder or to settle a covered claim against its policyholder may open its policy limit for liability or judgments that the policyholder subsequently confronts.[2] For example, an insurer that issues an automobile liability policy with policy limits of $15,000 could be held liable for a multi-million dollar judgment against its insured if it had the opportunity to settle the claim against its insured and failed to do so.

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[1] White v. Western Title Ins. Co., 710 P.2d 309, 328 n.2 (Cal. 1986) (Kaus, J., concurring and dissenting).

[2] *See, e.g.,* Perera v. U.S. Fid. & Guar. Co., 35 So. 3d 893 (Fla. 2010); Fortner v. Grange Mut. Ins. Co., 686 S.E.2d 93 (Ga. 2009); Founders Ins. Co. v. Shaikh, 937 N.E.2d 1186 (Ill. App. Ct. 2010); Shobe v. Kelly, 279 S.W.3d 203 (Mo. Ct. App. 2009).

Paul S. White is a partner at Tressler LLP in the firm's Los Angeles, California office. He is co-chair of the firm's Extra-Contractual Liability and Claims Handling practice group. A major focus of Mr. White's practice is on complex insurance coverage and bad faith litigation. His insurance coverage practice includes advising and representing insurers in bad faith litigation and in insurance policy disputes, including first-party property policies, general liability coverage, errors & omissions insurance, and media liability insurance. He also advises and represents insurers in subrogation actions on property losses. Mr. White also represents defendants in commercial litigation. His litigation practice includes the defense of commercial business litigation, products liability, construction defect and intellectual property disputes. In addition to his insurance and litigation practice, Mr. White also advises entertainment and technology companies on management of intellectual property risks. Mr. White has been named a Southern California Super Lawyer in practice areas of Insurance Coverage and Professional Liability (Defense) since 2006. He is the co-author of Errors & Omissions Insurance found in 4-25 New Appleman on Insurance Law Library Edition *(LexisNexis). Mr. White regularly speaks and publishes on insurance coverage issues including intellectual property, bad faith, professional liability, employment, environmental and construction defects. He is a member of the State Bar of California and is admitted to practice in all U.S. District Courts in California and in the Ninth Circuit Court of Appeals.*

With the stakes for insurer "failures" so high, and presumably in an effort to maximize recoverable damages, plaintiffs' attorneys are—with recurring frequency—engaging in deliberate efforts to set up insurers in order to capitalize on case law that requires insurers to cover settlements or judgments—irrespective of policy limits—when the insurer has failed to properly act on its insured's behalf.[3] The typical scenario generally involves a tort

[3] Interesting articles addressing insurer "set-ups" and possible legislative reformation include the following: Michael F. Cunningham & Lewis F. Collins, Jr., *Turning Bad Faith Inside-Out: How Plaintiff Attorneys Are Creating Third Party Bad Faith Claims*. 61 Fed'n Def. & Corp. Counsel. Q. 366 (2011); Gwynne A. Young & Johanna W. Clark, *The Good Faith, Bad Faith, and Ugly Set-Up of Insurance Claims Settlement*, 85 Fla. B.J. 9 (2011); Steven Plitt & John K. Wittwer, *A Critical Review of the Practice of Setting Up Insurance Companies for Bad Faith*, 32 No. 10 Ins. Litig. Rep. 299 (July 1, 2010); Thomas F. Segalla, *Bad Faith as a Continuum,* 52 Fed'n Def. & Corp. Counsel. Q. 103 (2001); Stephen R. Schmidt, *The Bad Faith Setup,* 29 Tort & Ins. L.J. 705, 720 (1994).

claimant who makes a policy limits settlement demand with a limited timeframe for the insurer to respond.[4] The demand may also contain conditions, such as requiring the insurer to provide an affidavit confirming that the insured was not acting in the course and scope of employment or that the insured does not have other available insurance.[5] Oftentimes the demand is also missing any or complete supporting information, such as medical records or documented damages.[6] When the insurer fails to accept the demand within the timeframe, the claimant cries the legal equivalent of "gotcha" and demands that the insurer then pay all claimed damages, including those in excess of policy limits. In some cases, in the wake of an insurer's failure to accept a settlement demand within the prescribed time period, the claimant will take a catastrophic injury case to trial, notwithstanding a financially unviable defendant, to obtain a multi-million dollar judgment. The claimant then pursues an action against the insurer (either directly or via assignment from the insured) for failing to accept the earlier policy limits demand.[7]

Unfortunately, some insurers create their own obstacles or fall prey to these set-ups by failing to respond at all or by providing a limited or incomplete response. With diligence and care, however, along with an understanding of the consequences of failing to accept a settlement offer with a sensitive time constraint, an insurer can better avoid breaching its duty to settle or finding itself liable for an excess judgment.[8] Insurers subjected to set-up demands may also have judicial support to challenge liability arising from such a set-up.[9] Similarly, from a reasonableness perspective, insurers may have the capacity and ability to explain what information, if any, they need to respond to a claim and should always request, in writing, additional, reasonable time to respond to a demand as well as any necessary information when required.[10]

Part II of this Article will discuss the duty to settle; consequences for insurers that wrongfully fail to settle; and proactive, preventative, and responsive measures that insurers can utilize to avoid falling prey to a bad faith set-up and to preserve policy limits. Part III will provide a brief overview of potential bad-faith liability for breaches of the duty to defend. Much of the focus and context of this article is on California law, which has provided precedent and volumes of authority on the issues presented. Nevertheless, decisions and articles discussing authorities from other jurisdictions are also referenced throughout, both in the text and in the footnotes.

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[4] Cunningham & Collins, *supra* note 3, at 370–371.

[5] *Id*. at 371–372.

[6] *Id.* at 375–379.

[7] *See* Cunningham & Collins, *supra* note 3, at 370.

[8] Schmidt, *supra* note 3, at 717.

[9] Cunningham & Collins *supra* note 3, at 387–389.

[10] Schmidt, *supra* note 3, 715–717.

II.
The Duty to Settle

Settlements are generally favored by courts, as they conserve time, expense, and judicial resources.[11] As such, an unreasonable refusal of a settlement demand can result in the imposition of hefty costs on the insurer who refuses to accept the settlement.[12]

California courts have described the insurer's duty to settle as the duty to settle the entire action for reasonable demands within policy limits.[13] When deciding whether to accept an offer of settlement, an insurer must give the claim "at least as much consideration as it does its own interest. When there is great risk of a recovery beyond the policy limits so that the most reasonable manner of disposing of the claim is a settlement which can be made within those limits," the insurer must settle the claim.[14] The duty to settle counterbalances the incentive that insurers have to "reject settlement demands in cases where potential liability exceeds [policy] limits."[15]

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[11] *See, e.g.*, Vill. Northridge Homeowners Ass'n v. State Farm Fire & Cas. Co., 237 P.3d 598, 608 (Cal. 2010).

[12] *See, e.g.*, Comunale v. Traders & Gen. Ins. Co, 328 P.2d 198, 202 (Cal. 1958).

[13] *See, e.g.*, Johansen v. Cal. State Auto. Ass'n. Inter-Ins. Bureau, 538 P.2d 744, 746 (Cal. 1975); Crisci v. Sec. Ins. Co., 426 P.2d 173, 176 (Cal. 1967); PPG Indus., Inc. v. Transamerica Ins. Co., 975 P.2d 652, 654 (Cal. 1999); Marie Y. v. Gen. Star Indem. Co., 2 Cal. Rptr. 3d 135, 157–58 (Ct. App. 2003). Other decisions have also addressed the scope and limits of an insurer's duty to settle. For example, under California law, an insurer has a duty of good faith towards *all* insureds, including additional insureds. Strauss v. Farmers Ins. Exch., 31 Cal. Rptr. 2d 811, 814 (Ct. App. 1994) ("[A]n insurer's duty extends to all of its insureds."); Smith v. State Farm Mut. Auto. Ins. Co., 7 Cal. Rptr. 2d 131, 134 (Ct. App.1992) ("[A]n insurer owes a duty of good faith and fair dealing to additional insureds as well as to named insureds."). As such, the insurer's duty to settle also extends to additional insureds. Nw. Mut. Ins. Co. v. Farmers' Ins. Grp., 143 Cal. Rptr. 415, 425 (Ct. App. 1978) ("While the estate of Robert Kessler was not named as an insured in defendants' policy, it was an additional insured under the policy's express terms, and as we have determined, defendants' duty to settle extended not only to Barnett Kessler but also to the estate of Robert Kessler."). For this reason, an insurer would be in bad faith if it accepted a settlement demand on behalf of one insured only and left the other insured without sufficient policy limits to settle the claims against it. Lehto v. Allstate Ins. Co., 36 Cal. Rptr. 2d 814, 820–823 (Ct. App. 1994) (concluding that insurer's insistence that both of its insureds be released in exchange for the policy proceeds was not bad faith; acceptance of offer for only one insured only would have been in bad faith towards the other). *See, e.g.*, Shell Oil Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA., 52 Cal. Rptr. 2d 580, 587 (Ct. App. 1996) ("And when there is more than one insured, '[a]n insurer owes the duty of good faith and fair dealing to each of its insureds, and cannot favor the interests of one insured over the other.'"). *See also* Schwartz v. State Farm Fire & Cas. Co., 106 Cal. Rptr. 2d 523, 532–533 (Ct. App. 2001) (stating that excess carrier may be in bad faith if it fails to save a proportionate share of the benefits for an additional insured even if the primary policies for that additional insured have not yet been exhausted).

[14] Comunale v. Traders & Gen. Ins. Co., 328 P.2d 198, 201(Cal. 1958).

[15] Kent D. Syverud, *The Duty to Settle*, 76 Va. L. Rev. 1113, 1127–-1130 (1990).

Insurance policies, by their terms, do not create a duty to settle.[16] Rather, the duty to settle is derived from the implied covenant of good faith and fair dealing.[17] This implied covenant supplements the express contractual promises to prevent either party from frustrating the other's rights under the insurance agreement.[18] "It is the obligation … under which the insurer must act fairly and in good faith in discharging its contractual responsibilities."[19] According to the California Supreme Court,

> [t]here is an implied covenant of good faith and fair dealing in every contract that neither party will do anything which will injure the right of the other to receive the benefits of the agreement. This principle is applicable to policies of insurance. . . . [T]he rights of the insured "go deeper than the mere surface of the contract written for him by defendant" and ... implied obligations are imposed "based upon those principles of fair dealing which enter into every contract." It is common knowledge that a large percentage of the claims covered by insurance are settled without litigation and that this is one of the usual methods by which the insured receives protection. Under these circumstances the implied obligation of good faith and fair dealing requires the insurer to settle in an appropriate case although the express terms of the policy do not impose such a duty.[20]

An insurer's duty to settle is implicated from the moment an insurer receives a *reasonable* settlement demand.[21] This section will describe ways insurers can spot "reasonable" (and unreasonable) settlement demands and thereby avoid liability in excess of policy limits.

A. *The Settlement Demand*

An insurer can only be liable for rejecting a *reasonable* settlement offer.[22] Under California law, "[a] settlement demand is reasonable if [the defendant] knew or should have known at the time the settlement demand was rejected that the potential judgment was likely to exceed the amount of the settlement demand based on [the plaintiff's] injuries or loss and the [the plaintiff's] probable liability."[23]

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[16] Robert H. Jerry, II, & Douglas R. Richmond,Understanding Insurance Law 866 (4th Ed. 2007).

[17] *Comunale*, 328 P.2d at 200–201.

[18] Waller v. Truck Ins. Exch., 900 P.2d 619, 639 (Cal. 1995).

[19] Gruenberg v. Aetna Ins. Co., 510 P.2d 1032, 1037 (Cal. 1973).

[20] *Comunale*, 328 P.2d at 200-201 (quoting Hiker v. W. Auto. Ins. Co., 231 N.W. 257, 258 (Wis. 1930)).

[21] *See, e.g.*, Jerry & Richmond, *supra* note 16, at 874.

[22] *See, e.g.,*CACI Jury Instruction No. 2334, *available at* http://www.courts.ca.gov/partners/317.htm (last visited Oct 1 2011) (identifying the failure to accept a *reasonable* settlement demand as an element of a bad faith claim).

[23] *Id.*

Whether an offer or settlement demand is reasonable depends upon the information that was available to the insurer when the demand was made.[24] The insurer's conduct is evaluated under the totality of circumstances in which the claim and the settlement demand were presented.[25]

1. Statutory Requirements

California Code of Civil Procedure section 998[26] provides requirements for both written settlement demands as well as statutory offers of judgment. The California Supreme Court has explained that

> [s]ection 998 provides that any party to an action may "serve an offer in writing upon any other party to the action to allow judgment to be taken or an award to be entered in accordance with the terms and conditions stated at that time." "If the offer is accepted, the offer with proof of acceptance shall be filed and the clerk or the judge shall enter judgment accordingly." However, "[i]f an offer made by a plaintiff is not accepted and the defendant fails to obtain a more favorable judgment or award . . . , the court or arbitrator, in its discretion, may require the defendant to pay a reasonable sum to cover costs of the services of expert witnesses . . . actually incurred and reasonably necessary in either, or both, preparation for trial or arbitration, or during trial or arbitration, of the case by the plaintiff, in addition to plaintiff's costs." An offer is deemed withdrawn if it is not accepted before trial, or within 30 days after it is made.
>
> Fundamental rules of statutory construction require that, in construing section 998, we attempt to "'ascertain the intent of the Legislature so as to effectuate the purpose of the law.'" That purpose is clear: Section 998 is intended "to encourage settlement by providing a strong financial disincentive to a party—whether it be a plaintiff or a defendant—who fails to achieve a better result than that party could have achieved by accepting his or her opponent's settlement offer. (This is the stick. The carrot is that by awarding costs to the putative settler the statute provides a financial incentive to make reasonable settlement offers.)"[27]

Section 998's specificity requirement is particularly crucial in the context of settlement demands to multiple defendants.[28] In general, a demand made to multiple defendants is not "reasonable" since it is impossible to determine whether the plaintiff received "a judgment

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[24] Isaacson v. Cal. Ins. Guar. Ass'n., 750 P.2d 297, 309 (Cal. 1988).

[25] Wallbrook Ins. Co., Ltd. v. Liberty Mut. Ins. Co., 7 Cal. Rptr. 2d 513, 518 (Ct. App. 1992).

[26] Cal Civ. Proc. Code § 998 (West 2009).

[27] Berg v. Darden, 15 Cal. Rptr. 3d 829, 832–33 (Ct. App. 2004) (citations omitted) (quoting Cal. Civ. Proc. Code § 998(b) (West 2009)).

[28] *See, e.g.,* Taing v. Johnson Scaffolding Co., 11 Cal. Rptr. 2d 820, 822–24 (Ct. App. 1992).

more favorable than she would have received under the offer."[29] In *Taing v. Johnson Scaffolding Co.,*[30] the court noted that the purpose of section 998 was defeated with a non-specific demand to multiple defendants:

> [A]t the time [the insured] made his section 998 offer to settle, it was his stated position that *all three* defendants were liable, although he did not advise them of his position as to their individual percentage of liability. Given this position, it is questionable whether [the insured] could reasonably have expected appellant to pay the entire settlement figure and then litigate the liability and damage factors with its codefendants. This defeats one of the benefits of section 998 for the defendant: avoidance of the time and expense of litigation.[31]

An unspecified demand to multiple defendants "places a reasonable defendant at the mercy of codefendants whose refusal to settle may be unreasonable."[32] Thus, the demand must be directed to each individual defendant so that the defendant can determine whether the demand should be accepted, without having to wait for or convince other defendants to accept the demand. However, where several defendants face joint and several liability, there is an exception to this general rule. In such an instance, a section 998 demand need not be apportioned among the various defendants.[33]

2. Conditions Precedent

Offers to settle for policy limits may require an insurer to fulfill various conditions precedent to valid acceptance.[34] Although some conditions are acceptable, certain conditions

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[29] Gilman v. Beverly Calif. Corp., 283 Cal. Rptr. 17, 20 (Ct. App. 1991) ("Without an apportionment of the damages among the four plaintiffs, it is impossible to say that any one of them received a judgment more favorable than she would have received under the offer."). Hurlbut v. Sonora Comm. Hosp., 254 Cal. Rptr. 840, 853 (Ct. App.1989) ("We hold that the joint settlement demand presented by plaintiffs was not a valid settlement demand under Code of Civil Procedure section 998.").

[30] 11 Cal. Rptr. 2d 820(Ct. App.1992). *See also* Burch v. Children's Hosp. of Orange Cnty. Thrift Stores, Inc.,135 Cal. Rptr. 2d 404, 411(Ct. App. 2003) ("Consequently, a plaintiff who makes a § 998 offer to joint defendants having *potentially varying liability* must specify the amount plaintiff seeks from *each defendant*."); Austin B. v. Escondido Union Sch. Dist., 57 Cal. Rptr. 3d 454, 477–78 (Ct. App. 2007).

[31] *Taing,* 11 Cal. Rptr.2d at 823.

[32] *Id.*

[33] Steinfeld v. Foote-Goldman Proctologic Med. Grp. Inc., 58 Cal. Rptr. 2d 371, 374 (Ct. App.1996) (Where defendants faced joint and several liability, "the fact that the settlement offer was unapportioned did not place appellants in an untenable position, since if they were liable at all, they were jointly and severally liable"); *Hurlbut*, 254 Cal. Rptr. at 852 ("Code of Civil Procedure section 998 speaks in the singular 'any party may serve an offer . . . .' This language has been interpreted to apply to a joint offer to defendants only where sued under a theory of joint and several liability").

[34] Cunningham & Collins, *supra* note 3, at 371–372.

may render a settlement offer unreasonable and thus preclude insurer bad-faith liability. For example, in California, a settlement demand is not "a settlement offer within policy limits" if it contains conditions beyond simply paying the policy limit.[35] Such conditions include requiring the insured to participate as parties at trial or requiring the insurer to provide a defense for the insured.[36] A settlement offer that includes these conditions cannot serve as the basis for a bad faith claim.[37]

3. Absence of a Release

The absence of a release can also render a settlement demand unreasonable and invalid as a basis for bad faith. When a settlement demand does not promise a release of all claims against the insured, the insurer is not obligated to accept the demand.[38] An insurer may also reject a settlement demand that leaves its insured vulnerable against claims by other parties.[39]

For example, in *Coe v. State Farm Mutual Automobile Insurance Co*., the plaintiff made a policy limits demand with an eleven-day deadline for the insurer to respond.[40] State Farm inquired whether the settlement would include a release of a workers' compensation lien and assured the plaintiff that "upon receipt of the very basic information requested, we shall promptly advise you of our position regarding settlement."[41] The plaintiff's attorney did not reply to this inquiry, took the case to trial, and obtained a large verdict in excess of the policy limits.[42] The appellate court reversed and ruled that State Farm was not responsible for any damages over the policy limits because the demand did not provide the company with a reasonable opportunity to settle all claims including liens.[43]

4. Demands in Excess of Policy Limits

Whether a demand in excess of policy limits is "reasonable" varies by jurisdiction. In some jurisdictions, "an insurer's settlement duty is not activated until a settlement demand within policy limits is made, and the terms of the demand are such that an ordinarily prudent insurer would accept it."[44] However, in other jurisdictions, the fact that a settlement

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[35] Heredia v. Farmers Ins. Exch., 279 Cal. Rptr. 511, 516 (Ct. App. 1991).

[36] *Id.*

[37] *See id*. at 516.

[38] Strauss v. Farmers Ins. Exch., 31 Cal. Rptr. 2d 811, 814 (Ct. App. 1994) ("[A]n insurer may, within the boundaries of good faith, reject a settlement offer that does not include a complete release of all its insureds.").

[39] *See* Coe v. State Farm Mut. Auto Ins. Co., 136 Cal. Rptr. 331, 337–338 (Ct. App. 2006).

[40] 136 Cal. Rptr. 331, 332–333 (Ct. App.1977).

[41] *Id.* at 334.

[42] *Id.*

[43] *Id*. at 338–340.

[44] *See, e.g*., Rocor Int'l v. Nat'l Union Fire Ins. Co., 77 S.W.3d 253, 262 (Tex. 2002).

demand exceeds the policy limits may not absolve the insurer from a duty to settle. In these jurisdictions the insurer has a duty to make a counteroffer for an amount within the policy limit in an effort to resolve the claim against its insured.[45]

5. Lack of Information

Some settlement demands arrive unsupported by necessary evidence and information.[46] A claimant's failure or refusal to provide key information (e.g., medical records) may significantly affect whether an insurer's rejection of a settlement demand was "reasonable."[47] For example, In *Robins v. Allstate Insurance Co.*, the insurer unsuccessfully attempted to obtain medical records and information from the claimant for two years.[48] The insurer subsequently received a settlement offer for policy limits that included only some past medical bills, but very little medical evaluation and diagnosis to explain the medical bills and their relevance to the claim.[49] The court found that the insurer's refusal to settle without ascertaining the medical status of the insured was not unreasonable and did not give rise to a bad faith claim.[50]

As a corollary to this principle, an insurer has a right—indeed, a duty— to conduct a reasonable investigation.[51] Hence, an insurer who was not permitted to conduct a sufficient investigation to determine the likelihood of an excess judgment cannot be held liable for bad faith.[52] Although plaintiffs or claimants will continue to try setting arbitrary and unreasonable time frames for insurers to respond to policy limit settlement demands, courts have held that such deadlines are not dispositive and that insurers have the right to investigate and evaluate the plaintiff's claims.[53]

The Ninth Circuit has recently upheld an insurer's right to conduct and complete an investigation, notwithstanding plaintiff's arbitrary time frame imposed for the insurer's response to a policy limits demand. In *Allstate v. Herron,*[54] the court addressed "whether

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[45] *See, e.g.*, Rova Farms Resort, Inc. v. Investors Ins. Co., 323 A.2d. 495, 506–507 (N.J. 1974).

[46] Cunningham & Collins, *supra* note 3, at 375–379.

[47] Robin v. Allstate Ins. Co., 870 So. 2d 402, 412-413 (La. Ct. App. 2004).

[48] *Id.* at 411.

[49] *Id.*

[50] *Id.* at 413; *see* Kelley v. British Comm. Ins. Co., 34 Cal. Rptr. 564, 562-63 (Ct. App. 1963).

[51] *See, e.g.*, Egan v. Mut. of Omaha Ins. Co., 620 P.2d 141, 146 (Cal. 1979); Guebara v. Allstate Ins. Co., 237 F.3d 987, 995 (9th Cir. 2001).

[52] Globe Indem. Co. v. Superior Court, 8 Cal. Rptr. 2d 251, 255 (Ct. App. 1992). *See also* Christopher Lyle McIlwain, *Clear as Mud: An Insurer's Rights and Duties Where Coverage Under a Liability Policy Is Questionable*, 27 Cumb. L. Rev. 31, 42-43 (1997). *See also, e.g.*, State Farm Mut. Auto. Ins. Co. v. Hollis, 554 So. 2d 387, 389–390 (Ala. 1989); Gilderman v. State Farm Ins. Co., 649 A.2d 941, 946 (Pa. Super. Ct. 1994).

[53] Pavia v. State Farm Mut. Auto. Ins. Co., 626 N.E.2d 24, 28–29 (N.Y. 1993).

[54] 634 F.3d 1101 (9th Cir. 2011).

an insurance company's failure to settle a claim against its insured by a claimant's stated settlement deadline constitutes a breach of the insurer's duty of good faith and fair dealing."[55] In *Herron*, plaintiff's counsel demanded the policy limits five months after the accident. A couple of months later, he wrote another letter and placed a unilateral deadline on the time frame for the insurer to respond to the demand for the policy limits.[56]

Allstate responded by advising that it had not completed its investigation, but that it would do so by the end of the month—fourteen days *after* the plaintiff's unilateral deadline.[57] Allstate subsequently offered its policy limits in settlement of the claim, but the plaintiff rejected the offer as too late.[58] Allstate's insured confessed to a judgment in the amount of $1,937,500 in favor of the plaintiff.[59] Thereafter, Allstate filed an action for declaratory relief seeking, *inter alia,* a declaration that the insured breached the cooperation clause by consenting to judgment and that Allstate's liability was limited to the policy limits.[60]

The case was tried before a jury. The jury determined that Allstate acted reasonably by offering its policy limits on May 30, 2003, even though it was after the plaintiff's time limit demand expired.[61] The Ninth Circuit affirmed, holding that "[v]iewing this evidence in the light most favorable to Allstate, it is not clear that Allstate failed to comply with the terms of Power's deadline, let alone that it failed reasonably to offer to settle at policy limits."[62] A crucial factor in the court's decision was that "Allstate began its investigation two days after [the insured's] accident occurred and was consistently in contact with [the insured] throughout the process."[63]

It is important to note that an insurer's lack of information is not an absolute shield to liability for bad faith. If an insurer's lack of sufficient information is due to the insurer's own negligence or lack of diligence, this lack of information will not provide a defense against a bad faith claim.[64] California courts have held insurers liable for bad faith for failing to thoroughly investigate a claim or for unreasonably delaying the commencement of an investigation or coverage decision.[65] Therefore, insurers should document all steps necessary to determine whether a claim is likely to exceed policy limits, inform the insured of the settlement offer and involve the insured when prudent, and request additional information or additional time to evaluate the claim.

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[55] *Id*. at 1105.

[56] *Id.*

[57] *Id.* at 1105–1106.

[58] *Id*. at 1106.

[59] *Id.*

[60] *Id.*

[61] *Herron,* 634 F.3d at 1107.

[62] *Id.* at 1110.

[63] *Id*. at 1109.

[64] *Kelley*, 34 Cal. Rptr. at 562–63.

[65] *See, e.g.,* Egan, 620 P.2d at 146; Love v. Fire Ins. Exch., 271 Cal. Rptr. 246, 252 (Ct. App.1990).

6. Time Limits

Offers to settle for policy limits may include short deadlines that pass before there has been adequate time for investigation or discovery, and may be revoked on technicalities.[66] Time limit demands are also often made without important documents in support of the claim, most notably medical records.[67] This lack of documents prevents the insurer from adequately assessing its liability to make a settlement decision before the time limit offer expires. If the insurer fails to accept the settlement demand before it expires, then the insurer may find itself defending against a bad faith failure to settle claim.

Valid time limits for acceptance may be statutorily prescribed. For example, under California law, a demand lapses if the demand is not accepted "within 30 days after it is made."[68] However, offers to settle may come with much shorter time limits, giving insurers as little as ten days[69] or even one week to respond.[70]

Although the courts have not provided bright-line rules regarding what time limits are acceptable,[71] the Tenth Circuit Court of Appeals provided instructive guidance in *Wade v. Emasco Insurance Co.*[72] In *Wade,* the court held it was not bad faith for an insurer to reject a settlement limits demand because the time limit set by the plaintiff's attorney was unreasonable.[73] Indeed, the court found it was reasonable and acceptable for the insurance company to wait to review the relevant medical records before responding to a policy limits demand.[74] The timeline in *Wade* was as follows:

> May 1, 2001: Plaintiff demands settlement for policy limits. Plaintiff does not set a response deadline.[75]
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> May 21, 2001: Plaintiff sends insurer medical records and sets a June 15, 2001 deadline for the insurer to respond.[76]
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> August 20, 2001: Plaintiff withdraws second policy limits demand.[77]

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[66] Cunningham & Collins, *supra* note 3, at 371–372.

[67] *See id.* at 375–376.

[68] Cal. Civ. Proc. Code §998(b)(2) (West 2009).

[69] DeLaune v. Liberty Mut. Ins. Co., 314 So. 2d 601, 602 (Fla. Dist. Ct. App. 1975).

[70] Critz v. Farmers Ins. Grp., 41 Cal. Rptr. 401, 403 (Ct. App. 1964).

[71] Cunningham & Collins, *supra* note 3, at 370.

[72] 483 F.3d 657 (10th Cir. 2007).

[73] *Id*. at 674.

[74] *See id.* at 668–669.

[75] *Id.* at 661.

[76] *Id.* at 662.

[77] *Id.*

> November 1, 2001: After reviewing medical records, insurer conveys settlement offer, which plaintiff subsequently refused.[78]

Thereafter, plaintiff's counsel and the insured entered into a stipulated judgment in the amount of $3,150,000, the insured assigned rights to the plaintiff, and the plaintiff sued the insurer based on the assignment.[79] The insurer moved for summary judgment, in part on the grounds that the settlement demand did not allow sufficient time for a response.[80] The Tenth Circuit affirmed the lower court's grant of the motion. In its decision, the court reasoned that

> [p]ermitting an injured plaintiff's chosen timetable for settlement to govern the bad-faith inquiry would promote the customary manufacturing of bad-faith claims, especially in cases where an insured of meager means is covered by a policy of insurance which could finance only a fraction of the damages in a serious personal injury case. Indeed, insurers would be bombarded with settlement offers imposing arbitrary deadlines and would be encouraged to prematurely settle their insureds' claims at the earliest possible opportunity in contravention of their contractual right and obligation of thorough investigation.[81]

Other courts have similarly refused to hold an insurer responsible for a verdict in excess of policy limits on the basis that allowing a plaintiff to set an arbitrary timetable for settlement would promote the manufacture of bad faith claims.[82]

In sum, a demand must give the insurer a reasonable time to evaluate both the demand and the claim to determine whether it will accept the demand. If an insurer is not given a fair opportunity to evaluate the demand, its failure to accept the demand may be justified and excusable, even if a subsequent verdict exceeds both the demand and the policy limit.[83]

7. Defense Counsel's Valuation of the Claim

In *Howard v. American National Fire Insurance Co.*,[84] the court addressed whether an insurer should rely on defense counsel's evaluation of the case when assessing the reason-

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[78] *Id*. at 663.

[79] *Id.* at 664.

[80] *Wade*, 483 F.3d at 665.

[81] *Id.* at 670 (quoting Pavia v. State Farm Mut. Auto. Ins. Co., 626 N.E.2d 24, 28–29 (N.Y. 1993).

[82] *See, e.g.,Pavia*, 626 N.E.2d at 28-29; Adduci v. Vigilant Ins. Co., 424 N.E.2d 645, 649 (Ill. App. Ct.1981).

[83] *See Wallbrook ,* 7 Cal. Rptr. 2d at 519.

[84] 115 Cal. Rptr. 3d 42 (Ct. App. 2010).

ableness of a settlement demand.[85] In *Howard*, the underlying action involved a suit against the Roman Catholic Bishop of Stockton, who was insured under several commercial general liability policies, including a policy issued by American National Fire Insurance Company.[86] American denied coverage on the grounds that the incidents giving rise to liability occurred after the American policy expired.[87]

On appeal, one of the issues before the *Howard* court was whether American had breached its duty to settle in the underlying action. American argued that it had not breached its duty to settle, in part because the settlement demands in the underlying action were unreasonably high.[88] In its analysis, the court first noted that American's argument was substantially weakened because the ultimate judgment against the insured exceeded the amount of the settlement offer: the settlement demand was for $1.85 million, and judgment was entered for

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[85] Under California law, for example, an insurer may offer proof that it acted in good faith reliance on advice of competent counsel to negate allegations that it acted in "bad faith" toward its insured and to negate claims that it acted with the requisite "oppression, fraud or malice" for an award of punitive damages. Along with other relevant evidence, a showing of good faith reliance on advice of counsel may tend to show the insurer was acting "reasonably" in its handling of the claim. Reliance on counsel's advice tends to show the insurer had "proper cause" for its actions and thus tends to negate "bad faith." In *State Farm Mutual Automobile Insurance Co. v. Superior Court (Johnson Kinsey, Inc.)*, the California Court of Appeal considered the application of the "advice of counsel" defense in a bad faith case where an insurer refused to defend an employee driver of its insured pursuant to its wrongful invocation of an exclusion in its policy to the insured. The court discussed the "advice of counsel" defense, insisting that an

> insurer may defend itself against allegations of bad faith and malice in claims handling with evidence the insurer relied on the advice of competent counsel. The defense of advice of counsel is offered to show the insurer had "proper cause" for its actions even if the advice it received is ultimately unsound or erroneous.

State Farm Mut. Auto. Ins. Co. v. Superior Court (Johnson Kinsey, Inc.), 279 Cal. Rptr. 116, 117–118 (Cal Ct. App.1991) (citations omitted). "Good faith reliance on counsel's advice negates allegations of bad faith and malice as it tends to show the insurer had proper cause for its actions." *Id*. at 118. To successfully assert the "advice of counsel" defense, an insurer defendant must show that

> (1) the defendant acted on the opinion and advice of counsel; (2) counsel's advice was based on full disclosure of all the facts by defendant or the advice was initiated by counsel based on counsel's familiarity with the case; and (3) the defendant's reliance of the advice of counsel was in good faith.

Melorich Builders, Inc., v. Superior Court, 207 Cal. Rptr. 47, 50 (Ct. App. 1984). An insurer's reliance on the advice of counsel may also preclude recovery of punitive damages. *See* Stewart v. Truck Ins. Exch., 21 Cal. Rptr. 2d. 338, 348 (Ct. App. 1993). Such reliance is a "complete defense to a claim of extreme and outrageous conduct." *Melorich*, 207 Cal. Rptr. at 50. It should also prevent any finding of "oppression, fraud or malice." Tibbs v. Great Am. Ins. Co., 755 F.2d 1370, 1375 (9th Cir. 1985) (required for an award of punitive damages).

[86] *Howard*, 115 Cal. Rptr. 3d at 52.

[87] *Id*. at 52–53.

[88] *Id.* at 65.

$2.5 million in compensatory damages.[89] American argued that the demand seemed excessive at the time it was made, and for support it relied upon the fact that underlying defense counsel never valued the underlying case above $1 million.[90] However, the court noted that defense counsel had reported his nationwide search of jury verdicts in cases with similar facts, in which he found a verdict range of $150,000 to $10 million.[91] The court further noted that "[c]ounsel gave his estimated value of the . . . case with the cautionary note that '[t]hese cases are difficult to evaluate'" and that others involved in the underlying action warned American of the potential for a substantial jury verdict.[92] As a result, the court concluded that "substantial evidence support[ed] the trial court's finding that James Howard made a reasonable settlement offer in asking for $1.85 million and that the ultimate judgment was likely to exceed the amount of the settlement offer, which it did."[93] The court further concluded that there was no evidence that American ever relied on defense counsel's evaluation of the case in refusing to settle; rather, the insurer refused to settle because it claimed that molestation was not covered by its policy.[94] "Having taken that position and then rejecting a reasonable settlement offer, [the court concluded that] American [was] liable for wrongful failure to settle."[95]

8. Applicability of Coverage Defenses

In *Comunale v. Traders & General Insurance Co.*,[96] the California Supreme Court found that where (1) there is a settlement demand within policy limits, and (2) there is a great risk of a judgment in excess of policy limits, an insurer that refuses to accept the settlement demand does so at its own risk.[97] Importantly, the court clearly stated that such risk includes liability for the entire excess judgment, and that even a reasonable but erroneous belief in non-coverage is no defense.[98]

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[89] *Id.* at 66.

[90] *Id*. at 66–67.

[91] *Id*. at 67.

[92] *Id.*

[93] *Id*.

[94] *Id.*

[95] *Id.*

[96] 328 P.2d 198 (Cal. 1958).

[97] *Id.* at 201.

[98] *Id*. at 201–202. However, in many jurisdictions the insurer has no duty to settle when there is a "fairly debatable" coverage question. *See, e.g.,* Lasma Corp. v. Monarch Ins. Co., 764 P.2d 1118, 1122–1123 (Ariz. 1988); Mowry v. Badger States Mut. Cas. Co., 385 N.W.2d 171, 180 (Wis. 1986); Snodgrass v. State Farm Mut. Auto. Ins. Co., 804 P.2d 1012, 1022–1023 (Kan. Ct. App. 1991); Pham v. State Farm Mut. Ins. Co., 70 P.3d 567, 572 (Colo. App. 2003); Farmland Mut. Ins. Co. v. Johnson, 36 S.W.3d 368, 375 (Ky. 2000); Harman v. Estate of Miller, 656 N.W.2d 676, 681 (N.D. 2003).

Similarly, in *Johansen v. California State Automobile Association Inter-Insurance Bureau*,[99] Johansen offered to settle the underlying action for the $10,000 policy limit.[100] Although the Dearings' insurer "conceded the virtual certainty of a judgment against the Dearings in excess of the policy limits," it refused to accept the settlement offer because the insurer "believed that the accident did not fall within the policy's coverage."[101] The underlying action went to trial, and a judgment of $33,899 was entered against the Dearings.[102] The Dearings then assigned their bad faith claim against their insurer to Johansen, and Johansen filed a bad faith action against the insurer.

Citing *Comunale,* the *Johansen* court found that "an insurer's 'good faith,' though erroneous, belief in noncoverage affords no defense to liability flowing from the insurer's refusal to accept a reasonable settlement offer."[103] The court further explained that

> the only permissible consideration in evaluating the reasonableness of the settlement offer becomes whether, in light of the victim's injuries and the probable liability of the insured, the ultimate judgment is likely to exceed the amount of the settlement offer. Such factors as the limits imposed by the policy, a desire to reduce the amount of future settlements, *or a belief that the policy does not provide coverage*, should not affect a decision as to whether the settlement offer in question is a reasonable one.[104]

Since the Dearings' insurer had conceded that it was aware of the risk for an excess judgment due to the serious nature of Johansen's injuries, the court found that the insurer's refusal of a settlement demand within policy limits was unreasonable, and thus a breach of the implied covenant of good faith and fair dealing.[105] However, the court declined to make a bright-line rule that whenever an insurer rejects a settlement demand within policy limits, it automatically becomes liable for the final judgment. Rather, the court appeared to believe that the analysis of bad faith refusal to settle should be conducted on a case-by-case basis.[106]

Three recent California Court of Appeal decisions have relied on *Comunale* and *Johansen* to hold that an insurer cannot rely on its coverage defenses to determine the reasonableness

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[99] 538 P.2d 744 (Cal. 1975).

[100] *Id*. at 746.

[101] *Id.*

[102] *Id*. at 747.

[103] *Id*. at 748.

[104] *Id.* at 748–749 (internal citations omitted) (emphasis added).

[105] *Id.* at 751.

[106] *See id*. at 750.

of a settlement demand.[107] Policyholders utilize these decisions to argue that the reasonable settlement value of claim is not limited to the reasonable settlement value of covered claims but of all claims against the insured, as an insurer's "good faith" belief in non-coverage will afford no defense to liability flowing from its refusal to accept a reasonable settlement offer.[108]

When coverage is dubious, an insurer can protect itself by accepting a settlement demand under a reservation of rights to seek reimbursement of payments for non-covered claims.[109] Indeed, the insurer can make settlement payments over the objections of the insured and later seek reimbursement when it is determined that the underlying claim was not covered under the policy.[110]

9. Valuation of "Mixed Claims"

In the absence of coverage, an insurer does not owe its insured a duty to settle.[111] Therefore, a settlement demand's reasonableness may be evaluated with respect to covered damages only.[112] According to one California treatise,

> [a] settlement demand's "reasonableness" is normally appraised with respect to *covered* damages only. Noncovered damages—those outside the policy's insuring clause or specifically excluded—are not considered. . . .
>
> If the insurer offers the reasonable settlement value of the *covered* portion, *it need not concern itself* with the risk of excess liability arising from the third party's non-covered claims. Any excess liability in such cases arises from the *lack of coverage*, not from the insurer's "unreasonable" refusal to settle covered claims.[113]

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[107] Rappaport-Scott v. Interinsurance Exch. of the Auto. Club, 53 Cal. Rptr. 3d 245, 247 (Ct. App. 2007); Archdale v. Am.Int'l Specialty Lines Ins. Co. 64 Cal. Rptr. 3d 632, 645–647 (Ct. App. 2007); Howard v. Am. Nat'l Fire Ins. Co., 115 Cal. Rptr. 3d 42, 52–53 (Ct. App. 2010).

[108] *Archdale*, 64 Cal. Rptr. 3d at 646.

[109] When an insurer defends under a reservation of rights, it defends the insured but "reserves" the right to later contest coverage. *See, e.g.*, 3–16 Appleman on Insurance § 16.03.

[110] Blue Ridge Ins. Co. v. Jacobsen , 22 P.3d 313, 321–323 (Cal. 2001).

[111] Love v. Fire Ins. Exch., 271 Cal. Rptr. 246, 254–255 (Ct. App. 1990).

[112] *See, e.g.*, Marie Y. v. Gen. Star Indem. Co., 2 Cal. Rptr. 3d 135, 157–58 (Ct. App. 2003); Camelot by the Bay Condo. Owners' Ass'n v. Scottsdale Ins. Co., 32 Cal. Rptr. 2d 354, 364–65 (Ct. App.1994).

[113] Hon. H. Walter Croskey et al., California Practice Guide: Insurance Litigation, ¶¶ 12:338-39.

Hence, "where the *kind* of claim asserted is not covered by the insurance contract (and not simply the *amount* of the claim), an insurer has no obligation to pay money in settlement of a noncovered claim."[114] In other words, "[t]he insurer does not . . . insure the entire range of an insured's well-being, outside the scope of and unrelated to the insurance policy, with respect to paying third party claims. It is an insurer, not a guardian angel."[115]

Using a similar analysis the California Supreme Court has also held that an insurer need not consider possible punitive damage awards in evaluating settlement demands against insureds.[116]

10. Withdrawn Settlement Demands

It is important to remember that an insurer cannot necessarily reverse the consequences of an unreasonable settlement demand by subsequently offering to settle for policy limits. When a settlement offer for policy limits is later withdrawn and subsequent offers by the insurer to settle for the same amount are rejected, an insurer may still be found to have acted in bad faith.[117]

In *Berges v. Infinity Insurance Co.,* for example, an accident victim's widower made an offer to settle for the $10,000 policy limit for his wife's death and the $10,000 policy limit for his daughter's injuries.[118] Less than a month after the accident, the insurer concluded that its insured was entirely at fault. A few days later, the victim's husband personally delivered the hand-written offer to settle for policy limits to the insurer.[119] He indicated that he had missed many days of work, and medical bills were mounting for his daughter.[120] His offer to settle had a twenty-five-day time limitation and included a note that he needed court approval to deem him the personal representative of his wife's estate and the authority to settle his minor daughter's claim.[121] The insurer's claims adjuster called the claimant a week after

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[114] *Marie Y*., 2 Cal. Rptr. 3d at 158; *see also* McCormick v. Sentinel Life Ins. Co., 200 Cal. Rptr. 732, 739 (Ct. App. 1984) ("[T]he duty of good faith and fair dealing does not require an insurer to honor 'every claim presented to it.' Nor does it require an insurer to pay 'meritless claims.'") (citations omitted); Zurich Ins. Co. v. Killer Music, Inc., 998 F.2d 674, 679 (9th Cir. 1993) (allowing allocation of a settlement between covered and uncovered damages.); Raychem Corp. v. Fed. Ins. Co., 853 F. Supp. 1170, 1183 (N.D. Cal. 1994) (holding that the burden was on the insured to allocate the settlement between the two groups of defendants).

[115] *Scottsdale Ins. Co*., 32 Cal. Rptr. 2d at 364.

[116] PPG Indus., Inc. v. Transamerica Ins. Co., 975 P.2d 652, 656–658 (Cal. 1999). *See also* Zieman Mfg. Co. v. St. Paul Fire & Marine Ins. Co., 724 F.2d 1343, 1346 (9th Cir. 1983); J.B. Aguerre, Inc. v. Am. Guar. & Liab. Ins. Co., 68 Cal. Rptr. 2d 837, 843 (Ct. App. 1997).

[117] *See, e.g*., Berges v. Infinity Ins. Co. 896 So. 2d 665, 669 (Fla. 2004).

[118] *Id*.

[119] *Id*.

[120] *Id*. at 669–670.

[121] *Id*. at 669.

receiving the settlement demand, and it is disputed whether there was a verbal agreement to settle for the policy limit or a time extension requested.[122] Nevertheless, the insurer wrote to the claimant to accept the settlement offer a few days before the original twenty-five-day deadline expired, but due to an addressing error, the claimant did not receive the letter until nearly a month after the deadline had expired.[123] In the interim, the claimant's attorney had revoked the settlement offer due to expiration and filed suit against the insured.[124] The jury awarded a verdict of nearly $1.5 million, and the insured filed a bad faith claim against the insurer.[125] The Florida Supreme Court found that the jury properly concluded that in light of the insurer having "dropped the ball" in handling the claim, combined with its failure to notify its insured of its negligent handling of the settlement offer and time demand, the way the insurer handled the claim amounted to bad faith.[126]

B. *Accepting a Settlement Offer*

1. Compliance with the Terms of the Offer

A settlement offer may stipulate that acceptance can only be made in a specific manner (e.g. "mailing the lawyer a check for the amount of the policy limits").[127] If such a requirement is present and the insurer accepts in a form that does not comply with the demand, the claimant may have an excuse to reject the acceptance and pursue a bad faith claim.

2. Attaching Conditions to an Acceptance

An insurer must be mindful when attaching any kind of condition to its acceptance of a settlement demand. Some conditions may be deemed to be merely precatory[128] while others may change the character of an acceptance to that of a counteroffer.[129]

In *Herring v. Dunning*, the defendant's insurer issued an acceptance letter that included language requesting a confirmation that no liens existed relevant to the case.[130] The court characterized this language as a mere recommendation—not a "mandatory direction"—especially in light of the acceptance letter's grant of a full and final release; thus, the letter was "an unequivocal and unconditional acceptance of plaintiff's written offer to settle."[131]

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[122] *Id.* at 670.

[123] *Id*. at 670.

[124] *Id*. at 671.

[125] *Id.*

[126] *Id.* at 682.

[127] Stephen S. Ashley, Bad Faith Actions Liability & Damages §7:26.

[128] Herring v. Dunning, 446 S.E.2d 199, 203 (Ga. Ct. App. 1994). "Precatory words are words 'whose ordinary significance imports entreaty, recommendation, or expectation rather than any mandatory direction.'" *Id*. (quoting Raines v. Duskin, 277 S.E.2d 26, 34 (Ga. 1981)).

[129] Frickey v. Jones, 630 S.E.2d 374, 376–377 (Ga. 2006).

[130] *Herring*, 446 S.E.3d at 201.

[131] *Id*. at 203.

In contrast, in *Frickey v. Jones*, the insurer responded to a policy limit offer with a letter stating its willingness to pay the policy limit, but only upon receipt of a full release and a resolution of hospital liens and medical insurance liens.[132] The court found that this response constituted a counteroffer and thus a rejection of the original offer to settle.[133] The Georgia Supreme Court distinguished this case from *Herring* on the grounds that the insurer's acceptance letter did not accept the offer "unequivocally and without variance of any sort" and that the requirement to resolve liens rose above the request in *Herring* to confirm the nonexistence of any outstanding liens.[134]

The tenuous distinction drawn by the Georgia Supreme Court serves as a warning to insurers to be careful when accepting settlement demands with conditions. In sum, certain conditions can change an acceptance letter into a repudiation and counteroffer, thereby creating an opportunity for a plaintiff to claim that the insurer failed to settle in good faith.[135]

C. *Standards for Bad Faith Liability*

Each jurisdiction has its own standard for determining bad faith.[136] However, one thing is consistent among jurisdictions: mere negligence is not sufficient to establish a breach of the implied covenant of good faith and fair dealing.[137] For example, in *Beck v. State Farm Mutual Automobile Insurance Co.,* the court stated that an insurer's coverage position must be "patently untenable" in order to be in bad faith.[138] Similarly, in *Critz v. Farmers Insurance Group*, the court stated that an insurer's conduct must evidence "unfair dealing rather than mistaken judgment or poor prognostication" in order to support a finding of bad faith.[139]

Courts have uniformly held that even to *plead* the requisite unreasonable conduct in a first-party or third-party bad faith claim, the plaintiff must allege specific facts showing unreasonable conduct. In *J.B. Aguerre, Inc. v. American Guarantee & Liability Insurance Co.*, the insured sought to recover damages from its insurer for breach of the covenant of good faith and fair dealing.[140] Sometime after third-party claimants filed suit against the plaintiff and its employee, the insurer refused to settle the matter for $2 million, following

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[132] *Frickey*, 630 S.E.2d at 375.

[133] *Id*. at 376–377.

[134] *Id*. at 376 (quoting *Herring*, 446 S.E.2d at 203).

[135] Butler v. First Acceptance Ins. Co., 652 F. Supp. 2d 1264, 1276–1278 (N.D. Ga. 2009).

[136] Jerry & Richmond, *supra* note 16, at 185–189.

[137] Chateau Chamberay Homeowners Ass'n. v. Associated Int'l Ins. Co., 108 Cal. Rptr. 2d 776, 784–785 (Ct. App. 2001); Nat'l Life & Acc. Ins. Co. v. Edwards, 174 Cal. Rptr. 31, 38 (Ct. App. 1981); Aceves v. Allstate Ins. Co., 68 F.3d 1160, 1166 (9th Cir. 1995).

[138] Beck v. State Farm Mut. Auto. Ins. Co.,126 Cal. Rptr. 602, 606 (Ct. App.1976).

[139] Critz v. Farmers Ins. Grp., 41 Cal. Rptr. 401, 405 (Ct. App. 1964).

[140] J.B. Aguerre, Inc. v. Am. Guar. & Liab. Ins. Co., 68 Cal. Rptr. 2d 837, 838–839 (Ct. App. 1997).

a demand by the third-party claimants.[141] The plaintiff/insured nevertheless entered a settlement agreement with the claimants for this amount.[142] In its own suit against its carrier, the plaintiff alleged that it was bad faith for the insurer to refuse to settle the matter because "the case had a value of $2 million."[143] The Court of Appeal found that the trial court had properly sustained the insurer's demurrer to the plaintiff's claim for breach of the implied covenant because there were no facts that the insurer's refusal to meet the plaintiff's $2 million demand was unreasonable.[144]

In *Congleton v. National Union Fire Insurance Co.*, the court confronted the argument that the insurer's policy interpretation was unreasonable, and thus that the denial of coverage was in bad faith.[145] In *Congleton*, National Union had issued a first-party aviation insurance policy for a twin-engine aircraft. The plane mysteriously could not be located, and the insured submitted a claim for the missing plane.[146] National Union denied the claim for loss, based in part upon the insured's inability to show that the definition of "disappearance" as "missing and not reported for 60 days following a flight" had been met.[147] In short, while the insured could show that the plane was missing, it could not demonstrate that the aircraft commenced a flight immediately before vanishing. The court held that since the requirement for "disappearance" was contained in the insuring grant, the insured had the burden of showing that that definition had been satisfied.[148] Since the insured could show only that the whereabouts of the plane were unknown, but not that it had vanished following a flight, the policy requirement for a "disappearance" was not met.[149] Thus, the court held that National Union's refusal to pay policy benefits was reasonable and not in bad faith.[150]

D. *Damages for Breach of the Duty to Settle*

Damages claims arising from an insurer's failure to accept a reasonable settlement offer can be broken down, generally, into three categories: (1) contractual damages; (2) bad faith damages; and (3) punitive damages. The law on each type of claimed damages varies significantly among jurisdictions.[151] This section of the article will discuss the general theories utilized by claimants who pursue such damages. However, specific research should be conducted into each jurisdiction's particular requirements for such claims.

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[141] *Id*. at 840.

[142] *Id.*

[143] *Id.*

[144] *Id*. at 843.

[145] Congleton v. Nat'l Union Fire Ins. Co., 234 Cal. Rptr. 218,222–224 (Ct. App.1987).

[146] *Id*. at 220.

[147] *Id.*

[148] *Id*. at 223–224.

[149] *Id*. at 224.

[150] *Id*. at 224.

[151] Jerry & Richmond, ***s****upra* note 16, at 877.

1. Contractual Damages

"Contractual damages" are not necessarily limited to the policy limits.[152] In circumstances where there has been a demand within policy limits, however, California courts have recognized that a subsequent judgment in excess of policy limits may constitute recoverable contract damages.[153] The scope of recoverable damages based on a breach of contract claim will typically involve an allegation that the insurer's breach of the duty to settle resulted in foreseeable contract damages measured by the judgment in excess of the policy limits.[154]

According to the California Supreme Court in *Comunale*, "[t]he policy limits restrict only the amount the insurer may have to pay in the performance of the contract as compensation to a third person[;] . . . they do not restrict the damages recoverable by the insured for a breach of contract by the insurer."[155] Therefore, because a breach of the duty to settle is effectively a breach of the insurance contract, the proper measure of damages is "the amount which will compensate the party aggrieved for all the detriment proximately caused by the breach."[156] Therefore, in cases where an insured receives a judgment following an insurer's unreasonable refusal of a settlement demand within policy limits, the "allowance of a recovery in excess of the policy limits will not give the insured any additional advantage but merely place him in the same position as if the contract had been performed."[157] The court further ruled that "[a]n action for damages in excess of the policy limits based on an insurer's wrongful failure to settle is assignable whether the action is considered as sounding in tort or in contract."[158] Consequently, it has become commonplace for an insured defendant to assign at least part of any claim it may have against its insurer to the claimant.

In *Critz v. Farmers Insurance Group*, Arnold lost control of his vehicle, and he crashed head-on into Critz's car, severely injuring her.[159] Farmers insured Arnold under a policy that had limits of $10,000.[160] Critz offered to settle the claim against Arnold (before actually filing suit) for the policy limits. The offer was made directly to Farmers, and Farmers did not inform Arnold of the offer. Farmers countered with an offer of $8,250.[161] Arnold was then apparently informed of the offer and its rejection by Farmers, and he entered into an

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[152] Comunale v. Traders & Gen. Ins. Co, 328 P.2d 198, 201-202 (Cal. 1958).

[153] *Id.*

[154] *Id*. at 202.

[155] *Id.* at 201.

[156] *Id.* at 202.

[157] *Id*. (emphasis added).

[158] *Id.*

[159] Critz v. Farmers Ins. Grp., 41 Cal. Rptr. 401, 402 (Ct. App. 1964).

[160] *Id*.

[161] *Id.* at 402–403.

assignment of rights with Critz against Farmers. Arnold also executed a covenant not to execute any judgment in the matter against Critz's personal assets.[162]

Critz sued Arnold, and Farmers defended that action.[163] Farmers then "offered to settle the case for $10,000, but . . . Critz refused."[164] The matter went to trial, and the "defense offered no evidence to exonerate Arnold . . . except evidence tending to show that [Critz's] husband had been under the influence of alcohol at the time of the accident."[165] The jury reached a verdict of $48,000 against Arnold.[166] Critz then filed suit against Farmers for recovery of the excess judgment. Two reports from Farmers' claim office showed that Farmers knew that the underlying matter was a case of "obvious liability," and that the value of the case against Arnold "w[ould] exceed [its] policy limits."[167]

In deciding coverage, the *Critz* court followed the rationale set forth in *Comunale*. First, the *Critz* court noted that Farmers had known that there was a great risk of a recovery beyond its policy limits of $10,000, yet Farmers had rejected a policy limits settlement demand. Under *Comunale*, an unreasonable refusal to settle constitutes a breach of the implied covenant of good faith and fair dealing, subjecting the insurer to liability for the entire amount of the judgment—even if that amount greatly exceeds policy limits. Thus, the *Critz* court found Farmers liable for the judgment.[168]

2. Bad Faith Damages

In addition to the damages that may result for wrongfully disclaiming coverage, an insured may recover attorney's fees for pursuing its coverage claim against an insurer that has acted in bad faith.[169] The leading case for this proposition is *Brandt v. Superior Court*.[170] The *Brandt* court reasoned that

> [w]hen an insurer's tortious conduct reasonably compels the insured to retain an attorney to obtain the benefits due under a policy, it follows that the insurer should be liable in a tort action for that expense. The attorney's fees are an economic loss — damages — proximately caused by the tort. These fees must be distinguished from recovery of attorney's fees qua attorney's fees, such as those

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[162] *Id*. at 403.

[163] *Id.*

[164] *Id.*

[165] *Id.*

[166] *Id.*

[167] *Id.*

[168] *Id.* at 407–408.

[169] Brandt v. Superior Court, 693 P.2d 796, 798–799 (Cal. 1985).

[170] Id.; 1-7 Appleman on Insurance § 7.07.

> attributable to the bringing of the bad faith action itself. What we consider here is attorney's fees that are recoverable as damages resulting from a tort in the same way that medical fees would be part of the damages in a personal injury action. When a pedestrian is struck by a car, he goes to a physician for treatment of his injuries, and the motorist, if liable in tort, must pay the pedestrian's medical fees. Similarly, in the present case, an insurance company's refusal to pay benefits has required the insured to seek the services of an attorney to obtain those benefits, and the insurer, because its conduct was tortious, should pay the insured's legal fees.[171]

However, *Brandt* fees do not extend to costs incurred by an insured in responding to an insurer's unsuccessful appeal of a bad faith award.[172] Nor are such fees recoverable where the insurer acted in good faith in bringing a declaratory relief action to resolve a bona fide coverage dispute.[173]

Insureds can generally recover for emotional distress as a result of bad faith.[174] However, California courts typically limit an insured's ability to recover for negligent infliction of emotional distress in connection with bad faith, as that cause of action usually requires a physical "impact."[175] Although an insurer may be liable for emotional distress for bad faith conduct, such damages are not assignable under California law.[176] However, California courts have held that once an insured assigns its rights under a policy to a third party (including the underlying claimant), the covenant of good faith and fair dealing runs between the insurer and the assignee. Thus, upon assignment, the insurer owes an independent duty of good faith to the assignee, and the breach of such duty can expose the insurer to tort damages including damages for emotional distress.[177]

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[171] *Brandt*, 693 P.2d at 798–799 (Cal. 1985) (internal citations and quotations omitted).

[172] Burnaby v. Standard Fire Ins. Co., 47 Cal. Rptr. 2d 326, 330–331 (Ct. App.1995).

[173] Dalrymple v. USAA, 46 Cal. Rptr. 2d. 845, 861 (Ct. App. 1995).

[174] Fletcher v. W. Nat'l Life Ins. Co., 89 Cal. Rptr.78, 93 (Ct. App. 1970) (allowing individual insured to recover for intentional infliction of emotional distress as part of insurer's breach of the implied covenant of good faith and fair dealing).

[175] *See, e.g.* Soto v. Royal Globe Ins. Co., 229 Cal. Rptr.192, 199(Ct. App.1986). The Soto court explained that

> it is fair to observe, in non-impact cases, that there are only two salient in which liability has been successfully established. One such salient is the so called "direct victim" concept[,]. . . [and] the other is the traumatized bystander scenario. . . . On the facts alleged in the case here [involving insurer bad faith] it would be a massive contortion of logic to describe defendant insurer's action in delaying payment of plaintiff employee's WCAB award as "directed" at the plaintiff family members. Accordingly, we hold that no cause of action was alleged by these plaintiffs.

Id. (internal citations omitted). *But see* Williams v. Transport Indem. Co., 203 Cal. Rptr. 868, 878 (Cal. Ct. App. 1984) (recognizing potential for recovery for emotional distress for insurer bad faith).

[176] Murphy v. Allstate Ins. Co., 553 P.2d 584, 587 (Cal. 1976).

[177] Hand v. Farmers Ins. Exch., 29 Cal. Rptr. 2d 258, 263–264 (Ct. App. 1994).

Florida law presents noteworthy conclusions regarding assignments. Stipulated judgments involve an agreement whereby the insured assigns its bad faith claims against the insurer to the claimant who agrees to collect on the judgment from only the insurer, leaving the insured's personal assets untouched.[178] In Florida, for example, "if, prior to any valid assignment of the insured's bad faith claim, the injured party releases the insured from any further liability for the excess damages that are alleged to have resulted from the bad faith of the insurer, the bad faith claim is extinguished."[179]

When an insured assigns the rights to his bad faith claim to another party, the insured still retains a duty to cooperate with appointed counsel.[180]

3. Punitive Damages

Whether insurer bad faith may result in liability for punitive damages varies by jurisdiction. Consequently, insurers should research the applicable law in any jurisdiction where a punitive damages claim accompanies a claim for contractual and bad faith damages arising from the insurer's purported failure to accept a demand within policy limits.

California permits punitive damages awards against insurers, provided that the insurer's conduct was more egregious than ordinary "bad faith."[181] There must be evidence that the insurer engaged in "intentional," "willful" or "conscious" wrongdoing of a "despicable" or "injurious" nature.[182] Specifically, there must be "clear and convincing evidence" of oppression,[183] fraud,[184] or malice[185] within the meaning of California Civil Code section 3294(a).[186] The clear and convincing standard requires that the evidence be "so clear as to

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[178] Schmidt, *supra* note 3, at 720.

[179] Clement v. Prudential Prop. & Cas. Ins. Co., 790 F.2d 1545, 1548 (11th Cir. 1986) (citing Fide. & Cas. Co. v. Cope, 462 So.2d 459, 459 (Fla. 1985)).

[180] *See* Patrick E. Shipstead & Scott S. Thomas, *Comparative and Reverse Bad Faith: Insured's Breach of Implied Covenant of Good Faith and Fair Dealing as Affirmative Defense or Counterclaim*, 23 Tort & Ins. L.J. 215, 218–221 (1987); 1 Corbin on Contracts § 47.05.

[181] For a detailed discussion of punitive damages in this context, see Michael J. Brady, *Insurance Bad Faith and Punitive Damages*, 58 Fed'n Def. & Corp. Counsel. Q. 405 (2008).

[182] College Hosp., Inc. v. Superior Court, 882 P.2d 894, 904 (Cal. 1994) (citing Cal. Civ. Code § 3294 (b) (West 1997)).

[183] "Oppression" is defined as "despicable conduct that subjects a person to cruel and unjust hardship in conscious disregard of that person's rights." Cal. Civ. Code § 3294(c)(2) (West 1997).

[184] "Fraud" is defined as "an intentional misrepresentation, deceit, or concealment of a material fact known to the defendant with the intention on the part of the defendant of thereby depriving a person of property or legal rights or otherwise causing injury." Cal. Civ. Code § 3294(c)(3) (West 1997).

[185] "Malice" is defined as "conduct which is intended by the defendant to cause injury to the plaintiff or despicable conduct which is carried on by the defendant with a willful and conscious disregard of the rights or safety of others." Cal. Civ. Code § 3294(c)(1) (West 1997).

[186] College Hosp., Inc. v. Superior Court, 882 P.2d 894, 897 (Cal. 1994) (citing Cal. Civ. Code § 3294(b) (West 1997)).

leave no substantial doubt; sufficiently strong to command the unhesitating assent of every reasonable mind."[187]

The same evidence that proves a defendant's tortious conduct (bad faith or some other tort) may be relevant to the issue of punitive damages; however, punitive damages awards require a higher standard of proof. Thus, a "marginally sufficient case of bad faith is not likely to prove malice or oppression by clear and convincing evidence."[188] "Something more than the mere commission of a tort is always required for punitive damages."[189] California courts have therefore held that the insurer's conduct must be "evil, criminal, recklessly indifferent to the rights of the insured, or with a vexatious intention to injure" for an award of punitive damages.[190] Moreover, a mere recital of the words "fraudulent" or "bad faith" is insufficient under Civil Code Section 3294. The specific facts supporting a claim for punitive damages must be specifically pleaded and, if proven, must present clear and convincing evidence of oppression, fraud, or malice. Where the required malice, oppression or fraud is stated in conclusory terms only, a valid claim for punitive damages has not been stated.[191]

III.
The Duty to Defend

Unlike the duty to settle, the duty to defend is a contractual obligation derived from the language of the policy itself.[192] "The duty to defend is broader than the duty to indemnify."[193] Under this duty, insurers are obligated to defend even frivolous or groundless claims that fall within coverage.[194] The California Supreme Court has explained that

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[187] Mock v. Mich. Millers Mut. Ins. Co., 5 Cal. Rptr. 2d 594, 610 (Ct. App. 1992).

[188] Shade Foods, Inc. v. Innovative Prods. Sales & Mkt., Inc., 93 Cal. Rptr. 2d 364, 408 (Ct. App. 2000). *See also* Tomaselli v. Transamerica, Inc. 31 Cal. Rptr. 2d 433, 443–444 (Ct. App. 1994); *Mock*, 5 Cal. Rptr. 2d at 607–610.

[189] *Mock*, 5 Cal. Rptr. 2d at 607. *See also* Neal v. Farmers Ins. Exch., 582 P.2d 920, 986 (Cal. 1978).

[190] Tomaselli v. Transamerica Ins. Co., 31 Cal. Rptr. 2d 433, 445 (Ct. App.1994). *See also* Food Pro Int'l, Inc. v. Farmers Ins. Exch., 89 Cal. Rptr. 3d 1, 15–16 (Ct. App. 2008).

[191] Grieves v. Superior Court, 203 Cal. Rptr. 556, 560 (Ct. App. 1984) ("The mere allegation that an intentional tort was committed is not sufficient to warrant an award of punitive damages. Not only must there be circumstances of oppression, fraud, or malice, but facts must be alleged in the pleading to support such a claim."); Brousseau v. Jarret, 141 Cal. Rptr. 200, 205 (Ct. App.1977) ("[T]he second count's conclusory characterization of defendant's conduct as intentional, willful and fraudulent is a patently insufficient statement of 'oppression, fraud or malice, express or implied' within the meaning of Section 3294."); *see also* Food Pro Int'l, Inc. v. Farmers Ins.Exch., 89 Cal. Rptr. 3d 1, 17 (Ct. App. 2008) ("In short, [the plaintiff] failed to present clear and convincing evidence of tortious conduct that would justify the imposition of punitive damages. We therefore find no error in the trial court's summary adjudication of the punitive damages claim.")

[192] Jerry & Richmond, *supra* note 16, at 826.

[193] Powerine Oil Co., Inc. v. Superior Court, 118 P.3d 589, 599–600 (Cal. 2005).

[194] Jerry & Richmond, *supra* note 16, at 826.

> [i]f any facts stated or fairly inferable in the complaint, or otherwise known or discovered by the insurer, suggest a claim potentially covered by the policy, the insurer's duty to defend arises and is not extinguished until the insurer negates all facts suggesting potential coverage. On the other hand, if, as a matter of law, neither the complaint nor the known extrinsic facts indicate any basis for potential coverage, the duty to defend does not arise in the first instance.[195]

A. *Consequences for Breach of the Duty to Defend*

As with the duty to settle, an insurer who breaches the duty to defend may be liable for both contractual and extra-contractual damages. An insurer who breaches the duty to defend may also lose the right to invoke certain conditions or rights under the insurance contract such as the insured's breach of the cooperation clause or the insured's late notice.[196]

1. Contractual Damages

California courts have held that where an insurer has wrongfully failed to defend a claim, it has breached its contract and it will be liable for proximately caused damages.[197] In the absence of bad faith, an insured's recovery is limited to reasonably foreseeable contract damages (*e.g.*, defense fees and costs, within policy limits).[198]

The court in *Comunale* applied this typical contract measure of damages to insurance policies in particular and specifically addressed whether an insurer that breached its duty to defend (not in bad faith) is typically liable for the amount of a judgment in excess of policy limits. The court stated

> [w]here … the only wrongful act of the insurer is the refusal to defend, the liability of the insurer is ordinarily limited to the amount of the policy plus attorneys' fees and costs. In such a case it is reasoned that, if the insured has employed competent counsel to represent him, there is no ground for concluding that the judgment would

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[195] Scottsdale Ins. Co. v. MV Transp., 115 P.3d 460, 466 (Cal. 2005).

[196] State Farm Fire & Cas. Co. v. Prive, 684 P.2d 524, 531 (N.M. Ct. App. 1984). *See also* Hartford Accident & Indem. Co. v. Civil Serv. Emp. Ins. Co., 108 Cal. Rptr. 737, 743 (Ct. App.1973); Jerry & Richmond, *supra* note 16, at 861.

[197] Jerry &. Richmond, *supra* note 16, at 851.

[198] Comunale v. Traders & Gen. Ins. Co, 328 P.2d 198, 202 (Cal. 1958). Under California law, this rule is codified by Cal. Civ. Code § 3300 (West 1997), which provides as follows:

> For the breach of an obligation arising from contract, the measure of damages, except where otherwise expressly provided by this code, is the amount which will compensate the party aggrieved for *all the detriment proximately caused thereby*, *or which*, in the ordinary course of things, *would be likely to result therefrom.*

Cal. Civ. Code § 3300 (West 1997) (emphasis added).

> have been for a lesser sum had the defense been conducted by insurer's counsel, and therefore it cannot be said that the detriment suffered by the insured as the result of a judgment in excess of the policy limits was proximately caused by the insurer's refusal to defend.[199]

Thus, the *Comunale* court confirmed that where an insurer's denial of a defense was reasonable, and where the insured defended the underlying action against it through competent counsel, the breaching insurer will typically be liable for defense fees and costs.

The *Comunale* court also included the amount of the policy as an element of the insured's damages. [200] Although not expressly discussed, this appears to refer to the amount of a judgment within policy limits if such judgment were actually covered. This conclusion is supported by the court's discussion in *Pruyn v. Agricultural Insurance Co.*:[201]

> One of the consequences of an insurer's wrongful failure to defend is that it may be bound, in a subsequent suit to enforce the policy . . . by the express or implied resolution in the underlying action of the factual matters upon which coverage turns. If it is not clear from the verdict in the underlying action on what theory the judgment was rendered against the insured, the insurer cannot thereby escape liability for that judgment simply because it was not necessarily based on a theory within the coverage of the policy. . . . "[T]he insurer [which wrongfully fails to defend] is liable [for the amount of the judgment against its insured] whenever the trial in the underlying action involved a theory of recovery within the coverage of the policy and it was not clear whether the jury's verdict was based upon that theory." However, where the issues upon which coverage depends are not raised or necessarily adjudicated in the underlying action, then the insurer is free to litigate those issues in the subsequent action and present any defenses not inconsistent with the judgment against its insured. If, in that subsequent action, it is determined

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[199] *Comunale*, 328 P.2d at 201 ("[T]he liability of the insurer is ordinarily limited to the amount of the policy plus attorneys' fees and costs.").

[200] *Id*.

[201] 42 Cal. Rptr. 2d 295, 302 (Ct. App. 1995).The *Pruyn* decision was based in *Hogan v. Midland National Insurance Co*., 476 P.2d 825, 832–33 (Cal. 1970). The *Hogan* court found that where an insurer has breached its duty to defend, it will be bound in the coverage litigation by the factual findings of the underlying litigation. *Id*. Thus, if the court in the underlying action determined facts that are also at issue in the coverage dispute (*i.e.*, the insured acted negligently, not intentionally), then the insurer cannot re-litigate those facts, and it will be bound by whatever coverage result flows from such facts (*i.e.*, the insurer will be estopped from presenting evidence that coverage is barred due to the insured's intentional acts). *Id*. at 833. However, where the facts at issue in the coverage dispute were *not* determined in the underlying action, then the insurer may litigate those issues in the coverage action and present its coverage defenses. If successful, then the insurer will not be bound by the judgment, and it will owe only the insured's defense fees and costs. *Id*.

that there was no coverage, then the measure of damages for a wrongful failure to defend would be limited to the costs and attorney fees expended by the insured in defending the underlying action.[202]

2. Bad Faith Breach of the Duty to Defend

An insurer's breach of the duty to defend does not constitute a bad faith breach of the implied covenant of good faith and fair dealing in every instance. Rather, "bad faith implies unfair dealing rather than mistaken judgment."[203] "Before an insured can be found to have acted tortiously, *i.e.*, in bad faith, in refusing to bestow policy benefits, it must have done so 'without proper cause.'"[204] As such, an insurer's reasonable breach of contract is insufficient to sustain a finding of bad faith conduct.[205]

California did not formally recognize an independent cause of action for the bad faith breach of the duty to defend until 1996, when the California Court of Appeal directly addressed the issue in *Campbell v. Farmers Insurance Co.*[206] In *Campbell*, Farmers argued that it could not be sued only for a bad faith breach of the duty to defend, because such liability arises only when the insurer has refused to settle a claim that is likely to exceed policy limits.[207] The court noted that an insurer can be held liable for bad faith when it refuses a reasonable settlement demand within policy limits but disagreed that bad faith liability cannot be found absent such refusal to settle, especially in light of the importance that California courts have given the duty to defend.[208]

With regard to the consequences of a bad faith refusal to defend, courts have imposed differing forms of liability based upon the specific nature of the denial and based upon the form of the determination of liability in the underlying matter. For example, many cases involving a bad faith denial of a defense obligation also involve allegations that the insurer unreasonably refused to *settle* the underlying action.[209] In those cases, the courts have stated that it is the refusal to settle that causes the harm to the insured, not the denial of the defense.[210] This is because an insurer's refusal to settle may take place in the context of

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[202] *Pruyn,* 42 Cal. Rptr. 2d at 302 n.15 (internal citations omitted).

[203] Cal. Shoppers, Inc. v. Royal Globe Ins. Co., 221 Cal. Rptr. 171, 201 (Ct. App. 1985).

[204] *Id*. at 200.

[205] *Id*. at 200–201.

[206] 52 Cal. Rptr. 2d 385, 386 (Ct. App. 1996).

[207] *Id*. at 389.

[208] *Id.* at 394.

[209] *See, e.g*., *Howard*, 115 Cal. Rptr. 3d at 54–55; Rider v. State Farm Mut. Auto. Ins. Co., 514 F.2d 780, 784–85 (10th Cir. 1975).

[210] *See, e.g.,* Esicorp, Inc. v. Liberty Mut. Ins. Co., 193 F.3d 966, 971–972 (8th Cir. 1999) ("[A] breach of the duty to defend sounds in contract, while a breach of the duty to settle sounds in tort. Punitive damages are not recoverable . . . for breaches of contract, even where the breach is intentional, willful, wanton or malicious.") (quoting Peterson v. Cont'l Boiler Works, Inc., 783 S.W.2d 896, 903(Mo. 1990)).

cases that it decides to defend or not. Moreover, where an insured defends itself but cannot afford to settle the matter within limits, the insurer's rejection of a settlement demand within limits is the proximate cause of a subsequent excess judgment.[211] Thus, in cases involving both a refusal to defend and a refusal to settle, the analysis is usually focused upon whether the insurer's refusal to settle was unreasonable, and then what damages were proximately caused by the failure to settle.[212]

In *Samson v. Transamerica Insurance Co.*, Vagle was driving his pickup truck and collided with the Samson family's car.[213] Milagrosa Samson was killed, and her husband and two children were injured. Vagle pled guilty to a charge of vehicular manslaughter.[214] Vagle's truck was insured by State Farm for $100,000.[215] Vagle also owned a tractor truck that was licensed by the P.U.C. as a "'radial highway common carrier,' which authorized him to transport property for compensation."[216] The tractor truck was insured by Transamerica for $300,000.[217] The Transamerica policy contained a P.U.C. endorsement that afforded coverage for bodily injury or property damages "resulting from the operation . . . or use of motor vehicles for which a . . . permit is required or has been issued to the insured by the [P.U.C.] regardless of whether such motor vehicles are specifically described in the policy or not."[218] Although not listed on the Transamerica policy, Vagle used his pickup truck in his trucking business.[219]

The Samsons brought a wrongful death action against Vagle.[220] State Farm defended Vagle, but Transamerica did not. State Farm eventually paid the Samsons its policy limits ($100,000), for which the Samsons signed a covenant not to execute against Vagle.[221] Vagle also "agreed to cooperate in a trial of the action against him against him, and to assign to the Samsons any rights against . . . Transamerica."[222] The court held a hearing, during which Vagle did not contest liability or damages. He "presented no defense and did not cross-examine witnesses."[223] The court was informed that Transamerica was the only other interested entity,

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[211] Campbell v. State Farm Mut. Auto. Ins. Co., 840 P.2d 130, 140 n.20 (Utah Ct. App. 1992).

[212] *See, e.g.*, Consol. Am. Ins. Co. v. Mike Soper Marine Serv., 942 F.2d 1421, 1425–1426 (9th Cir. 1991).

[213] Samson v. Transamerica Ins. Co., 636 P.2d 32, 35 (Cal. 1981).

[214] *Id*.

[215] *Id.*

[216] *Id*.

[217] *Id*.

[218] *Id.*

[219] *Sampson,* 636 P.2d at 36.

[220] *Id.*

[221] *Id.* at 37.

[222] *Id.*

[223] *Id*.

and that it was aware of the litigation. The Samsons presented lay and expert witnesses, including damages expert testimony. Based upon the uncontested, one-sided evidence of damages, the court entered judgment for the Samsons in the amount of $725,000.[224]

The Samsons offered to settle the $625,000 claim against Vagle (the $725,000 judgment minus the $100,000 payment by State Farm) with Transamerica for its policy limits, $300,000. Transamerica did not respond, and the Samsons filed a bad faith suit.[225]

In the coverage action, the court first determined that the underlying action was covered by Transamerica's policy. Transamerica then argued that even if there was coverage, it should not be bound by the entire $625,000 judgment, but rather should be allowed to re-litigate the amount of damages. Also, Transamerica argued that it should only be liable up to its policy limits of $300,000.

The *Samson* court disagreed with both of Transamerica's arguments. The court cited the well-settled rule that "[w]here the insurer has repudiated its obligation to defend, a defendant in the absence of fraud may, without forfeiture of his right to indemnity, settle with the plaintiff upon the best terms possible, taking a covenant not to execute."[226]

The court cited the general rule that "an insurer that wrongfully refuses to defend is liable on the judgment against the insured."[227] The court also agreed with the proposition that "an insurer who fails to accept a reasonable settlement offer within policy limits because it believes the policy does not provide coverage assumes the risk that it will be held liable for all damages resulting from such refusal, including damages in excess of applicable policy limits."[228] "Having breached the duty to defend, Transamerica is bound by the resulting judgment against its insured."[229]

IV.
Conclusion

Courts should not permit bad faith in the insurance milieu to become a game of cat-and-mouse between claimants and insurer, letting claimants induce damages that they then seek to recover, whilst relegating the insured to the sidelines as if only a mildly curious spectator.[230]

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[224] *Id.*

[225] *Id*.

[226] *Sampson,* 636 P.2d at 45 (citing Zander v. Texaco, Inc., 66 Cal. Rptr. 561, 568 (Ct. App.1968)).

[227] Gray v. Zurich Ins. Co., 419 P.2d 168,179 (Cal. 1966).

[228] *Samson*, 636 P.2d at 42 (citing Johansen v. Cal. State Auto. Assn. Inter-Ins. Bureau, 538 P.2d 744, 746 (Cal. 1975)).

[229] *Samson*, 636 P.2d at 44.

[230] Peckham v. Cont'l Cas. Co., 895 F. 2d 830, 835 (1st Cir. 1990).

The California Supreme Court has remarked that "attorneys who handle policy claims against insurance companies are no longer interested in collecting on those claims, but spend their wits and energies trying to maneuver the insurers into committing acts which the insureds can later trot out as evidence of bad faith."[231]

Given the increasingly frequent occurrence of insurer "set ups," insurers are wise to be attentive to any policy limits demand and to proactively respond to such demand. By carefully reviewing and investigating claims and being responsive to claimants, insurers can avoid liability and hopefully "set ups" will become a thing of the past.

[231] White v. W. Title Ins. Co., 710 P.2d 309, 328 n.2 (Cal. 1986) (Kaus, J., concurring and dissenting).

Handling Liability and Coverage Claims: Splitting Files, the Duty to Defend, and Ethical Considerations for Lawyers

Edward "Ned" Currie, Jr.
Joseph W. Gill
John G. Farnan
Laura "Megan" Faust

I.
Introduction

Liability insurers are contractually obligated to defend and indemnify their insured's covered claims,[1] but have no duty to indemnify or defend against claims that are clearly excluded by the insured's policy. The insurer's duty to defend is broader than its duty to indemnify.[2] Therefore, a prudent insurer will frequently defend its insured pursuant to a reservation of rights or non-waiver agreement, which permits the insurer to fulfill its duty to defend the insured without waiving its right to later dispute coverage.[3]

A reservation of rights defense virtually always creates a conflict of interest between the insurer and its insured.[4] For example, in the case of an automobile accident, coverage may or may not exist when an insured driver injures a third party. If the injury is caused by the

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[1] Douglas R. Richmond & Darren S. Black, *Expanding Liability Coverage: Insured Contracts and Additional Insureds*, 44 Drake L. Rev. 781, 792 (1996).

[2] *Id*. The duty to defend "is triggered by a complaint that alleges facts which, if established, would support liability." David N. May, *In House Defenders of Insureds: Some Ethical Considerations,* 46 Drake L. Rev. 881, 898 (1998).

[3] Reservation of rights and non-waiver agreements are discussed in Part II.C., *infra*.

[4] Karon O. Bowdre, *Enhanced Obligation of Good Faith: A Mine Field of Unanswered Questions After L & S Roofing Supply Co.*, 50 Ala. L. Rev. 755, 759 (1999).

Edward "Ned" Currie, Jr. is a founding member of Currie Johnson Gaines & Myers, P.A. which has offices located in Jackson and Biloxi, Mississippi. Mr. Currie is a former Adjunct Professor of Law at the Mississippi College School of Law. He is also a frequent lecturer on trial and insurance topics. Mr. Currie's practice covers the range of insurance defense matters. He has tried numerous significant cases in the fields of personal injury, large loss claims, insurance coverage matters, and bad faith. Mr. Currie has served in many leadership positions in local, state and national bar associations. He is currently the Vice President and a member of the Board of Directors of the National Lawyers Association. Mr. Currie is the past president of the Federal Bar Association, Mississippi Chapter and the Mississippi Defense Lawyers Association. He is also a member of the Federation of Defense & Corporate Counsel, the International Association of Defense Counsel, and the Council on Litigation Management. Mr. Currie is listed in The Best Lawyers in America and he was named Lawyer of the Year for 2012 for Insurance Law in the Jackson, Mississippi area.

driver's negligence, coverage probably exists. But if the driver ran the plaintiff off the road on purpose, coverage is excluded because the insured acted intentionally.[5] The insurer and the insured would both benefit from a finding that the insured is not liable. If the insured *is* found liable, however, the insured would prefer that he is liable for negligence—which is covered by the policy—while the insurer would prefer a finding that the insured acted intentionally—which is excluded by the policy—so that it does not have to indemnify the insured.[6] "Further, when defending covered and potentially non-covered claims, the insurance company through defense counsel representing the insured may learn confidential information from the insured that could affect the coverage question."[7]

When coverage is uncertain or disputed, insurers must address three overlapping considerations. First, the insurer must decide whether to "split the file." More specifically, the insurer must decide if and when it should have one claims adjuster investigate and handle the question of whether (and to what extent) the insured is liable to the plaintiff, while as-

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[5] *See, e.g.*, Lee R. Russ & Thomas F. Segalla, 7A Couch on Insurance. § 103:25 (3d ed. 2011) ("Many liability policies specifically exempt from coverage damage which is 'expected or intended.' Such exclusions are valid. In this context, 'expected' means 'considered more likely than not to occur' rather than 'foreseen as being possible.'").

[6] Bowdre, *supra* note 4.

[7] *Id*. at 759-760.

Joseph W. Gill is an associate in the Jackson, Mississippi office of Currie Johnson Griffin Gaines & Myers, P.A. He was admitted to practice in Mississippi after receiving his law degree from the University of Mississippi School of Law in 2007. While in law school, Mr. Gill was an Associate Editor for the Mississippi Law Journal, Vice Chairman of the Moot Court Board, and a member of Phi Delta Phi and the Christian Legal Society. Mr. Gill is a recipient of the Mississippi Bar Foundation Scholarship and American Jurisprudence Awards in Torts, Evidence, and Family Law. He is also a member of the Order of Barristers. Mr. Gill primarily practices in the areas of insurance coverage and personal injury defense.

signing another claims adjuster to investigate whether a successful coverage defense can be asserted by the insurer. Second, the insurance company must anticipate that someone may seek discovery of the insurance company's files if the insured (or the insured's assignee) files a bad faith claim or a similar type of lawsuit against the insurer. Third, attorneys who are involved in cases where coverage is unclear must be especially careful when assessing their ethical obligations in the context of the tripartite relationship between the insurer, the insured, and defense counsel. Duties of confidentiality and loyalty and obligations regarding client communications must be satisfied. Those goals can be more readily achieved if the insurance company makes good decisions regarding how and when to split files between indemnity and coverage and maintains adequate separation between the files as the claim progresses towards resolution.

Knowing how to effectively manage conflicts of interest is crucial because coverage questions can arise at any point between when the insurer first receives notice of a claim until the claim is resolved. The resolution of coverage issues may not occur until the insurer or insured seeks a declaratory judgment, a trial on the underlying claim occurs, or possibly even later when bad faith litigation against the insurer is concluded. Depending on the jurisdiction, an insurer who fails to effectively manage these inevitable conflicts may be estopped to deny coverage and forced to indemnify the insured, or could be held liable for damages for bad faith breach of the insurance contract.[8]

This Article will provide insurers and defense counsel with practical advice for how to effectively manage conflicts of interest. Part II of this Article will introduce the typi-

[8] *See, e.g.,* Allan D. Windt, *Bad faith and punitive damages*, 2 Insurance Claims & Disputes § 9:26 (5th ed. 2011).

John G. Farnan is a partner in the Cleveland office of Weston Hurd LLP. His practice focuses largely on insurance coverage and related litigation as well as defense of significant personal injury and wrongful death matters and construction litigation. Mr. Farnan lectures and publishes frequently on insurance coverage matters. He is a board member and the current and past president of the National Lawyers Association. Additionally, he served the Ohio Association of Civil Trial Attorneys as a board member from 2003 to 2009 and served as Chair of the Insurance Section from 2004 to 2009. Mr. Farnan is a member of the Federation of Defense & Corporate Counsel. In addition to being named an Ohio Super Lawyer for Appellate Law in 2004 and for Insurance Coverage every year since 2007, Mr. Farnan has been listed in the Best Lawyers in America in 2011 and 2012 for Personal Injury Litigation.

cal conflicts of interest that arise when an insurer disputes coverage, and explain how the insurance company should handle its duty to defend the insured. Part III provides practical advice regarding splitting files and assigning duties to claims handlers so that one file contains information regarding the insured's potential liability and defenses and the other file contains information regarding coverage defenses that the insurer may assert. Part IV addresses discovery of the insurance company's files. Finally, Part V will provide an overview of ethical considerations for defense counsel and explains how splitting the file into an "indemnity/defense" file and a "coverage" file can prevent or at least minimize conflicts of interest.

II.
Defending the Insured While Reserving the Right to Deny Coverage at a Later Date: Conflicts of Interest

Liability insurance companies owe their insured a duty to defend their insured against all potentially covered claims.[9] However, the scope of this duty may vary depending on the phase of the lawsuit. This section will discuss the insurer's obligations before and after a lawsuit has commenced, and tactics that protect insurers when conflicts of interest arise.

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[9] Insurers also owe their insured a duty to investigate all claims. *See, e.g.,* Lee R. Russ & Thomas F. Segalla, 14 Couch on Insurance § 198:28 (3d ed. 2011) ("An insurer's duty of investigation is generally construed to require sufficient investigation to determine coverage under the policy in question. The duty therefore requires that the insurer investigate before it denies or settles a claim, and before it makes a determination as to its duty to defend.").

Laura "Megan" Faust is a partner in the Akron office of Roetzel & Andress. Ms. Faust focuses her national practice on insurance coverage analysis; counseling and litigation, including first party and third party matters; employment matters; and construction, life, disability, and professional liability insurance issues. She has partnered with a wide-range of clients, including major corporations, nationwide and she also counsels and defends clients on bad faith cases. In addition to extensive trial work throughout Ohio, Ms. Faust has extensive experience handling appellate cases including advising trial counsel and briefing and arguing state appeals in Ohio and federal appeals before the Sixth and Eleventh Circuit Courts of Appeal. Ms. Faust is a member of the Federation of Defense & Corporate Counsel, the Council on Litigation Management, the Order of the Barristers, the Professional Underwriting Society (PLUS), USLAW Network, the Ohio Association of Civil Trial Attorneys, and the Ohio Women's Bar Association. She is a Board Member for The Arthritis Foundation, Great Lakes Region of Northeast Ohio; the College of Wooster, W Association; and the Greater Cleveland Council of Figure Skating Clubs. Ms. Faust has been selected as an Ohio Super Lawyer in Insurance coverage (2009-2012), Top 50 Female Lawyers in Ohio (2010-2011), Top 25 Female Lawyers in Cleveland (2009), Rising Star (2005-2006). She was also selected for inclusion in The Best Lawyers in America for Insurance Law and Professional Malpractice Law for 2007-2012.

A. *The Insurer's Obligations Before a Lawsuit Has Commenced*

Before being sued, an insured may notify the insurer of an accident that may give rise to a claim under a policy. At this point, there is no conflict between the insurer's obligation to defend and indemnify the insured and its position that the potential claim is not covered by the policy. The insurer may investigate the accident for the purposes of determining whether its insured is potentially liable for damages and whether its duties to indemnify or defend the insured will attach. One claims handler may be assigned to investigate all of these issues and that handler can inform the insured whether the claim is covered under the policy.

B. *The Insurer's Obligations After a Lawsuit Has Commenced*

Once a lawsuit is filed against the insured—especially if the complaint is the first notice of the claim—the insurer may not have sufficient time to investigate whether the claim is covered. Instead, the insurer will have to decide whether to provide a defense based on the

allegations in the complaint. As a practical matter, this means that the insurer will usually be obligated to defend the claim. "A liability insurer must . . . defend its insured if the plaintiff's allegations are even arguably or potentially within the scope of coverage."[10] Generally, any doubts regarding coverage are resolved in favor of the insured, and judicial decisions exhibit several rules of interpretation that illustrate this preference:[11]

> First, the complaint against the insured will be "liberally construed." Second, ambiguous language in the written insurance policy will be construed against the drafter of the policy - invariably the insurer. Third, where appropriate, an insurance policy may be viewed as an adhesion contract, and in such cases the reasonable expectation of the insured will prevail over the express terms of the policy. In any case, the final determination of the duty to defend is said to be a matter of law for the courts to decide.[12]

Therefore—unless it is absolutely clear that a particular claim is not covered—the prudent course of action is to undertake the defense of the insured, pursuant to a reservation of rights or non-waiver agreement.

C. *Reservation of Rights and Non-Waiver Agreements Can Protect an Insurer Both Before and After a Lawsuit Has Commenced*

Normally, an insurer who undertakes the defense of its insured waives its right to later contest coverage.[13] However, an insurer can preserve its right to contest coverage by having the insured sign a *non-waiver agreement* or by sending the insured a *reservation of rights* letter in a timely manner.[14] A reservation of rights letter informs the insured that the insurer will undertake the defense of the insured, but reserves its right to challenge coverage.[15] A reservation of rights is unilateral: in the typical case, the insurer sends a letter to the insured that explains the reason it disputes coverage, and in states requiring *Cumis* counsel, informs

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[10] *Id*.

[11] Guy William McRoskey, *The Rule in a Contribution Action Between Third-Party Insurers Wherein the Plaintiff Insurer Seeks Reimbursement of Defense Costs from the Defendant Insurer After a Collusive Fraud on the Plaintiff Insurer Under California Law*, 36 San Diego L. Rev. 797, 810–811 (1999).

[12] *Id*.

[13] May, *supra* note 2, at 898 ("If an insurer silently accepts the duty to defend, that acceptance is generally seen as an acknowledgment of coverage." *Id.*).

[14] Gregory P. Deschenes & Kurt M. Mullen, 1-11 New Appleman Insurance Law Practice Guide 11.11[2] (2011).

[15] Bowdre, *supra* note 4 at 755 n.4.

the insured of its right to obtain independent counsel at the insurer's expense.[16] In contrast, a non-waiver agreement is a bilateral contract between the insurer and insured "in which the *insured acknowledges* that the insurance company does not waive its right to challenge coverage."[17] Both methods specifically delineate the reasons the insurer currently has doubts about coverage and notify the insured that it will be informed if other reasons to deny coverage are discovered in the future,[18] and both methods can be used either before or after a lawsuit is commenced.[19]

In general, non-waiver agreements and reservation of rights letters have the same effect[20] and serve the same purpose: they allow the insurer to investigate claims and provide a defense to the insured without foregoing its right to later dispute coverage. Both are favored by courts because they permit an expeditious resolution of tort litigation.[21] One court remarked that

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[16] *Id. Cumis* counsel refers to counsel chosen by the insured to represent its interests exclusively, where a conflict of interest exists, while being funded by the insurer under a reservation of rights. The term derives from *San Diego Navy Fed.Credit Union v. Cumis Ins. Society, Inc.*, 208 Cal. Rptr. 494 (Ct. App. 1984). A significant number of courts in other jurisdictions have followed the precedent set in *Cumis*. *See, e.g.,* CHI of Alaska, Inc. v. Employers Reinsurance Corp., 844 P.2d 1113, 1120 (Alaska 1993) (citing to *Cumis*, among other cases, as authority for the proposition that other jurisdictions require the insurer have the right to select independent counsel when the insurer represents the insured under a reservation of rights); Arden J. Olson, *When Will Oregon Courts Face the "*Cumis *Counsel" Question?: Insurance Counsel Conflict of Interest*, Or. St. B. Bull., August/September 2008, at 36 (stating that *Cumis* is the "leading case" on situations where the lawyer may have a conflict of interest by representing both the insured and the insurer). *See also* Gregory P. Deschenes & Kurt M. Mullen, 1-11 New Appleman Insurance Law Practice Guide 11.11[1][e] (2011).

[17] Bowdre, *supra* note 4 at 755 n.4 (emphasis added).

[18] It is important that the insurer provides thorough reasons for doubting coverage; giving incomplete reasons for doubting coverage could later be construed as a waiver of the coverage defenses that are not specified. *See, e.g*., Founders Ins. Co. v. Olivares, 894 N.E.2d 586, 594 (Ind. Ct. App. 2008); Royal Ins. Co. v. Process Design Assoc., Inc. 582 N.E.2d 1234, 1242 (Ill. App. Ct. 1991).

[19] For example, before an investigation begins, a cautious insurer will send the insured a reservation of rights letter explaining that the insurer's investigation of the facts reported by the insured is not a waiver or a relinquishment of the insurer's right to subsequently contend that the situation under investigation is not covered by the policy. Similarly, where an insurer must base its coverage decision on the allegations in a complaint, in most cases the insurer should provide the insured with a defense and can also reserve its right to deny coverage at a later date. The timing of the issuance of a reservation of rights or non-waiver agreement is critical. If an insurer delays in the issuance of a reservation of rights or assumes the defense absent a reservation it may be deemed to have waived its coverage defenses, particularly if an insured can later show prejudice thereby.

[20] Draft Systems, Inc. v. Alspach, 756 F.2d 293, 296 n.2 (3d Cir. 1985).

[21] *Id.* at 296.

> [i]n many instances, the validity of policy defenses requires protracted investigation. If coverage is not determined at the time the claimant files suit, both the insured and the carrier are at a disadvantage. If the insurance company fails to provide a defense, the claimant may enter a default judgment against the insured. If, however, the company affords representation without some understanding with the insured, the carrier may later be estopped to assert an otherwise valid coverage defense. From the insured's standpoint, the prospect of a default judgment is unacceptable, as is the perhaps unnecessary expense of retaining competent counsel on short notice.
>
> To accommodate the concerns of both the insured and the carrier, the practice of using a non-waiver agreement has developed. This practice not only serves the interests of the parties to the insurance policy but is helpful to claimants and the courts as well because the claimant's tort litigation may proceed expeditiously. Indeed, in most instances, the coverage issues are amicably resolved along with the tort claims. It is unlikely that such settlements would be reached if the carrier could not reserve its right to ultimately disclaim liability.[22]

D. *The Insured's Right to Independent Counsel*[23]

When an insurer defends its insured under a non-waiver agreement or a reservation of rights, three conflicts of interest may potentially arise:

> (1) the insurer may steer the defense so as to make the likelihood of a plaintiff's verdict greater under an uninsured theory; (2) the insurer may offer a less than vigorous defense if the insurer knows that it can later assert non-coverage, or if it thinks that the loss it is defending will not be covered under the policy; and (3) the insurer might gain access to confidential or privileged information, which it might later use to its advantage in litigation concerning coverage.[24]

In some states, the insurer must permit the insured to select his or her own individual counsel with the fees and costs to be paid by the insurer whenever one of these conflicts is potentially present.[25] As noted above, independent counsel selected by the insured is commonly termed *Cumis* counsel.[26]

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[22] *Id.* (citations omitted).

[23] Note that not all states require insurers to provide independent counsel, *i.e.*, *Cumis* counsel, to their insureds when defending under a reservation of rights. As such, the information provided within this section relates only to those states requiring the hiring of *Cumis* counsel.

[24] Armstrong Cleaners, Inc. v. Erie Ins. Exch., 364 F. Supp. 2d 797, 814–15 (S.D. Ind. 2005) (citing CHI of Alaska, Inc. v. Employers Reinsurance Corp., 844 P.2d 1113, 1116, 1118 (Alaska 1993)).

[25] Liberty Mut.Ins. Co. v. Tedford, 658 F. Supp. 2d 786, 794 (N.D. Miss. 2009).

[26] *See supra* note 16.

1. The Insurer Must Inform the Insured of its Right to Independent Counsel

In some states requiring the hiring of *Cumis* counsel, the insurer must inform its insured of the insured's right to seek independent counsel whenever a potential conflict is present. *Liberty Mutual Insurance Co. v. Tedford* illustrates this principle.[27] In *Tedford,* the district court denied the insurer (Liberty Mutual) summary judgment in its action to recoup defense costs paid under a reservation of rights. It was undisputed that the insurer never informed the insured about its right to independent counsel "or any conflicts of interest created by the insurer's defense pursuant to a reservation of rights."[28] The insured had an adverse judgment rendered against it in the underlying tort action,[29] and there was testimony that had Liberty Mutual advised the insured of his right to choose independent counsel, the insured would have selected a different attorney than the one appointed by Liberty Mutual.[30] These facts were sufficient to raise a question of fact regarding whether the insured was prejudiced by this lack of information. Thus, since the insurer failed to inform the insured of its rights to independent counsel, it would be estopped from denying coverage if the insured could demonstrate that it was prejudiced.[31]

If the reservation of rights or non-waiver agreement does *not* create a conflict of interest, the insurer may continue to control the defense. "For instance, if the basis for the reservation does not create any incentive for the insurer to encourage the establishment of liability on a non-covered ground, the independent counsel would be unnecessary."[32] But "[h]ow should courts, insurers, and policyholders distinguish between reservations of rights that create conflicts of interests requiring informed consent by the insured and those that do not?"[33] One court articulated the following standard:

> Whether the potential conflict of interest is sufficient to require the insured's consent is a question of degree that requires some predictions about the course of the representation. If there is a reasonable possibility that the manner in which the insured is defended could affect the outcome of the insurer's coverage dispute, then the conflict may be sufficient to require the insurer to pay for counsel of the insured's choice. Evaluating that risk requires close attention to the details of the underlying litigation. The court must then make a reasonable judgment about whether there is

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[27] 658 F. Supp.2d 786, 795 (N.D. Miss. 2009).

[28] *Id.* at 796.

[29] *Id.* at 797.

[30] *Id.* at 798.

[31] *Id.* at 802.

[32] Deschenes & Mullen, *supra* note 14.

[33] Armstrong Cleaners, Inc. v. Erie Ins. Exch., 364 F. Supp. 2d 797, 807 (S.D. Ind. 2005).

> a significant risk that the attorney selected by the insurance company will have the representation of the insureds significantly impaired by the attorney's relationship with the insurer.[34]

III.
"Splitting the File": Best Practices

Best practices for splitting a file are far from clear, especially due to the fact that there are very few cases that discuss file-splitting in detail, and the few that discuss the issue do not provide bright-line rules that are easy to apply.[35]

One principle is clear, however: in any case where a potential conflict of interest is present, the safer course of action for the insurer is to split the file. Although failure to split a file is not *per se* improper,[36] doing so is a developing standard practice in the insurance industry and is an appropriate mechanism for avoiding the appearance of impropriety.[37] "Insurers that

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[34] *Id*. at 808.

[35] *See, generally,* Steven Plitt & Steven J. Gross, *Splitting Claim Files: Managing the Concern for Conflicts of Interest Through the Use of Insurance Company Conflict Screens*, 32 No. 6 Ins. Litig. Rep. 151 (April 26, 2010).

[36] *See, e.g*., Employers Ins. of Wausau v. Seeno Constr., 945 F.2d 284 (9th Cir. 1991). In that case, the Ninth Circuit Court of Appeals held that the insured's

> argument that most other carriers in the California insurance industry choose to segregate their liability and coverage activities does not establish that it is Wausau's duty to do so. As stated above, the nature of Wausau's duty to its insured does not require such a segregation. The fact that other carriers may choose to segregate does not necessarily arise out of any duty to do so, but may arise from a precautious decision to avoid later complaints of mishandling from the insured.

Id. at 287. This case illustrates that failure to split a file is not *per se* improper; however, it is the position of this Article that the best practice for insurers is to split files to avoid liability whenever a potential conflict of interest is present.

[37] *See, e.g.,* Brent W. Huber and Angela P. Krahulik, *Bad Faith Coverage Litigation: The Insurer's Covenant of Good Faith and Fair Dealing*, 42 Tort Trial & Ins. Prac. L.J. 29, 47 (2006). *See, also, e.g.,* Harleysville Lake States Ins. Co. v. Granite Ridge Builders, Inc., No. 1:06-CV-00397, 2008 WL 4935974, at *11 (N.D. Ind. Nov. 17, 2008) ("Berklich had split the file with another adjuster because he felt it was improper for him to handle both the defense and the coverage issues, knowing that Harleysville needed a full reservation of rights and intended to file a declaratory judgment action."); World Harvest Church, Inc. v. Guideone Mut. Ins. Co., No. 1:07-CV-1675-RWS, 2008 WL 5111218, at *1 (N.D. Ga. Dec. 2, 2008) ("Defendant recognized that there may be coverage issues under the Policy so the file was split, with one claim handler assigned to address the liability issues and one claim handler assigned to the coverage issues."). It should be noted that the district court in *World Harvest* ultimately held that the insurance company was not estopped from denying coverage after defending its insured for eleven months without reserving its rights because insured was not prejudiced. However, this issue was appealed, and the Eleventh Circuit Court of Appeals certified the question to the Georgia Supreme Court. *See* World Harvest Church, Inc. 586 F.3d 950, 961 (11th Cir. 2009). The Georgia Supreme Court answered the certified question, holding that a showing of prejudice is not required for estoppel to apply. World Harvest Church, Inc. v. Guideone Mut. Ins. Co., 695 S.E.2d 6, 12 (Ga. 2010).

fail to establish an adequate conflict screen when their coverage position creates a conflict of interest . . . run the risk of subjecting themselves to significant bad faith liability."[38] Even if bad faith liability is not an issue, depending on the jurisdiction, an insurer that fails to split files runs the risk that it will later be estopped from raising any coverage defenses.[39]

This section will discuss strategies that insurers may employ to avoid potential bad-faith liability or coverage by estoppel, using case law to illustrate the types of situations that insurers frequently confront when a conflict of interest arises.

A. *Timing Issues*

The determination of *when* to split the file frequently depends on when the insurer received notice of the claim. Prior to suit being filed on a claim, there is generally no need to split a file between coverage and defense. If the insurer has advised the insured of potential coverage issues and reserved its rights in a timely manner, the insurer is entitled to request and use any information provided by its insured in order to investigate liability and coverage. The insured generally has a contractual duty to cooperate with its insurer's investigation.

In contrast, after the suit is filed, the insurer's duty to defend may conflict with the insurer's position on coverage, resulting in the need to split the files. When an insurer's first notice of a claim is the complaint in the underlying action, the insurer may not yet recognize any potential conflict. Further, the insurer usually does not have enough time to make an informed decision on its duty to defend before the answer is due.

In these circumstances, the insurer should conduct an investigation for liability and coverage under a reservation of rights. An insurer may take one of two courses to manage potential conflicts of interest. First, the insurer can maintain one claim file and ask the insured's personal counsel (if such exists) to answer the complaint while the insurer continues to investigate coverage. Alternately, the insurer can retain defense counsel to answer the complaint and defend under a reservation of rights.[40] In the second situation, an insurer must decide whether it is prudent to split the file between coverage and liability/defense.

Regardless of when the insurer first receives notice of the claim, the safer course, if potential for no coverage exists, is to split the file. This course of action protects the interests of the insured and the insurer.

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[38] Huber & Krahulik, *supra* note 37, at 48-49.

[39] *See e.g.,* Twin City Fire Ins. Co. v. City of Madison, Miss., 309 F.3d 901, 908 (5th Cir. 2002).

[40] Defense counsel retained by the insurer to defend the insured under a reservation of rights must withdraw from the representation of the insured when the insured selects independent counsel in jurisdictions following *Cumis*. Moreover, to the extent that the defense attorney selected by the insurer represents both the insurer and the insured, "if during the representation of both parties a conflict of interest arises, defense counsel should withdraw from representation of either if there is any possibility that representing one and not the other may be injurious to the client the attorney ceases to represent." Moeller v. Am. Guar. & Liab. Ins. Co., 707 So. 2d 1062, 1070 (Miss. 1996).

B. *The Respective Roles of the Coverage Adjuster and the Defense Adjuster*

If an insurer determines that splitting a file is appropriate, the best way to accomplish this is by maintaining absolute separation between the coverage and defense files. Personnel working on the files should be prohibited from communicating with each other. In cases where a lawsuit is filed on an existing claim, a best practice is for the adjuster who had the file prior to suit to keep the liability/defense file, and for the insurer to appoint a separate adjuster to handle coverage issues. The separation between the files "must actually and sufficiently protect the policyholder's interest and must not be established as a mere formality."[41] Maintaining appropriate boundaries between the coverage adjuster and defense adjuster throughout all stages of the investigation of a claim is crucial.

1. Use of Information Obtained from the Insured

Whether the coverage adjuster may use information obtained from the insured prior to suit being filed often depends on whether the insurer has provided the insured with prompt, pre-suit notice of coverage issues. If notice has been provided, then the coverage adjuster may access pre-suit information from the insured (or elsewhere) to determine coverage and to plan the defense of the coverage claim. However, the failure to timely reserve rights, as previously discussed, may, depending on the jurisdiction, be deemed a waiver of certain coverage defenses by the insurer.

Once suit is filed and the file is split, the defense adjuster should not participate in coverage determinations, and the coverage adjuster should not participate in the direction of the defense of the underlying claims.[42]Assuming that the insurer hires *Cumis* counsel, defense counsel should not disclose to the insurer (including the defense adjuster) confidential information that could result in a denial of coverage to the client, the insured. If defense counsel provides such confidential information to the defense adjuster, the defense adjuster should not pass the information along to the coverage adjuster.[43]

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[41] Huber & Krahulik, *supra* note 37, at 48. *See also* Armstrong Cleaners, Inc. v. Erie Ins. Exchange, 364 F. Supp. 2d 797, 817 (S.D. Ind. 2005) (addressing insufficiency of "Chinese wall" erected between front-line adjusters).

[42] However, the coverage adjuster may request information from the defense adjuster to the extent that such information is public or on the official record, *e.g.* court filings, deposition transcripts, expert reports, etc.

[43] Where *Cumis* counsel voluntarily discloses such confidential information to the adjuster where a file is not split, the sole adjuster may not be precluded from using the information in formulating the insurer's coverage position. *See, e.g.,* Travelers Indem. Co. v. Page & Assocs. Const. Co., No. 07-01-0022-CV, 2002 WL 1371065, at *10 (Tex. Ct. App. June 25, 2002) (holding that sole adjuster in an un-split file did not act inappropriately by using information [requested and] voluntarily provided by defense counsel in his coverage analysis); State Farm Fire & Cas. Co. v. Superior Court, 216 Cal. App. 3d 1222, 1227-28 (Ct. App. 1989) (holding that *Cumis* counsel was not required to provide "privileged materials relevant to coverage disputes" to sole adjuster in an un-split file and that defense counsel "must have assumed that communications to [the adjuster] were the same as communications to [the insurer] itself").

2. Settlement Negotiations

Settlement issues can pose a delicate problem in split-file cases. At some point in the settlement process, a decision-maker for the insurance company must have the opportunity to review all the relevant information—including both coverage and defense issues—to determine whether the case should settle.[44] One commentator described the dilemma as "an all or nothing situation":

> The insurance company's inherent duty to give equal consideration to its insured's interests does not resolve this dilemma. . . . Either coverage exists and, therefore, the insurance company has an obligation to protect the insured's interest within the boundaries of policy limits, or, if no coverage exists, the insurance company has no obligation to indemnify the insured. Because the nature of the competing interests present in an "all or nothing" fashion, a strict all encompassing conflict screen militates against the insurance company's ability to settle a potentially covered liability claim.[45]

There are no hard and fast rules regarding when, and at what level, a decision-maker for the insured should review all of the available information to make a settlement decision.[46] However, some basic guidelines can help insurers navigate this potentially difficult decision in split file cases.

First, with respect to the function of liability adjusters in settlement negotiations in split file cases, a best practice is for the liability adjuster to evaluate the exposure and settlement value of the claim as to the insured without regard to any coverage issues. Once this evaluation is made, the liability adjuster can make independent recommendations to the coverage adjuster for settlement authority.

Second, with respect to the function of coverage adjusters in these cases, the coverage adjuster should accept the liability adjuster's assessment or evaluation of the liability and exposure to the insured without question. The coverage adjuster should then review and analyze the claims against the insured which are being settled for determination of coverage. Once this evaluation has taken place, the coverage adjuster should provide whatever settlement authority is appropriate to the liability adjuster in light of the value of the case and the insurer's coverage analysis.

Both adjusters can exchange opinions on settlement, but the coverage adjuster should have the ultimate responsibility to take an accurate position on coverage, to be fair to the

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[44] Plitt & Gross, *supra* note 35.

[45] *Id.*

[46] *See id.*

insured, and to protect the insured's uninsured interests. A division of these responsibilities helps in the defense against a claim that the final decision by the insurance company was unreasonable.[47]

3. Some Crossover May be Acceptable

Although an insurer should ideally maintain absolute separation between the files, some crossover may be acceptable.[48] For example, in *Flynn's Lick Community Center & Volunteer Fire Department v. Burlington Insurance Co.*, a Tennessee court held that an insurance company did not behave improperly despite the fact that there was some technical overlap between the defense and coverage aspects of the claims.[49]

In *Flynn's Lick*, three lawsuits were filed against the insured (Flynn's Lick Community Center) stemming from an accident at a Halloween hay ride event. Flynn's Lick Community Center then filed a claim with its insurer (Burlington).[50] Due to doubts regarding coverage, Burlington defended the Community Center under a reservation of rights.[51] Burlington decided to split the file, and it assigned one adjuster and one attorney to the coverage issue and another adjuster and attorney to the defense of the Community Center.[52]

Coverage counsel determined that there was no coverage, and in turn, the *defense* adjuster informed the Community Center of Burlington's coverage position, and that Burlington intended to file a declaratory judgment action that it had no duty to defend the Community Center.[53] Later, the coverage adjuster and the defense counsel attended a settlement conference in which a settlement agreement was reached.[54] After the conference, the Community Center sought to have the declaratory judgment action dismissed, and in response, the *defense* adjuster submitted an affidavit stating reasons why there was no coverage for the Community Center's claim.[55] The declaratory judgment action was dismissed, and the Community Center's request for attorney fees related to the declaratory judgment was denied.[56]

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[47] *Id.*

[48] The term "crossover" refers to the coverage adjuster's and/or the defense adjuster's "'cross[ing] over' the wall between the defense and coverage aspects of the claim[]." *See* Flynn's Lick Cmty. Ctr. & Volunteer Fire Dep't. v. Burlington Ins. Co., M2002-00256-COA-R3CV, 2003 WL 21766244, at *9 (Tenn. Ct. App. July 31, 2003).

[49] *Id.* at *1. The court was analyzing whether the insurer's conduct complied with the Tennessee Consumer Protection Act. *See generally* Tenn. Code. Ann. § 47-18-101 *et seq*. (2011). It is important to note that insurers may be held to different standards of conduct, depending on the jurisdiction.

[50] *Flynn's Lick*, 2003 WL 21766244, at *1.

[51] *Id.* at *2.

[52] *Id.*

[53] *Id.*

[54] *Id.* at *3.

[55] *Id.* at *4.

[56] *Id.* at *3.

As a result, the Community Center filed a lawsuit against Burlington, alleging that Burlington acted in bad faith and in an unfair or deceptive manner by allowing the defense and coverage agents to "cross over."[57] First, the Community Center argued that it was improper for the *defense* adjuster to send a letter stating that Burlington was denying coverage.[58] Burlington responded by saying that the adjuster was simply sending an updated reservation of rights letter, which was a common practice.[59] The Community Center also argued that it was improper for the *coverage* counsel to attend the settlement conference with the accident victims.[60] Burlington responded by saying that this action "constituted a type of 'crossing over' from the coverage side to the defense side of the proverbial 'wall,'" but that it was permissible since the coverage counsel "was essentially waiving the coverage defense by agreeing to pay Flynn's Lick's claim and, thus, was justified in breaching the wall."[61] Finally, the Community Center argued that it was improper for the *defense* adjuster to file an affidavit in the declaratory judgment suit stating that coverage did not exist and that this action was "irreconcilable with her duty to represent the interests" of the Community Center.[62]

A jury found for Burlington and the Tennessee Court of Appeals upheld this finding.[63] The court held that Burlington had introduced enough evidence to provide "a cogent explanation for its actions and decisions."[64] Although the court does not give any further insight into why it upheld the jury's action, or what it would consider to be an improper cross over, the case does give an initial starting point to determine what actions are permissible by the coverage and liability representatives.

C. *Splitting the File: The Role of Independent Counsel*

When determining whether to split a file, one relevant consideration is whether the insured will be provided with independent counsel. As the following discussion demonstrates, providing *Cumis* counsel is a wise—and frequently, required—move whenever a potential conflict of interest is present. Although splitting a file will not relieve the insurer's duty to provide independent counsel, providing independent counsel may render splitting a file unnecessary. Where an insurer neither provides independent counsel *nor* splits a file when a conflict of interest is present, the insurer may face a risk of being estopped from denying coverage—or even bad-faith liability, depending on the jurisdiction at issue.[65]

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[57] *Id.*

[58] *Id.* at *5.

[59] *Id.*

[60] *Id.*

[61] *Id.* at *5.

[62] *Id.* at *4.

[63] *Id.* at *9.

[64] *Id.*

[65] *See, e.g.,* Windt, *supra* note 8.

1. Splitting a File Does Not Eliminate the Insurer's Duty to Provide Independent Counsel When a Conflict of Interest is Present

Splitting a file is not an adequate substitute for providing the insured with appointment of independent counsel if the situation and the laws of the particular state at issue so require. For example, in *Armstrong Cleaners, Inc. v. Erie Insurance Exchange*, when the insurer agreed to defend the insured under a reservation of rights, the court held (1) that the insurer was required to pay for an independent attorney and (2) that the insurer's internal policy of constructing a "Chinese Wall" between the two aspects of the case was insufficient to provide the insureds a meaningful defense.[66] The Armstrongs (the insureds) tendered the defense of the underlying liability action to Erie (their insurer). Erie accepted the defense under a reservation of rights but "insist[ed] on using counsel of its own choice to defend the Armstrongs in the underlying lawsuits."[67] The Armstrongs wanted to force Erie to pay for independent counsel, arguing that any counsel hired by Erie would not provide a meaningful defense because some of the issues that would be litigated in the underlying lawsuit were covered by the reservation of rights.[68] Erie argued that splitting the file had adequately addressed any conflict of interest.[69]

The court rejected Erie's argument, noting that even though the adjusters were prohibited from interacting, there was no indication that supervisors "or others who would exercise final authority" on settlement or trial strategy were prohibited from interacting. For example, the court noted that the defense adjuster had a copy of the reservation of rights letter that identified the coverage issues."[70] Based on these facts, the court granted the Armstrongs' motion for summary judgment, and required Erie to pay for independent counsel to represent their insureds.[71] Thus, even without any indication that any commingling did in fact occur, the court upheld the insureds' right to obtain independent counsel.

2. One Jurisdiction Held that Splitting the File May Be Unnecessary if *Cumis* Counsel is Provided

In *State Farm Fire & Casualty Company v. Superior Court*,[72] the court held that as long as the insurer hired independent counsel to represent the insured's interests in the underlying action, the insurer could employ a single claims adjuster to handle both the defense and coverage issues.[73] At the time State Farm accepted the defense of its insureds under a

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[66] 364 F. Supp. 2d 797, 817 (S.D. Ind. 2005).

[67] *Id.* at 801.

[68] *Id.*

[69] *Id.* at 817.

[70] *Id.* at 805.

[71] *Id.* at 817.

[72] 265 Cal. Rptr. 372 (Ct. App. 1989).

[73] *Id.* at 375.

reservation of rights, it agreed to pay the defense costs for their *Cumis* counsel.[74] State Farm then retained its own counsel to pursue an action for a declaratory judgment "to establish the lack of coverage."[75] However, State Farm assigned a single adjuster to manage both cases, and the adjuster "maintained only one file."[76] The adjuster "served in a dual capacity, assisting and communicating with counsel defending [the insureds] in the liability case, and at the same time communicating with and assisting the State Farm counsel asserting lack of coverage in the declaratory relief case."[77] The adjuster communicated State Farm's coverage position to the insured's defense counsel, advising "that not one penny would be offered in settlement, [and] that State Farm was only obligated to provide . . . a 'defense,' because, in his opinion, there was no coverage under the policy."[78] In response to the adjuster's dual role, the insureds argued that merely hiring *Cumis* counsel was insufficient to protect their interests in the liability action.[79]

The court disagreed with the insured, and declined to impose "a veritable wall . . . between the insurance company's administration of the two cases."[80] The court reasoned that the adjuster can be an agent of both the insurer and the insured.[81] When the insurance policy clearly covers the insured, the adjuster becomes an agent of the insured.[82] But when coverage is questionable, the adjuster has divided loyalties.[83] In this situation, *Cumis* counsel is appointed to provide the insured impartial representation.[84] The court rejected the insured's contention that separate adjusters should be assigned for the coverage issue and for insured's interests, stating that because of the increasingly high costs of processing insurance settlements, "it would be unwise to impose yet another layer of administration."[85]

In addition to administrative and cost considerations, the court also noted "recent legislation which affirms the principle stated in *Cumis* that 'privileged materials relevant to coverage disputes' need not be reported to the insurance company."[86] The court held that it is *Cumis* counsel's "obligation to guard against improvident revelations to the insurance

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[74] *Id*. at 373.

[75] *Id.*

[76] *Id.* at 374.

[77] *Id.*

[78] *Id.*

[79] *Id.*

[80] *Id*. at 374.

[81] *Id.* at 375.

[82] *Id.*

[83] *Id.*

[84] *Id.*

[85] *Id.*

[86] *Id*. at 375. (citing Cal. Civ. Code § 2860(d) (1988)).

company" and that *Cumis* counsel must assume that communications to the insurer's adjuster are the same as communications to the insurer itself.[87] So long as *Cumis* counsel is acting in accordance with these legislative and judicially imposed obligations, it is sufficient to protect the insured's interests.

D. *Multiple Insureds*

In *Specialty Surplus Insurance Company v. Second Chance, Inc.*,[88] the court held that an insurer may have acted improperly when, after it split its file between the defense of one of its insureds [employer] and another [employee] as a result of a potential conflict of interest between the two, the insurer engaged in "crossover" using information obtained in one defense file to build coverage defenses against the other insured. In this case, the insurer agreed to defend both insureds under a reservation of rights.[89] At the beginning of the lawsuit against its insureds, the insurer assigned a single adjuster to represent the employer and the employee.[90] The employer's defense to the suit was based on its allegation that the employee acted outside the course and scope of his employment. As noted above, the file was split later so that two defense files existed, one for each insured, due to a potential conflict of interest between the insureds.[91] The employee insured subsequently made a bad faith claim stemming from the conduct of the adjuster handling his defense after the insurer split the defense files of the insureds.[92]

Applying Washington law,[93] the district court held that the "commingling of files of two *defendant-insureds*" had no "bearing on the existence of a conflict of interest between the *insurer* and the *insured [employee]*," nor did it demonstrate that the insurer showed greater concern for its own monetary interests than for its insured's.[94] The court denied the insured's motion for summary judgment with respect to its bad faith claim against the insurer based on its failure to split the file earlier.[95]

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[87] *State Farm,* 265 Cal. Rptr. at 375.

[88] 412 F. Supp. 2d 1152, 1169 (W.D. Wash. 2006).

[89] *Id.* at 1154-55.

[90] *Id.*

[91] *Id.*

[92] *Id.* at 1160–61.

[93] Washington law imposes a duty upon insurers in a reservation of rights defense to "retain competent defense counsel for the insured, and both retained defense counsel and the insurer must understand that only the insured is the client." Johnson v. Cont'l Cas. Co., 788 P.2d 598, 600 (Wash. Ct. App. 1990) (citing Tank v. State Farm Fire & Cas. Co., 715 P.2d 1133, 1137 (Wash. 1986)). It should be noted that it is not entirely clear whether Specialty Surplus retained independent *Cumis* counsel for its insureds.

[94] *Specialty Surplus*, 412 F. Supp. 2d at1169.

[95] *Id.*

Months later, the district court re-examined the insurer's bad faith relating to splitting the file, and held that although the insurer had no duty to split the file earlier than it did, the subsequent "cross-file communications" presented an issue of material fact on whether the insurer acted in bad faith.[96] The court noted that most of the communications at issue were nothing "more than . . . immaterial matter[s] of internal procedure," and that there were also "notes indicating that the separation between the files was occasionally functional."[97] On the other hand, there was evidence that the insurer "improperly used the information garnered from both files to come to the conclusion that it was in Specialty Surplus's best interests to allow the underlying matter [to] proceed to trial, because of its coverage defenses."[98] The notes indicated that the insurer no longer wanted to settle the claim against the employee, since it likely would be able to "assert an effective coverage defense and disclaim coverage after the underlying trial."[99] Thus, *Second Chance* indicates that even if an insurer initially satisfies its duty to avoid conflicts of interest by splitting a file at the appropriate time, a court may refuse to grant the insurer's summary judgment motion if the insurer later "crosses over" and uses information from one insured's the defense file in order to build its coverage defenses with respect to *another* insured in the same litigation.

E. *Splitting the File is the Safer Course of Action*

Splitting the file may limit the insurer's exposure to bad faith claims and coverage by estoppel in jurisdictions recognizing this doctrine. Ultimately, the insurance carrier will be judged with hindsight with respect to (1) if it did not split the file, whether its decision was improper, and (2) if it did split the file, whether it was able to maintain complete separation between the coverage and defense aspects of the case. If a court finds the insurer's actions to be improper under either situation, the insurer may be liable because it failed to defend its insured, may be liable under a theory of bad faith, or may be estopped from denying coverage, depending on which jurisdiction's laws apply. To prevent liability, the best course for the insurer is to split the file and to maintain separation between the coverage and liability aspects of the case.

IV.
Discovery of the Insurer's File Materials

Regardless of whether the file is split, the discovery of claim file materials is routinely an issue in coverage litigation, and jurisdictions vary on what materials are discoverable. The

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[96] Specialty Surplus Ins. Co. v. Second Chance, Inc., No. C03-0927C, 2006 WL 2459092, at *15–17 (W.D. Wash. Aug. 22, 2006).

[97] *Id.* at *16.

[98] *Id.* Specifically, the adjuster for the employee defense file concluded that the employer probably would receive a defense verdict based on a finding that the employee was acting outside the course and scope of employment which would cause a judgment against the employee to have no coverage under the policy. *See id.* at *17.

[99] *Id.* at 16.

following section will explain each of the principles that apply to discovery of an insurer's claim file in coverage disputes:

- In general, in an action to determine whether the insured is liable, the insurer's claim file is not discoverable.
- In an action to determine the insured's coverage under the policy, the insurer's file is considered work product and is not discoverable.
- In bad faith actions against the insurer, some jurisdictions take the position that entire claim file is discoverable, while other jurisdictions find that all or part of the file is protected by attorney-client privilege or the work product doctrine.

A. *Discovery of Claims Files in Underlying Liability Actions*

The discovery of the insurer's claim file generally is not allowed in the underlying liability action against the insured, even where the insurer is joined as a party to the action.[100] According to one commentator,

> [w]hile the claims and underwriting files may be discoverable in the bad faith action, they may not be discoverable during the litigation of the underlying actions. Therefore, the practitioner should seek a bifurcation of the actions and a resolution of the actions separately. It may be preferable to have the underlying action resolved first, but this should be analyzed case by case.[101]

B. *Discovery of Claims Files in Coverage Actions*

Several courts have held that discovery of the insurer's claim file is not allowed in actions to determine whether coverage exists under the policy at issue. The general rule is that "while a coverage issue is pending," discovery of the insurer's claim file is improper.[102] Discovery is improper "because the claims file is the insurer's work product. Moreover, the contents of the file are irrelevant to the question of whether the policy obligates the

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[100] *See* Kraus v. Maurer, 740 N.E.2d 722, 725 (Ohio Ct. App. 2000) ("It is abundantly clear that the claim file being sought is protected by both the 'attorney-client privilege' and the 'work product doctrine.' The file is not being sought in concert with a bad faith claim and, therefore, is not discoverable.").

[101] Lee R. Russ & Thomas F. Segalla, 17A Couch on Insurance § 250:29 (2010).

[102] *See, e.g.*, United Servs. Auto. Ass'n v. Kindl, 49 So.3d 807, 808 (Fla. Dist. Ct. App. 2010).

insurer to defend or indemnify the insured for some particular loss or liability."[103] "When a litigant files claims for both coverage and bad faith in the same action, the insurer's claim file is not discoverable until the issue of coverage has been resolved."[104] For example, the court in *Garg v. State Auto Mutual Insurance Company*[105] held that although insureds were entitled to discovery of certain of the insurer's documents for purposes of their bad faith claim, such materials were not discoverable for purposes of insureds' breach of contract and unfair claims practices claims.[106] Therefore, the court bifurcated the bad faith claim from other claims, and the court stayed discovery in the bad faith claim until resolution of other claims,[107] holding that to require the insurer "to divulge its otherwise privileged information prior to a resolution" of breach of contract and unfair claims practices claims would have unquestionably impacted insurer's ability to defend against them.[108]

C. *Discovery of Claims Files in Bad Faith Actions*

When an insured asserts bad faith claims against its insurance carrier after all coverage issues have been resolved, the insured is generally entitled to discover at least some portions of the insurer's claim file.[109] However, the scope of the documents discoverable is often a source of litigation and varies from jurisdiction to jurisdiction.

1. Position that All Claim File Materials Are Discoverable in Bad Faith Actions

Some jurisdictions hold that all claim file materials are discoverable in bad faith actions. For instance, in *United Services Automobile Association v. Jennings*,[110] the court held that

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[103] Scottsdale Ins. Co. v. Camara De Comercio Latino-Americana De Los Estados Unidos, Inc., 813 So. 2d 250, 252 (Fla. Dist. Ct. App. 2002). *See also* Fed. Ins. Co. v. Exec. Coach Luxury Travel, Inc., Nos. 1-09-17, 1-09-18, 2009 WL 3720556, at *8 (Ohio Ct. App. Nov. 9, 2009) (holding that intervenors failed to demonstrate that underwriting and claims files were relevant to interpretation of insurance contract in declaratory judgment action over coverage), *rev'd on other grounds*, 944 N.E.2d 215 (Ohio 2010).

[104] GEICO Gen. Ins. Co. v. Hoy, 927 So. 2d 122, 125 (Fla. Dist. Ct. App. 2006). *See also* Imperial Cas. & Indem. Co. v. Bellini, 746 A.2d 130, 134–35 (R.I. 2000) (holding that judgment creditor's bad-faith claim against debtor's alleged liability insurer did not entitle the creditor to discovery of the entire claim file prior to resolution of statutory, reformation, estoppel, and waiver claims, as the creditor's need for information in the claim file to prove its bad-faith claim was outweighed by the insurer's need to defend itself).

[105] 800 N.E.2d 757 (Ohio Ct. App. 2003).

[106] *Id.* at 763-64.

[107] *Id.*

[108] *Id.* at 764.

[109] *See* U.S. Fire Ins. Co. v. Clearwater Oaks Bank, 421 So. 2d 783, 784 (Fla. Dist. Ct. App. 1982) (stating that "[i]n a bad faith suit against an insurance company for failure to settle within the policy limits, the plaintiff may obtain discovery of the original claim file").

[110] 707 So. 2d 384, 385 (Fla. Dist. Ct. App. 1998).

an injured third-party claimant who stands in the shoes of the insured with respect to its bad-faith action against the liability insurer[111] is entitled to discover the liability insurer's *entire* claim file on the underlying tort claim up to the date of entry of an excess judgment against the insured or a *Cunningham* stipulation.[112] According to the court in *Jennings*,

> [n]either the settlement agreement between respondents and the insured nor the *Cunningham* stipulation specifically addressed whether respondents would be entitled to discovery of the entire claims file during the third party bad-faith action, notwithstanding any attorney-client or work-product privileges. When respondents sought discovery of the entire claims file during the bad-faith case, petitioner objected on grounds that the requested material was protected by both the attorney-client and work product privileges. The trial court compelled production of the entire claims file over petitioner's objection.
>
> Generally, the third party in a third party bad-faith action stands in the shoes of the insured and is entitled, therefore, to discovery of the insurer's entire claims file on the underlying tort claim up to the date of an excess judgment, notwithstanding any objections from the insurer based on the attorney-client or work product privileges.[113]

The court did not believe the rule would be any different in light of the existence of a *Cunningham* stipulation, but certified the question to the Florida Supreme Court. The appellate court's decision was ultimately approved.[114]

2. Claim File Materials Protected by the Attorney-Client Privilege

Where the attorney in the underlying action represents both the insured and the insurer as joint clients, there is an argument that the attorney-client privilege is inapplicable as between them in a bad faith case. However, with respect to the adjuster's communications with coverage counsel who represents the interests of the insurer exclusively, courts have held that such information is not discoverable. For instance, the discovery of the insurer's com-

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[111] Note that not all jurisdictions allow third-party claimants who are not insureds to bring "bad faith" claims against the putative tortfeasor's insurer absent an assignment from the tortfeasor.

[112] A *Cunningham* stipulation, taking its name from *Cunningham v. Standard Guar. Ins. Co.*, 630 So. 2d 179 (Fla. 1994), is a stipulation in a settlement agreement whereby the insured agrees that the settlement serves as the functional equivalent of an excess judgment and specifically grants the third-party claimant the right to pursue a bad faith claim against the insured's liability carrier in the absence of an actual excess judgment.

[113] *United Services*, 707 So.2d at 384-85.

[114] *See* United Servs. Auto. Ass'n v. Jennings, 731 So. 2d 1258 (Fla. 1999).

munications with coverage counsel was the issue addressed in *State Farm Fire & Casualty Company v. Superior Court*.[115] The court summarized the insureds' argument as follows:

> Their contention, broadly put, is that the adjuster aiding in defense of the liability action is the agent of the insured and the insured's *Cumis* counsel, that the [insureds] and their counsel are entitled to know everything their agent learns, and that they are hence privileged to see everything in the file.[116]

The insureds argued that because the adjuster was their agent, the insurance carrier waived "any attorney-client privilege which might otherwise be available" for communications between it and its coverage counsel.[117] The court reasoned that where the insurer had advised its insured of the conflict of interest resulting from the presence of coverage questions and hired independent counsel of the insured's own choosing, the adjuster was solely acting as the agent of the insurer and not the insured.[118] Thus, the court held that in this insurance bad faith case, the insurer was not required to produce to the insured any communications between the insurer and its coverage counsel as such communications were subject to an attorney-client privilege that had not been waived.[119]

Similarly, in *Lexington Insurance Company v. Swanson*, the district court held that the production of documents was not required.[120] In *Swanson*, the insurer filed an action seeking a declaration of no coverage under its policy, and Sandra Swanson (the injured third-party claimant to whom the insured assigned all of its claims against the insurer) counterclaimed for bad faith.[121] The insurer had not split the file and had not appointed *Cumis* counsel to the insured.[122] With respect to her counterclaim, Swanson argued that she was entitled to discover the sole adjuster's file materials relating to the adjuster's communications with coverage counsel.[123] As in *State Farm Fire & Casualty Company*, the district court held that production of such documents was not required. The court stated the following:

> [The adjuster] was employed as a claims handler by Lexington [the insurer]. In essence, Lexington and its employees had a dual role: (1) they acted on behalf of [the insured] in providing a defense to the underlying tort claim against ICC; and

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[115] 265 Cal. Rptr. 372 (Ct. App. 1989).

[116] *Id.* at 374.

[117] *Id.*

[118] *State Farm,* 265 Cal. Rptr. at 375.

[119] *Id.* at 376.

[120] 240 F.R.D. 662, 670–71 (W.D. Wash. 2007).

[121] *Id.* at 665.

[122] *See id.* at 666.

[123] *Id.* at 668–69.

> (2) they acted on behalf of Lexington in retaining coverage counsel to ascertain Lexington's coverage obligations. As noted earlier, Lexington may assert attorney-client privilege for its communications with coverage counsel. Ms. Swanson provides no authority indicating that this privilege may be defeated because the same Lexington employee acted in the "dual roles" served by the company as a whole. Ms. Swanson cites no case law suggesting that an insurer must have different employees interact with "coverage counsel" and counsel in the underlying tort action in order to preserve its privileges.[124]

Despite the fact that communications with coverage counsel are generally protected from discovery, there are still ways for insureds to obtain the otherwise privileged material. For instance, some insureds have had success with the argument that an insurer's bad faith constitutes fraud such that the attorney-client privilege does not apply when the insurer communicates with an attorney in order to perpetuate a fraud upon the insured.[125] Moreover, despite the protection afforded to communications between the adjuster and coverage counsel, "there is authority that this privilege does not apply to notes and memoranda prepared by a liability insurer's claims supervisor for himself and his supervisor, where the supervisor was not acting at the direction of or for the insurer's attorney and where the documents contained no confidential communications to counsel."[126]

3. Claim File Materials Protected by the Work Product Doctrine

Courts have taken a variety of positions on the question of how much of the claims file is discoverable in light of the work product doctrine. Some courts reject the application of the work product doctrine altogether with respect to bad faith claims against the insurer and thus allow discovery of the insurer's claims file.[127] Other courts apply a case-by-case

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[124] *Id.* at 671.

[125] *See, e.g.,* Hutchinson v. Farm Family Cas. Ins. Co., 867 A.2d 1, 11 (Conn. 2005) (holding that attorney-client privilege would not apply where insured established probable cause to believe that insurer sought advice of counsel to facilitate or conceal its bad faith, even though plaintiffs in the case had not established probable cause); United Servs. Auto. Ass'n v. Werley, 526 P.2d 28, 32–33 (Alaska 1974) (holding that plaintiff could defeat claim of attorney-client privilege between insurer and its counsel where plaintiff made prima facie showing that insurer engaged in bad faith conduct with assistance of counsel).

[126] Russ & Segalla, *supra* note 101 (citing Athridge v. Aetna Cas. & Sur. Co., 184 F.R.D. 181 (D.D.C. 1998); Birth Ctr. v. St. Paul Cos., Inc., 727 A.2d 1144 (Pa. Super. Ct. 1999)).

[127] *See, e.g.,* Diamond State Ins. Co. v. Utica First Ins. Co., 829 N.Y.S.2d 465, 466–67 (N.Y.App.Div. 2007) (stating that "this Court has held that an insurer may not use attorney-client, litigation or work product privileges to shield it from disclosing relevant information in an action predicated on bad faith").

analysis.[128] For example, the Utah Supreme Court acknowledged the various approaches used in analyzing work product doctrines, and found the case-by-case approach best. The court explained,

> in determining whether documents in an insurance claim file were prepared in anticipation of litigation[, t]he trial court should consider the nature of the requested documents, the reason the documents were prepared, the relationship between the preparer of the document and the party seeking its protection from discovery, the relationship between the litigating parties, and any other facts relevant to the issue.[129]

Some courts hold that unless a particular document in the claims file was prepared at the specific direction or request of counsel, the document is discoverable.[130] For instance, the Colorado Supreme Court applied this standard, which was to be applied using a case-by-case approach:

> Because a substantial part of an insurance company's business is to investigate claims made by an insured against the company or by some other party against an insured, it must be presumed that such investigations are part of the normal business activity of the company and that reports 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. This is not to say, however, that under appropriate circumstances an insurance company's investigation of a claim may not shift from an ordinary business activity to conduct "in anticipation of litigation[."] Admittedly, there is no bright line which will mark the division between these two types of activities in all cases. On the one hand a document may be prepared "in anticipation of litigation" prior to the actual commencement of litigation and, on the other, the commencement of litigation is not sufficient by itself to confer a qualified immunity from discovery on a document thereafter prepared. The general standard to be applied is whether, in light of the nature of the document and the factual situation in the particular case, the party resisting discovery demonstrates that the document was prepared or obtained in contemplation of specific litigation.[131]

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[128] State ex rel. Allstate Ins. Co. v. Gaughan, 508 S.E.2d 75, 92 (W. Va. 1998).

[129] Askew v. Hardman, 918 P.2d 469, 474 (Utah 1996).

[130] *See, e.g.,* Hawkins v. Dist. Court, 638 P.2d 1372, 1377 (Colo. 1982) ("Courts generally have held that reports made and statements taken by an insurance adjuster for an insurance company in the normal course of investigating a claim are prepared in the regular course of the company's business and, therefore, not in anticipation of litigation or for trial.").

[131] *Id.* at 1378-79 (citations omitted).

Several courts have held that the work product doctrine has no application to documents created or gathered prior to suit being filed. For example, in *Goodrich Corp. v. Commercial Union Insurance Company*,[132] the court held the insured was entitled to discover even those claim file materials containing attorney-client communications related to coverage that were created prior to the insurer's denial of coverage. The rationale for this decision was that prior to the coverage denial, the claim file materials would not have contained work product, or things prepared in anticipation of litigation, as litigation was not anticipated between the insured and the insurer due to the fact that no position had been taken on coverage.[133]

V.
Ethical Considerations

A defense attorney who is retained by an insurer pursuant to a reservation of rights walks a very fine line. Defense counsel is in a tri-partite relationship with the insurer and the insured.[134] This section will discuss three aspects of the defense attorney's ethical duties: communication within the tri-partite relationship, confidentiality, and loyalty. While both the insurance company and the insured are clients of the defense counsel,[135] defense counsel must protect the insured and is ultimately controlled by the insured's best interests. A lawyer may avoid potential conflicts at the outset, however, by specifically delineating the scope of his or her representation as early as possible in the litigation. The carrier may avoid or minimize the conflicts of interest internally and for its lawyer by splitting files within the insurance company.

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[132] Nos. 23585, 23586, 2008 WL 2581579, at *26 (Ohio Ct. App. June 30, 2008).

[133] *Id. See also* Hurtado v. Passmore & Sones, LLC, No. 10-cv-00625, 2011 WL 2533698, at *4 (D. Colo. June 27, 2011) ("Because there was no actual claim pending when the investigation was undertaken here, nor had Defendant been contacted by Plaintiffs or their counsel about filing a potential claim, I find that the documents and information derived therefrom [in the claim file] are not protected by the work product privilege."); Lawyers Title Ins. Corp. v. U.S. Fid. & Guar. Co., 122 F.R.D. 567, 568 (N.D. Cal. 1988) (holding that handling of claim ceases to be a part of the insurer's "normal course of business" and becomes anticipation of litigation only when lawsuit is filed); Boone v. Vanliner Ins. Co., 744 N.E.2d 154, 156–57 (Ohio 2001) (holding that insured was entitled to discover claim file documents containing attorney-client communications related to the issue of coverage that were created before the denial of coverage).

[134] *See, generally, e.g.,* Douglas R. Richmond, *Walking a Tightrope: The Tripartite Relationship Between Insurer, Insured, and Insurance Defense Counsel*, 73 Neb. L . Rev. 265 (1994).

[135] *See* Moeller v. Am. Guar. & Liab. Ins. Co., 707 So.2d 1062, 1070 (Miss. 1996) ("The attorney selected and employed by the insurance carrier, of course, has an ethical and professional obligation to represent the company. That attorney is the carrier's attorney. This attorney also has an ethical and professional obligation to represent the insured in the defense of the claim, thus representing two separate and distinct clients.").

The attorney's conduct in relation to the client is guided and controlled by the Rules of Professional Conduct. Model Rule 1.2 provides for the scope of representation and allocation of authority between the client and the lawyer: "a lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued."[136] Rule 1.4 concerns client communications:

> (a) A lawyer shall:
>
> (1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e) is required by these Rules;
>
> (2) reasonably consult with the client about the means by which the client's objectives are to be accomplished;
>
> (3) keep the client reasonably informed about the status of the matter;
>
> (4) promptly comply with reasonable requests for information; and
>
> (5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.
>
> (b) A lawyer shall explain the matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.[137]

When a defense lawyer is in a tri-partite relationship, the ethical obligations set forth above may conflict as between duties owed to the insurer client and the insured client. This conflict becomes even more apparent when one considers Rule 1.6(a), which provides that "a lawyer shall not reveal confidential information relating to the representation of the client unless the client gives informed consent."[138]

1. Duty of Confidentiality

Two common issues involving defense counsel's duty of confidentiality are (1) what information should be provided to the insured and the insurer, and (2) what information should be withheld from either. For example, imagine a situation where defense counsel learns something about the insured's actions that may provide a defense for the insurer in

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[136] Model Rules of Prof'l Conduct R. 1.2.

[137] *Id.* at 1.4.

[138] *Id.* at 1.6(a).

a coverage action. Model Rule 1.2 generally requires the lawyer to promptly respond to reasonable requests for information and keep the client (insurer) informed; while Model Rule 1.6 states that the lawyer shall not reveal information relating to the representation of a client (the insured) unless the client gives informed consent. Thus, in this situation, is the lawyer bound to inform the insurer of the insured's conduct based on the duty to keep the client (insurer) informed? Alternatively, is the lawyer prohibited from informing the insurer of the insured's actions based on the lawyer's duty of confidentiality to the insured?

There is a split among jurisdictions regarding the disclosure of this type of confidential information between the insurer and the insured. In some jurisdictions, such as Alabama and Minnesota, the policyholder and the insurer have been considered "dual" or "joint" clients.[139] Joint clients generally have no expectations of confidentiality between themselves with respect to matters on which they are jointly represented.[140] Other states take a different view of the relationship and find that the insured is the "primary" client.[141] But in other states, such as Texas, Montana, Michigan and Connecticut, the law is clear that the policyholder is the only client.[142] These states are referred to as "one-client states"[143] and often there is substantial friction between the insurance carrier's demand for file information and the client's expectation of confidentiality.

2. Duty of Loyalty

In addition to the duty of confidentiality, the attorney also owes a duty of loyalty to his or her clients. Model Rule 1.7 sets forth the attorney's duty of loyalty. "An attorney shall not represent a client if the representation involves a concurrent conflict of interest."[144] The Rule sets forth various scenarios in which a conflict may occur, including one where "there

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[139] *See, e.g.,* Mitchum v. Hudgens, 533 So.2d 194, 200 (Ala. 1988); Shelby Mut'l Ins. Co. v. Klenman, 255 N.W.2d 231, 235 (Minn. 1977).

[140] *See* Austin T. Fragomen, Jr. & Nadia H. Yakoob, *No Easy Way Out: The Ethical Dilemmas of Dual Representation*, 21 Geo. Immigr. L.J. 621, 626 (2007) (stating that "[t]he standard and more reasonable approach has been to view communications with either client as not privileged because consent to disclose has been impliedly authorized by virtue of the agreement to joint representation").

[141] *See, e.g.,* Paradigm Ins. Co. v. Langerman Law Offices, 24 P.3d 593, 602 (Ariz. 2001) (although the insurer was not the "client," the defense lawyer nonetheless owed a duty to the insurer); *State Farm Mut'l Auto v. Federal Ins. Co.*, 86 Cal. Rptr. 2d 20, 24 (Ct. App.1999).

[142] *See, e.g.,* Safeway Managing Gen. Agency, Inc. v. Clark & Gamble, 985 S.W.2d 166, 168 (Tex. App. 1998) (no attorney-client-relationship exists between an insurance carrier and the attorney it hired to defend one of the carrier's insureds); Bradt v. West, 892 S.W.2d 56, 77 (Tex. App. 1998); State Farm Mut'l Auto Ins. Co. v. Traver, 980 S.W.2d 625, 628 (Tex. 1998) (the attorney owes unqualified loyalty to the insured).

[143] *See, e.g.,* Denise Purpura, *Should Insurers in Texas Be Prohibited from Using Staff Attorneys to Defend Third Party Claims Brought Against Insureds?: A Closer Look at American Home Assurance,* 13 Conn. Ins. L.J. 177, 185 (2007).

[144] Model Rules R. 1.7(a).

is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to . . . a third person."[145] If a conflict of interest arises, the attorney must withdraw from representation unless the conflict is one to which a client validly may consent under the requirements of Rule 1.7(b) and each client affected gives informed consent in writing. The lawyer should "proceed in the best interests of the insured . . . and, if applicable, consistent with the lawyer's duties to the insurer as co-client."[146] Under Rule 1.7, if the lawyer cannot work under the direction of the insurer while still advancing the best interests of the insured, then the lawyer must withdraw from representation. He or she may not abide by any insurer instructions that adversely and materially impact the insured.[147]

3. Communications within the Tri-Partite Relationship

As a practical matter, the personnel on the coverage side of the file must know at least as much as the personnel on the defense side or the insurance company can be sued for bad faith if it denies the claim. In this situation, the lawyer is caught on the quintessential "tight-rope" of his or her client loyalties. Information must be shared between the two sides of the file—but it is crucial to do so without the "appearance of impropriety." Sharing information, which may be harmful to the policyholder/client, must be done with care. For example, if the lawyer elicits harmful testimony in depositions, the lawyer should not highlight that testimony to the carrier—he or she should report on the liability aspects of the case. The deposition transcript may be provided to the carrier and the personnel on the coverage side may review it independently.

VI.
Conclusion

Ultimately, the insurance carrier will be judged with hindsight with respect to whether it adequately addressed any conflicts of interest when defending its insured under a reservation of rights or non-waiver agreement. An insurer who fails to properly handle those conflicts that prejudice the insured and favor the insurer may be estopped from denying coverage or held liable under a theory of bad faith.[148] However, these negative outcomes may be avoided by using the best practices discussed in this Article. Insurers with appropriate procedures for monitoring conflicts of interest—including providing their insured with independent counsel where required; splitting-files; and addressing discovery and ethical issues—can rest assured that they are fulfilling all legal obligations to their insured, while also looking out for their own interests.

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[145] *Id.* at 1.7(a)(2).

[146] Restatement (Third) of Law Governing Lawyers § 134, illus. 5 (2000).

[147] *Id.*; Model Rules R. 1.8.

[148] *See* Twin City Fire Ins. Co. v. City of Madison, Miss., 309 F.3d 901, 907-09 (5th Cir. 2002).

The Self-Critical Analysis Privilege: It is Time For Formal Adoption[†]

Kurtis B. Reeg
Matthew A. Temper

I.
Introduction

Commonplace in American jurisprudence is the concept of the right to privacy. Although enjoyed by both you and me as private citizens, this right is not necessarily present in corporate America.[1]

If corporations enjoyed the same privacy rights as individuals do, they could safeguard the results of internal investigations from disclosure in discovery.[2] But the American adjudicative process contains expansive discovery rules that litigants frequently rely upon to gain

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[†] Submitted by the authors on behalf of the FDCC Class Action and Multidistrict Litigation Section. Mark W. Dinsmore II, a former associate at Reeg Lawyers, LLC, assisted in the preparation of an earlier version of this paper.

[1] Cruzan v. Miss. Dep't of Health, 497 U.S. 261 (1990) (privacy right recognized in person's choice to refuse medical treatment); Roe v. Wade, 410 U.S. 113 (1973) (woman's privacy right in choosing to abort fetus); Eisenstadt v. Baird, 405 U.S. 438 (1972) (right to privacy includes use of contraceptives outside marital relationship); Griswold v. Conn., 381 U.S. 479 (1965) (recognizing privacy right in use of contraceptives within marital relationship); Paul v. Virginia, 75 U.S. 168 (1868) (holding that the Privileges and Immunities Clause of the Constitution creates a distinction between corporations and individual citizens), *overruled in part by* U.S. v. South-Eastern Underwriters Ass'n., 322 U.S. 533 (1944).

[2] Robert J. Bush, Comment, *Stimulating Corporate Self-Regulation—The Corporate Self-Evaluative Privilege: Paradigmatic Preferentialism or Pragmatic Panacea*, 87 Nw. U. L. Rev. 597, 599 (1993) (discussing the purpose of the self-evaluative privilege).

Kurtis B. Reeg is the President and Managing Partner of Reeg Lawyers, LLC, in St. Louis, Missouri. For more than thirty years, Mr. Reeg has focused his litigation practice in the fields of toxic torts, products liability, insurance, environmental law, and alternative dispute resolution. He has represented clients in more than twenty states before their state and federal courts and has served as National and Regional Coordinating Counsel for various clients. Mr. Reeg has been involved in several landmark cases, including the W.R. Grace nationwide asbestos insurance coverage litigation in the federal courts of New York, in which he prevailed in the United States District Court and Second Circuit Court of Appeals; the ground-breaking and massive Minnesota Landfill direct action case against the insurance industry, State of Minnesota v. Allstate Insurance Co., et al.; and the nationwide Burlington Northern noise-induced hearing loss coverage cases in St. Clair County, Illinois. Mr. Reeg currently represents the target defendant in massive herbicide class action litigation pending in the Madison County, Illinois state court and the United States District Court for the Southern District of Illinois. Mr. Reeg is a member of the bars in Missouri, Illinois, Kansas, and Nebraska. He is also admitted to practice before the United States Supreme Court, the United States Courts of Appeal for the Second, Seventh, and Eighth Circuits, and United States District Courts for the Eastern District of Missouri, the Southern District of Illinois, the District of Arizona, the Central District of Illinois, the Western District of Missouri, and the District of Colorado. A member of the FDCC, Mr. Reeg has served as Chair of the Class Action and Multidistrict Litigation Section as well as the Toxic Torts and Environmental Law Section. He is also a member of the Defense Research Institute (DRI), the International Association of Defense Counsel (IADC), and he is a sustaining member of the Product Liability Advisory Council (PLAC), which is made up of member Fortune 500 manufacturing companies and their select trial and appellate counsel. Mr. Reeg is the author of numerous articles. He was awarded the Andrew C. Hecker Award in 2001 for the most outstanding article in the Federation of Defense & Corporate Counsel Quarterly.

access to these internal investigative materials.[3] These rules create a difficult dilemma for corporate America. Should a company (1) consistently evaluate the inner workings of the company to ensure a safer, more efficient company and product for both employees and the customer, respectively; or (2) avoid honestly examining safety shortcomings of the company and product to prevent that information from reaching potential litigants and ultimately the jury?

[3] *Id.*

Matthew A. Temper is an associate at Reeg Lawyers, LLC, in St. Louis, Missouri where he focuses his practice in the areas of products liability and toxic torts. He is admitted to the Missouri and Illinois state bars. Before joining the firm, Mr. Temper spent more than fifteen years in the industrial hygiene field providing Fortune 500 companies with regulatory expertise in the field of occupational exposures, including asbestos and lead. He received his J.D. from the Saint Louis University School of Law in 2007. While in law school, Mr. Temper served as a staff member and an editor on the Saint Louis University Law Review.

Some courts have recognized an evidentiary privilege for self-critical analysis that companies may assert to shield self-critical documents from discovery in lawsuits. The rationale behind the privilege is simply that a company will have more incentive to scrutinize its safety protocols, its compliance with environmental regulations, its compliance with equal opportunity laws, and the like, if the company has an assurance that those internal investigations will not be discoverable. The privilege sacrifices an individual's access to information in a lawsuit in favor of the greater public good in safety, a clean environment, and equal opportunities in employment. However, the privilege is not uniformly recognized or applied. Many decisions neither support nor outright reject the self-critical analysis privilege. As a result, it is not always clear when the privilege applies or whether a jurisdiction recognizes the privilege. Defense attorneys face this problem of uncertainty when they seek to assert the self-critical analysis privilege against invasive discovery requests.

Adding to the lack of uniform recognition, the self-critical analysis privilege has been inconsistently applied in those federal circuit courts and state courts that have been willing to consider and discuss it. Those courts that have discussed the privilege have given it a variety of names, including the self-critical subjective analysis privilege,[4] the peer review privilege,[5] the self-evaluation privilege,[6] the privilege for confidential self-evaluative analysis,[7]

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[4] *In re* Burlington N., Inc., 679 F.2d 762, 765–67 (8th Cir. 1982) (denying a petition for writ of mandamus despite Burlington Northern's argument that evaluations of employment practices are protected from disclosure by the self-critical subjective analysis privilege).

[5] Marshall v. Planz, 145 F. Supp. 2d 1258, 1266 (M.D. Ala. 2001) (allowing the peer review privilege with respect to statements made for the purpose of affecting the peer review process).

[6] Hoffman v. United Telecomm., Inc., 117 F.R.D. 440, 442 (D. Kan. 1987) (referring to the privilege as it is used to protect the information making up the critical analysis of an employer).

[7] Westmoreland v. CBS, Inc., 97 F.R.D. 703, 705–06 (S.D.N.Y. 1983) (determining that this was not a case for considering self-evaluative analysis).

and the self-examination privilege.[8] In addition, the privilege has been applied differently in various areas of the law.[9] A few state statutes recognize the privilege, and those statutes tend to recognize the privilege in a very narrow field. The fact that some legislatures have recognized the privilege and others have not has caused some courts to refuse to recognize the privilege without a clear effort by the legislature to establish it on the books.[10]

Part II of this Article discusses the history of the self-critical analysis privilege. Then, Part III discusses the application of the self-critical analysis privilege in several areas where it is commonly applied, including products liability claims, aviation-related claims, securities claims, governmental agency claims, and First Amendment claims. Part IV of this Article discusses the adoption of the self-critical analysis privilege in federal courts, state courts, and state legislatures. Finally, in Part V we conclude that even though the legal status of the self-critical analysis privilege is plagued by uncertainty, defense counsel should use all available opportunities to assert the privilege and explain the policies that underlie it. With better information about the history of the privilege and its virtues, more courts and legislatures may see that the general public will benefit when the self-critical analysis privilege is uniformly recognized.

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[8] Rosario v. N.Y. Times Co., 84 F.R.D. 626, 631 (S.D.N.Y. 1979) (maintaining the privilege of self-examination permits free discussion concerning compliance with the law).

[9] Morgan v. Union Pac. R.R. Co., 182 F.R.D. 261, 265 (N.D. Ill. 1998) ("The court agrees with Union Pacific that the test for determining whether the self-critical analysis privilege applies in an employment discrimination case should be different from the criteria used in a tort case. The rationale for the self-critical analysis privilege in employment discrimination cases is to assure fairness to entities who are legally required to engage in self-evaluation. In contrast, the justification for the privilege in tort cases is to promote public safety through voluntary and honest self-analysis.").

[10] Zoom Imaging, L.P. v. St. Luke's Hosp. & Health Network, 513 F. Supp. 2d 411, 413 (E.D. Pa. 2007) (stating that "Congress has also refused to create a self-critical analysis privilege"); Lara v. Tri-State Drilling, Inc., 504 F. Supp. 2d 1323, 1328 (N.D. Ga. 2007) (recognizing that other district courts in Georgia have applied the privilege in a state law context, but declining to "make such a leap of state law interpretation absent a recognition of the self-critical analysis privilege by Georgia state courts or the state legislature"); *Ex parte* Cryer, 814 So. 2d 239, 249 (Ala. 2001) ("[W]e elect not to adopt and apply the privilege [because] . . . we believe that the best procedure for consideration of a rule of evidence that appears to be controversial should be by . . . the Legislature."); *In re* Parkway Manor Healthcare Ctr., 448 N.W.2d 116, 120 (Minn. Ct. App. 1989) ("We find the legislature has indicated a desire to be the exclusive source of evidentiary privileges. We therefore decline to recognize the proposed privilege for self-evaluation data beyond that provided by statute."); Scroggins v. Uniden Corp. of Am., 506 N.E.2d 83, 86 (Ind. Ct. App. 1987) ("[N]o privilege against production of self-critical analysis exists in Indiana. All privileges are statutory and the creation thereof is the sole power of the legislature.").

II.
History of the Self-Critical Analysis Privilege

Bredice v. Doctors Hospital, Inc.[11] was the first decision in which a court recognized the self-critical analysis privilege and the benefits it produces for the general public.[12] In that case, the plaintiff sought discovery of meeting minutes and various documents from a hospital review board that assessed staff performance and procedures.[13] "The purpose of these staff meetings [wa]s the improvement, through self-analysis, of the efficiency of medical procedures and techniques."[14] The *Bredice* court pointed to an "overwhelming public interest" when it denied plaintiff discovery of these documents.[15] The *Bredice* court explained that this policy would encourage hospitals to do reviews to improve patient care and treatment.[16]

Several courts have applied the public policy analysis, as outlined by the court in *Bredice*, to equal employment opportunity cases. Shortly after *Bredice*, "another federal district court applied the SEP [self-evaluation privilege] to shield a corporation's confidential assessment of its equal employment opportunity (EEO) practices."[17] Other courts have applied the privilege "to prevent discovery of EEO reports in private employment discrimination cases."[18]

Additionally, courts have applied the self-critical analysis privilege to other areas, including academic peer review,[19] police department internal investigations,[20] railroad accident investigations,[21] and product safety assessments.[22] "The common theme linking all

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[11] *Bredice*, 50 F.R.D. at 250–51.

[12] Bush, *supra* note 2, at 603–04.

[13] *Bredice*, 50 F.R.D. at 249–50; Bush, *supra* note 2, at 603–04.

[14] *Bredice*, 50 F.R.D. at 250; Bush, *supra* note 2, at 604.

[15] *Bredice*, 50 F.R.D. at 251; Bush, *supra* note 2, at 604.

[16] *Bredice*, 50 F.R.D. at 250; Bush, *supra* note 2, at 604.

[17] Bush, *supra* note 2, at 605.

[18] *Id. See also* Roberts v. Nat'l Detroit Corp., 87 F.R.D. 30, 32 (E.D. Mich. 1980); O'Connor v. Chrysler Corp., 86 F.R.D. 211, 218 (D. Mass. 1980); Rosario v. N.Y. Times Co., 84 F.R.D. 626, 631 (S.D.N.Y. 1979). *But see* Emerson Elec. Co. v. Schlesinger, 609 F.2d 898, 907 (8th Cir. 1979) (declining to recognize the *Bredice* analysis because the documents in question were "not made solely for internal use"); Reynolds Metals Co. v. Rumsfeld, 564 F.2d 663, 667 (4th Cir. 1977) (declining to recognize the *Bredice* analysis because "reports were not prepared solely for internal use").

[19] EEOC v. Univ. of Notre Dame, 715 F.2d 331, 338 (7th Cir. 1983), *overruled by* Univ. of Pa. v. EEOC, 493 U.S. 182, 189 (1990); Gray v. Bd. of Higher Educ., 692 F.2d 901, 908 (2d Cir. 1982) (acknowledging the privilege).

[20] Kott v. Perini, 283 F. Supp. 1, 1 (N.D. Ohio 1968).

[21] S. Ry. Co. v. Lanham, 403 F.2d 119 (5th Cir. 1968) (railroad accident investigations); Granger v. Nat'l R.R. Passenger Corp., 116 F.R.D. 507, 509–10 (E.D. Pa. 1987) (railroad accident investigations).

[22] Lloyd v. Cessna Aircraft Co., 74 F.R.D. 518, 521–22 (E.D. Tenn. 1977) (finding that the self-critical analysis privilege was not applicable to the information sought regarding product safety assessments).

these cases is that, in each, the policies in favor of confidentiality— . . . promoting free communication of candid evaluations and criticisms within an organization—have been deemed strong enough to justify restrictions on liberal pretrial discovery."[23]

III.
Application of the Self-Critical Analysis Privilege

Businesses have asked the courts to recognize and apply the self-critical analysis privilege in many different areas of the law. Several courts have approved the policy behind the self-critical analysis privilege, yet they have rejected its application to the particular set of facts before the court, creating a pattern of uncertainty as to the appropriate circumstances under which the privilege should be applied. This section explains how some courts have applied the self-critical analysis privilege in cases involving products liability claims, aviation-related claims, securities law claims, suits against a government agency, and First Amendment cases.

A. *Products Liability Claims*

Typically, a plaintiff seeks discovery of documents related to a manufacturer's testing and analysis of the product that was allegedly the cause of the plaintiff's injury. Some courts have found that the self-critical analysis privilege should apply, while others have found that the privilege does not apply.[24] Courts in other jurisdictions have flat-out rejected the existence of this privilege.[25]

In *Bradley v. Melroe Co.*,[26] the court recognized and applied the privilege *sua sponte*. According to the court's decision, after the plaintiff was injured while using a Bobcat Skid Steer Loader, he brought a products liability suit against the defendant manufacturer. During discovery, the plaintiff learned of seven other accidents that involved the same seat bar interlock mechanism that was involved in the plaintiff's accident.[27] Responding to the plaintiff's requests for documents, the defendant provided basic accident reports, but it did not provide in-house investigative files for the accidents.[28] (The basic accident reports provided

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[23] N.Y. Stock Exch. v. Sloan, 22 Fed. R. Serv. 2d 500, No. 71CV2912, 1976 WL 169086, at *3 (S.D.N.Y. Oct. 21, 1976).

[24] Shipes v. BIC Corp., 154 F.R.D. 301, 307 (M.D. Ga. 1994) (holding that self-critical evaluation documents submitted to the Consumer Products Safety Commission pursuant to 15 U.S.C. § 2065(b) are protected by the self-critical analysis privilege).

[25] Lawson v. Fisher-Price, Inc., 191 F.R.D. 381, 386 (D. Vt. 1999) (declining to adopt the self-critical analysis privilege based on existing statutory and case law in Vermont); Lamitie v. Emerson Elec. Co. – White Rodgers Div., 535 N.Y.2d 650, 652 (App. Div. 1988) (declining to adopt the self-critical analysis privilege based on the relevant statutory language).

[26] 141 F.R.D. 1, 1 (D.D.C. 1992).

[27] *Id.*

[28] *Id.*

the date, place of the accident, the fact of injury, and the main address of the reporter.[29]) The defendant resisted plaintiff's motion to compel production of the in-house investigation files, asserting that they were covered by the work product doctrine. The court disagreed after determining that the investigations were conducted in the ordinary course of the defendant's business.[30] However, the court observed that the in-house investigation reports were prepared "for the purpose of ascertaining if preventative measures [could] be taken to avoid future accidents."[31] According to the court, in this situation "courts have recognized a privilege of self-critical analysis precluding the discovery of impressions, opinions and evaluations but allowing the discovery of factual data."[32] Although the court ordered the defendant to produce all factual data contained in the in-house investigative files, it allowed the defendant to "redact all mental impressions, opinions, evaluations, recommendations and theories" because those parts of the files were covered by the self-critical analysis privilege.[33]

B. *Aviation-Related Claims*

In the area of aviation, courts are split on the application of the privilege, but their decisions indicate that they understand the importance of the privilege as a tool for promoting safety reviews that enhance public safety. For example, in the Southern District of Florida, American Airlines unsuccessfully asserted the privilege in consolidated lawsuits seeking to protect documents prepared for the Aviation Safety Action Program.[34] The court would not apply the privilege to the reports due to the fact that American made the choice "to 'aggressively investigate' itself not just for purposes of internal quality control, but also in order to prepare a defense to th[e] lawsuit, draft appropriate submissions to the NTSB and the Colombian authorities and marshal evidence to present to the media in an effort to ease any public concern."[35] These facts negated any "meaningful risk of chill."[36] Additionally, American's evaluations were not "an 'in house' review undertaken primarily, if not exclusively, for the purpose of internal quality control," which the court characterized as "[t]he touchstone of a self-critical analysis."[37]

In *Lloyd v. Cessna Aircraft Co.*,[38] a federal court required a Cessna executive to answer deposition questions about Cessna's internal safety meetings. The court characterized these

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[29] *Id.*

[30] *Id.* at 2-3.

[31] *Id.* at 3.

[32] *Id.* at 2–3.

[33] *Id.*

[34] *In re* Air Crash Near Cali, Colom. on Dec. 20, 1995, 959 F. Supp. 1529, 1530–31 (S.D. Fla. 1997).

[35] *Id.* at 1533.

[36] *Id.*

[37] *Id.*

[38] 74 F.R.D. 518, 522 (E.D. Tenn. 1977).

questions as "very broad" and "general" and drew a distinction regarding the rules applicable to discovery of "copies of any minutes or reports arising from any 'top ten' meeting by any of Cessna's divisions."[39] ("Top ten" meetings were designed to review, analyze, and evaluate operations for the continued self-improvement in the quality of . . . products."[40]) In the case of minutes or reports, the court acknowledged that the self-critical analysis privilege might apply if the plaintiff could not show "good cause" regarding why discovery of these documents was needed.[41]

In contrast, the court applied the self-critical analysis privilege in *Tice v. American Airlines, Inc.*[42] In that case, retired airline pilots brought an age discrimination suit against American Airlines that challenged its policy of forcing pilots to retire after they turned sixty years old.[43] The plaintiffs tried to compel production of reports defendant had completed pursuant to an FAA mandate, a mandate that was designed to increase safety.[44] American Airlines objected to the production of the reports based on the self-critical analysis privilege.[45] The court decided that this was a hybrid case, and it had to decide whether it should be analyzed as an issue of employment discrimination or personal injury.[46] According to the court, "there is a 'fundamental difference between tort cases, which involve voluntary self-evaluations designed to enhance *safety*, and discrimination cases, which involve the fairness of disclosing documents written pursuant to a legal mandate.'"[47] Finding that the case was more like a personal injury action, the court decided that the safety reports were protected from discovery by the self-critical analysis privilege.[48]

C. *Securities Law Claims*

The self-critical analysis privilege has been applied to shield discovery of self-evaluative reports in litigation involving securities law. In *In Re Crazy Eddie Securities Litigation*,[49] the district court applied the self-critical analysis privilege to excuse the accounting firm of Peat Marwick from producing (1) an "internal review" of an audit conducted by Peat Marwick and (2) a "Peer Review" report and letter of comments on internal quality controls.[50] The

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[39] *Id.* at 520.

[40] *Id.*

[41] *Id.* at 522.

[42] 192 F.R.D. 270 (N.D. Ill. 2000).

[43] *Id.* at 271.

[44] *Id.* at 271-72.

[45] *Id.* at 272.

[46] *Id.* at 273.

[47] *Id.* (quoting Morgan v. Union Pac. R.R., 182 F.R.D. 261, 266 (N.D. Ill. 1998)).

[48] *Id.*

[49] 792 F. Supp. 197 (E.D.N.Y. 1992).

[50] *Id.* at 205.

district court stated that a "privilege of self-critical analysis . . . serves the public interest by encouraging self-improvement through uninhibited self-analysis and evaluation."[51] Additionally, Peat Marwick had asserted that production of the materials would "chill" its attempts at quality control.[52] The court was skeptical of the "chilling" claim in this case, but it found that the argument had some weight.[53] Ultimately, the court found that the plaintiff failed to demonstrate a need for the documents that outweighed the defendants' claim of privilege.[54]

However, in *In re Salomon Inc.,*[55] another New York securities case decided five months later, a different district court denied protection under the self-critical analysis privilege for the following Salomon documents: (i) a treasury auction manual; (ii) a government trading review report; (iii) workpapers underlying the reports; and (iv) the Coopers & Lybrand internal control and compliance review. The court concluded that "management control studies and internal audit reports are not the type of studies or reports whose flow would be curtailed if discovery is allowed."[56] The court reasoned that

> [t]he economic efficiencies, the accuracy of financial reporting and the improvement of business standards achieved by internal auditing programs and management control studies are so integral to the success of a business that the free flow of information is not likely to be stemmed by the possibility of future disclosure.[57]

The *Salomon* court declined to follow the *Crazy Eddie* ruling in reaching its decision.[58]

D. *Suits Against a Government Agency*

Courts have also found that the self-critical analysis privilege may apply to suits against government agencies.[59] In *O'Keefe v. Boeing Co.*, after a plane crash, the personal representatives of deceased crew members sued the manufacturer and sought United States Air Force internal investigation reports regarding the crash.[60] The plaintiffs not only sought reports

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[51] *Id.* (citing Lasky v. Am. Broad. Cos., 5 Fed. R. Serv. 3d 1366, No. 83 Civ. 7438, 1986 WL 9223, at *3 (S.D.N.Y. Aug. 13, 1986) (recognizing self-evaluating privilege in cases of violations of securities laws, medical malpractice, violations of civil rights, and libel); N.Y. Stock Exch. v. Sloan, 22 Fed. R. Serv. 2d 500, No. 71CV2912, 1976 WL 169086, at *3 (S.D.N.Y. Oct. 21, 1976)).

[52] *Crazy Eddie*, 792 F. Supp. at 206.

[53] *Id.* (citation omitted).

[54] *Id.*

[55] Nos. 91 Civ. 5442 (RPP), 91 Civ. 5471 (RPP), 1992 WL 350762, at *3 (S.D.N.Y. Nov. 13, 1992).

[56] *Id.* at *4.

[57] *Id.*

[58] *Id.*

[59] O'Keefe v. Boeing Co., 38 F.R.D. 329 (S.D.N.Y. 1965).

[60] *Id.* at 330.

regarding the crash involving their family members, but they also sought reports on three other accidents involving the same type of plane and similar structural failures.[61]

The Air Force objected to producing the reports on the basis of "executive privilege."[62] In reviewing the Air Force's claim of privilege, the court noted that the singular objective of the reports was to prevent future accidents by finding out the cause.[63] The investigative reports were furnished to the manufacturer to improve the safety of future aircraft models.[64] The reports were not prepared to defend lawsuits.[65]

The court separated the documents into two general classes: (1) records of facts made in the course of the investigation; and (2) opinions, speculations, recommendations, and discussions of policy.[66] The court found that the documents in the latter category were privileged, but the former were not.[67]

E. *First Amendment Claims*

The self-critical analysis privilege has also been examined and found to apply in First Amendment situations, such as libel. In *Lasky v. American Broadcasting Co*.,[68] the plaintiff alleged that he was libeled in an ABC News "closeup" documentary. After receiving plaintiff's complaint, ABC News reviewed the program and decided to issue a correction that was broadcast shortly thereafter.[69] After the broadcast, ABC conducted an internal investigation to "evaluate the broadcast in light of ABC's own journalistic standards, and determine whether those standards called for any subsequent amplification or correction."[70] As a result of the investigation, ABC generated various internal documents regarding the initial broadcast, the possibility of a lawsuit, and viewer responses.[71] ABC argued that the self-critical analysis privilege shielded these documents from discovery.[72]

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[61] *Id.*

[62] *Id.* at 329–30.

[63] *Id.* at 330.

[64] *Id.* at 334.

[65] *Id.* at 330.

[66] *Id.* at 334.

[67] *Id.* at 334–35.

[68] Lasky v. Am. Broad. Cos., 5 Fed. R. Serv. 3d 1366, No. 83 Civ. 7438 (JMW), 1986 WL 9223, at *1 (S.D.N.Y. Aug. 13, 1986).

[69] *Id.*

[70] *Id.*

[71] *Id.*

[72] *Id.*

The district court, reviewing the magistrate's order, discussed the self-critical analysis privilege, and found that it may apply in a libel context no less than in cases of medical malpractice, violations of securities laws, and violations of civil rights.[73] The court noted that "[t]he basic purpose underlying the privilege, to encourage self-improvement through unchilled self-analysis and evaluation, has particular force in the libel context where there is a societal need for the responsible exercise of First Amendment rights."[74] However, the privilege applies only to the evaluation, not to the facts themselves.[75] The privilege "must be balanced against the societal interest in discovery as it contributes to the full and fair adjudication of the issues invoked in litigation."[76]

Applying these policies, the district court found that documents containing facts, such as the number of viewer responses, were discoverable.[77] Analysis of viewer responses, however, was protected.[78] Additionally, the court found that handwritten notes by senior ABC officials containing self-evaluation were "part of an internal review process designed to examine the broadcast in light of ABC's journalistic standards" and were therefore protected.[79] In contrast, memos prepared to respond to a viewer's complaint were not self-evaluative and were not protected.[80]

IV.
Adoption of the Self-Critical Analysis Privilege in the Courtroom and in the Legislature

A few courts have recognized the self-critical analysis privilege,[81] and there are many glaring examples where the courts have rejected it.[82] For the most part though, the courts are often confused as to whether the privilege exists in their jurisdiction. This confusion has led to a number of courts analyzing and rejecting the application of the self-critical

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[73] *Id.* at *2.

[74] *Id.*

[75] *Id.*

[76] *Id.* (citing Gray v. Bd. of Higher Educ. of N.Y., 692 F.2d 901 (2d Cir.1982)).

[77] *Id.*

[78] *Id.*

[79] *Id.* at *3.

[80] *Id.*

[81] *See, e.g.*, Hickman v. Whirlpool Corp., 186 F.R.D. 362, 363 (N.D. Ohio 1999) (stating that "the Court believes . . . the Circuit would adopt the 'self-critical analysis' privilege when faced squarely with the issue").

[82] *See, e.g.*, RKB Enter., Inc. v. Ernst & Young, 600 N.Y.S.2d 793, 795 (App. Div. 1993) (stating that "'the self-critical analysis doctrine' . . . has no support in either New York statutes or case law"); Martin v. Potomac Elec. Power Co., Nos. 86-0603, 87-1177, 87-2094, 88-0106, 1990 WL 158787, at *5 (D.D.C. May 25, 1990) (holding that defendants "cannot shield from discovery documents . . . on the basis of a privilege for 'self-critical analysis'").

analysis privilege to the facts before them, even "assuming" that the privilege exists.[83] In federal courts, only few appellate courts have discussed the self-critical analysis privilege, and many district court opinions are conflicting. In state courts, some courts have approved of the privilege, some have rejected it, some have discussed the policy underlying the privilege, and some have reached out to the state legislature for a definitive proclamation of the existence and scope of the privilege. Finally, some state legislatures have passed statutes affirming the privilege, but these statutes tend to govern only a narrow area of the law.

A. *Federal Courts*

"Rule 501 of the Federal Rules of Evidence authorizes federal courts to define new privileges by interpreting 'common law principles . . . in the light of reason and experience.'"[84] In enacting Rule 501, Congress "manifested an affirmative intention not to freeze the law of privilege. Its purpose rather was to 'provide the courts with the flexibility to develop rules of privilege on a case-by-case basis . . . .'"[85] But "[t]he United States Supreme Court has cautioned federal courts to create or expand federal privileges only with extreme reluctance."[86] Thus, privileges "must be strictly construed and accepted only to the very limited extent that . . . excluding relevant evidence has a public good transcending the normally predominant principle of utilizing all rational means for ascertaining the truth."[87]

To date, the United States Supreme Court has not formally recognized or adopted the self-critical analysis privilege. In *University of Pennsylvania v. E.E.O.C.*,[88] the Supreme Court declined to create a privilege for peer review documents in a Title VII case. Several lower federal courts have relied on this ruling when examining the self-critical analysis privilege. "The Supreme Court and circuit courts have neither definitively denied the existence of such a privilege, nor accepted it and defined its scope."[89] Federal courts have even noted that the privilege is not recognized at federal common law.[90]

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[83] *See* U.S. *ex rel*. Sanders v. Allison Engine Co., Inc., 196 F.R.D. 310, 313 (S.D. Ohio 2000) ("Even if the privilege does exist, the justifications for it do not support its application . . . ."). Morgan v. Union Pac. R.R. Co., 182 F.R.D. 261, 264 (N.D. Ill. 1998) ("In this absence of binding authority, and recognizing that most courts afford some level of recognition to the privilege, this court presumes for purposes of this case that federal common law does recognize the privilege of self-critical analysis.").

[84] Jaffee v. Redmond, 518 U.S. 1, 8 (1996); Fed. R. Evid. 501.

[85] Trammel v. U.S., 445 U.S. 40, 47 (1980) (quoting 120 Cong. Rec. 40, 891 (1974) (statement of Rep. William Hungate)).

[86] Brunt v. Hunterdon County, 183 F.R.D. 181, 184 (D.N.J. 1998) (citing Univ. of Pa. v. E.E.O.C., 493 U.S. 182, 189 (1990)); Herbert v. Lando, 441 U.S. 153, 175 (1979) (stating that "[e]videntiary privileges in litigation are not favored").

[87] *Trammel*, 445 U.S. at 50 (citation omitted).

[88] 493 U.S. 182, 189 (1990).

[89] Dowling v. Am. Haw. Cruises, Inc., 971 F.2d 423, 425 n.1 (9th Cir. 1992).

[90] Spencer Sav. Bank, SLA v. Excell Mortg. Corp., 960 F. Supp. 835, 843–44 (D.N.J. 1997).

The federal circuits themselves are inconsistent with respect to recognizing the self-critical analysis privilege, as noted by district court judges: "Even the federal courts are in disarray on the question whether such a privilege applies to prevent disclosure of employer-generated analytical materials in federal discrimination cases."[91] "Cases are all over the map on whether the self-evaluative privilege exists in employment discrimination cases. The privilege is a creature of the state trial courts, and there is little uniformity of law even within particular states."[92]

In the First Circuit, a district court in *O'Connor v. Chrysler Corp*. gave four "'potential guideposts' for application of the 'self-critical analysis' defense."[93] A later district court noted that the *O'Connor* court recognized the privilege, but called into question the advisability of extending the privilege to the facts before the court because the documents the plaintiff asked defendant to produce had been prepared in response to the plaintiff's specific request for an informal employment review.[94] They were not the type of general affirmative action or employment policy reviews that might be curtailed if they could be discovered later in litigation.[95]

The Second Circuit has also inconsistently applied the policy. A number of district court cases state that the Second Circuit has recognized the self-critical analysis privilege.[96] But other district court cases have questioned whether the reasons for the privilege actually justify its application and recognition.[97]

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[91] Siskonen v. Stanadyne, Inc., 124 F.R.D. 610, 611 (W.D. Mich. 1989).

[92] Walker v. Cnty. of Contra Costa, 227 F.R.D. 529, 532 (N.D. Cal. 2005).

[93] O'Connor v. Chrysler Corp., 86 F.R.D. 211, 217 (D. Mass. 1980) (citing Webb v. Westinghouse Electric Corp. 81 F.R.D. 431, 434 (E.D. Pa. 1978)).

[94] Whittingham v. Amherst Coll., 164 F.R.D. 124, 129–30 (D. Mass. 1995).

[95] *Id.* at 130-131.

[96] *See, e.g.*, Miller v. Praxair, Inc., Civil No. 3:05 CV 402(CFD), 2007 WL 1424316, at *3 (D. Conn. May 10, 2007) (stating that "courts in the Second Circuit have recognized that significant segments of affirmative action plans are protected from discovery under the self-critical analysis privilege"); Flynn v. Goldman, Sachs & Co., No. 91 Civ. 0035 (KMW), 1993 WL 362380, at *1 (S.D.N.Y. Sept. 16, 1993) ("Courts have recognized a common-law privilege for self-critical analysis where 'an intrusion into the self-evaluative analyses of an institution would have an adverse effect on the [evaluative] process, with a net detriment to a cognizable public interest.'") (citing Cobb v. Rockefeller Univ., 1991 WL 222125, at *1 (S.D.N.Y. Oct. 24, 1991)).

[97] *See, e.g.*, Cruz v. Coach Stores, Inc., 196 F.R.D. 228, 232 (S.D.N.Y. 2000) ("As to the so-called 'self-critical analysis privilege,' the Court is doubtful it should be recognized at all."); Hardy v. N.Y. News, Inc., 114 F.R.D. 633, 641 (S.D.N.Y. 1987) (noting "serious questions about the underlying assumption of the privilege," and expressing doubt "that disclosure would significantly discourage self-critical activity").

A case from the Third Circuit has often been cited by district courts in other circuits when acknowledging the self-critical analysis privilege.[98] In *Webb v. Westinghouse Electric Corp.*,[99] the court laid out several factors that could be applied when the self-critical analysis defense was asserted. However, twenty years later, an appellate court gave a more definitive and opposite ruling: "The self-critical analysis privilege has never been recognized by this Court and we see no reason to recognize it now."[100]

The Sixth Circuit held that "[t]he practice of uninhibited self-critical analysis, which benefits both the union's and employer's substantial interest in increased worker safety and accident prevention, would undoubtedly be chilled by disclosure."[101] However, even though the appellate court applied the privilege, a later district court expressed skepticism.[102] "Even if the privilege does exist, the justifications for it do not support its application to voluntary, routine reviews."[103]

In the Seventh Circuit, several cases have discussed the privilege, some with approval and others with disapproval. The appeals court held that the self-critical portions of an affirmative action plan were protected by a qualified privilege: "The prevailing view is that self-critical portions of affirmative action plans are privileged and not subject to discovery by plaintiffs."[104] The court qualified its holding, however, stating that an employer cannot rely on its affirmative action policy in its defense and "at the same time be able to hide self-critical evaluations that may undercut the employer's portrayal of its efforts."[105] Subsequent district court decisions in the Seventh Circuit have applied the privilege.[106] However, at least

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[98] *See* Deana A. Pollard, *Unconscious Bias and Self-Critical Analysis: The Case for A Qualified Evidentiary Equal Employment Opportunity Privilege*, 74 Wash. L. Rev. 913, 973 (1999) (noting that the *Webb* court was the first attempt to "identify the parameters of the self-critical analysis privilege in the employment context").

[99] 81 F.R.D. 431, 434 (E.D. Pa. 1978).

[100] Ala. Elec. Pension Fund v. Pharmacia Corp., 554 F.3d 342, 351 n.12 (3d Cir. 2009) *cert. denied*, 130 S. Ct. 2401 (2010).

[101] ASARCO, Inc., Tenn. Mines Div. v. N.L.R.B., 805 F.2d 194, 200 (6th Cir. 1986).

[102] U.S. *ex rel.* Sanders v. Allison Engine Co., Inc., 196 F.R.D. 310, 313 (S.D. Ohio 2000).

[103] *Id.*

[104] Coates v. Johnson & Johnson, 756 F.2d 524, 551 (7th Cir. 1985).

[105] *Id.* at 552.

[106] *See* Robbins v. Provena Saint Joseph Med. Ctr., No. 03 C 1371, 2004 WL 502327, at *2 (N.D. Ill. Mar. 11, 2004) (holding that information requested was protected by the self-critical analysis privilege); Anderson v. Marion County Sheriff's Dept., 220 F.R.D. 555, 566 (S.D. Ind. 2004) (finding that disclosing internal investigations in a police department would have a chilling effect on open and frank communications).

one district court has taken a different view, noting that "contrary to Defendant's apparent argument, the *Coates* court did not recognize the privilege of self-critical analysis, rather they held only that *if* such a privilege existed, it had been waived."[107]

In the Eighth Circuit, the appellate court has not decided whether self-critical analysis is applicable. Predictably, district courts have issued a wide range of opinions. At least one court looked favorably on the privilege: "Disclosure of subjective 'self-evaluative' information would have a chilling effect on an employer's voluntary compliance with the laws."[108] Other courts, in determining whether to apply the privilege, have balanced the parties' interests.[109] Yet other courts have declined to apply the privilege.[110]

District courts in the Tenth Circuit are likewise inconsistent in their holdings, and the appellate court has yet to rule on the subject. Several district courts have acknowledged the privilege.[111] Other courts have declined to extend the privilege.[112]

The Eleventh Circuit is emblematic of the inconsistent application of the self-critical analysis privilege. The court of appeals has not ruled on the subject. A recent district court ruling put it best: "The history and application of the self-critical analysis privilege . . . are anything but clear. Not only has application of the privilege been rare, but many courts

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[107] Bell v. Woodward Governor Co., No. 03 C 50190, 2004 WL 5645759, at *2 (N.D. Ill. Jan. 26, 2004) (boldface omitted).

[108] Hoffman v. United Telecomm., Inc., 117 F.R.D. 440, 442 (D. Kan. 1987).

[109] *See, e.g.*, Holland v. Muscatine Gen. Hosp., 971 F. Supp. 385, 391 (S.D. Iowa 1997) (stating that "legitimate self-critical analysis material should in appropriate circumstances be treated as confidential business information" and that "a balancing of interests is involved"); Gatewood v. Stone Container Corp., 170 F.R.D. 455, 459 (S.D. Iowa 1996) (stating that the "question of whether a self-critical analysis privilege should be recognized in a particular case involves . . . balancing of interests").

[110] *See, e.g.*, LeClere v. Mut. Trust Life Ins. Co., No. C99-0061, 2000 WL 34027973, at *3 (N.D. Iowa June 14, 2000) (stating that "[t]his court does not believe that the Eighth Circuit Court of Appeals will ultimately recognize such a privilege"); Aramburu v. Boeing Co., No. 93-4064-SAC, 1994 WL 810246, at *5 (D. Kan. Sept. 22, 1994) (holding that "it should not recognize the privilege of self-critical evaluation in Title VII cases"); West v. Marion Labs., Inc., No. 90-0661-CV-W-2, 1991 WL 517230, at *2 (W.D. Mo. Dec. 12, 1991) (compelling discovery "[c]onsidering the general reluctance of the 8th Circuit to acknowledge the 'self-critical analysis' privilege").

[111] Steinle v. Boeing Co., No. 90-1377-C, 1992 WL 53752, at *9 n.13 (D. Kan. Feb. 4, 1992) (stating that the court believed "that there may be certain, limited, instances . . . that the privilege of self-critical analysis is sufficiently compelling to outweigh the plaintiff's need for discovery" but holding that the defendant did not meet the criteria); Weekoty v. U.S., 30 F. Supp. 2d 1343, 1346 (D.N.M. 1998) ("applying the self-critical analysis privilege . . . will promote the type of a [sic] and open discussions necessary to accurately analyze medical procedures and decisions so that errors may be corrected and patient care can be improved").

[112] Aramburu v. Boeing Co., 885 F. Supp. 1434, 1441 (D. Kan. 1995) (finding that "it is inappropriate to recognize the privilege of self-critical analysis in Title VII cases"); Mason v. Stock, 869 F. Supp. 828, 834 (D. Kan. 1994) (stating that the "court is unwilling to find that such a privilege exists in the present case," and calling the privilege "fundamentally flawed").

disagree over the extent to which the privilege should apply and whether any such privilege even exists."[113] At least two courts in the Eleventh Circuit have recognized the privilege.[114] Several other courts, however, have rejected the privilege.[115]

Other federal circuits have outright rejected the privilege.[116]

B. *State Courts*

For a variety of reasons, many state courts have been reluctant to recognize the self-critical analysis privilege. In states that have refused to recognize the privilege, many courts have still discussed the merits and policies behind the privilege of self-critical analysis. Several courts have deferred to the legislature in deciding whether to recognize the privilege. Finally, some states have conflicting case law about whether the privilege exists.

1. States that Recognize the Privilege of Self-Critical Analysis

The self-critical analysis has been recognized in Kansas.[117] (It was also recognized in an unreported Pennsylvania trial court decision.[118]) When applying a balancing test to determine whether the privilege applied, the Kansas Supreme Court stated that "[i]t is generally recognized that the maintenance of confidential communications is an important aspect of

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[113] Lara v. Tri-State Drilling, Inc., 504 F. Supp. 2d 1323, 1326 (N.D. Ga. 2007).

[114] Reichhold Chems., Inc. v. Textron, Inc. 157 F.R.D. 522, 526 (N.D. Fla. 1994) (having "no difficulty concluding in the abstract that an entity's retrospective self-assessment of its compliance with environmental regulations should be privileged in appropriate cases"); Reid v. Lockheed Martin Aeronautics Co., 199 F.R.D. 379, 387–88 (N.D. Ga. 2001) (stating that "there exists a strong public interest in preserving the candid and frank assessments contained in the reports as such evaluations would almost certainly be curtailed if discovery were allowed").

[115] Johnson v. United Parcel Serv., Inc., 206 F.R.D. 686, 693 (M.D. Fla. 2002) (stating that "until such time as the United States Supreme Court or the Eleventh Circuit Court of Appeals recognizes the self-critical analysis privilege, this Court is disinclined to recognize the privilege"); Abdallah v. Coca-Cola Co., No. CIV A1:98CV3679RWS, 2000 WL 33249254, at *7 (N.D. Ga. Jan. 25, 2000) (stating that "this Court finds the guidance provided by the Supreme Court to be persuasive and declines to recognize the self-critical analysis privilege").

[116] *See In re* Kaiser Aluminum & Chem. Co., 214 F.3d 586, 593 (5th Cir. 2000) (stating that "[t]he Fifth Circuit has not recognized the self-evaluation privilege"); Granberry v. Jet Blue Airways, 228 F.R.D. 647, 650 (N.D. Cal. 2005) ("As a matter of federal law—more specifically, as a matter of Ninth Circuit law—it is unlikely that the self-critical analysis privilege exists. The Ninth Circuit has not recognized this privilege."); Warren v. Legg Mason Wood Walker, Inc., 896 F. Supp. 540, 542 (E.D.N.C. 1995) (stating that "two recent decisions by United States District Courts in the Fourth Circuit have concluded that the Fourth Circuit does not recognize the self-critical analysis privilege").

[117] Kan. Gas & Elec. v. Eye, 789 P.2d 1161, 1166–67 (Kan. 1990).

[118] Anderson v. Hahnemann Med. Coll. & Hosp. of Philadelphia, 1985 WL 47218 (Pa.Com.Pl. 1985) (unreported).

self-critical analysis and whistle-blower programs."[119] A decade later, the court continued to give careful consideration to the privilege of self-critical analysis, noting in a 2010 decision that "a policy encouraging self-evaluation by the Department of Corrections would be in the public interest."[120] However, the court refused to keep confidential the Department of Correction records sought by a newspaper and its reporter because of the strong public policy of access to those records declared when the legislature enacted the Kansas Open Records Act. The court did not necessarily base its ruling requiring disclosure on the self-critical analysis privilege.[121]

2. States that Defer to the Legislature

In some jurisdictions, courts have been deferential to the legislative branch when considering recognition of the privilege.[122] The Alabama Supreme Court elected not to adopt the privilege, stating that "because [it] ha[d] appointed an Advisory Committee on Rules of Evidence, [the court] believe[d] that the best procedure for consideration of a rule of evidence that appears to be controversial should be by that Committee or by the Legislature."[123] In Minnesota, an appeals court found that "the legislature has indicated a desire to be the exclusive source of evidentiary privileges. [The court] therefore decline[d] to recognize the proposed privilege for self-evaluation data beyond that provided by statute."[124] However, while not directly addressing the self-evaluative privilege, the Minnesota Supreme Court stated that it "disagree[d] with dictum contained in opinions of the court of appeals deferring to the legislature as the primary regulator of evidentiary matters."[125]

3. States that Discuss the Merits of the Privilege

Even in jurisdictions where the privilege has not been recognized, several courts, while declining to recognize the privilege, have at least considered arguments that support adopting

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[119] *Kan. Gas & Elec.*, 789 P.2d at 1167.

[120] Wichita Eagle & Beacon Pub. Co., Inc. v. Simmons, 50 P.3d 66, 86 (Kan. 2002).

[121] *Id.*

[122] *See* Cloud v. Super. Ct., 58 Cal. Rptr. 2d 365, 369 (Ct. App. 1996) ("[T]he privileges contained in the Evidence Code are *exclusive* and the courts are not free to create new privileges as a matter of judicial policy.") (quoting Valley Bank of Nevada v. Super. Ct., 542 P.2d 977, 979 (Cal. 1975)); Scroggins v. Uniden Corp. of Am., 506 N.E.2d 83, 86 (Ind. Ct. App. 1987) ("[I]t is our opinion that no privilege against production of self-critical analysis exists in Indiana. All privileges are statutory and the creation thereof is the sole power of the legislature."); Wells Dairy, Inc. v. Am. Indus. Refrigeration, Inc., 690 N.W.2d 38, 50 (Iowa 2004) (finding no error in the district court's "refusal to extend the self-critical-analysis privilege, which is solely a creature of statute in Iowa").

[123] *Ex parte* Cryer, 814 So. 2d 239, 249 (Ala. 2001).

[124] *In re* Parkway Manor Healthcare Ctr., 448 N.W.2d 116, 120 (Minn. Ct. App. 1989).

[125] State v. Larson, 453 N.W.2d 42, 46 n.3 (Minn. 1990), *vacated on other grounds*, 498 U.S. 801 (1990).

the privilege.[126] For example, in *Register v. Wilmington Medical Center, Inc.*,[127] the Delaware Supreme Court discussed the defendant's claim that disclosure of evaluation reports in a medical malpractice suit "would chill the frankness of the evaluative process." The court noted that it "is an appealing argument but [the court] [was] unaware of any principle in [Delaware] law which would make the reports privileged or subject to non-disclosure or use in this action."[128] Subsequently, in *Artesian Water Supply Co. v. New Castle County*,[129] after noting that the Delaware Supreme Court had considered and rejected the privilege, the Court of Chancery of Delaware also refused to apply the privilege to data produced by experts attending a water pollution workshop. The court decided that the data sought by the plaintiff "was in no way analogous to a hospital review board on competency, a consideration which [according to the court] must go hand in glove with the claimed principle of self-evaluation."[130]

4. States with Conflicting Cases

The courts of some states have provided conflicting rulings on the subject. For example, an appellate court in Florida held that the state did not recognize the self-critical analysis privilege because in Florida there are no common law privileges.[131] Ten years later, Florida courts began to soften their position on self-critical analysis. In *Beverly Enterprises-Florida, Inc. v. Ives*, an appellate court noted that "other cases in Florida . . . recognize, as a matter of public policy, the confidential and privileged nature of minutes of medical committee meetings that relate to self-critical analysis."[132] In 2005, a Florida circuit court granted a motion protecting a hospital from producing confidential documents.[133] The court held that a recently enacted amendment to the Florida State Constitution did not invalidate "the

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[126] *See* State *ex rel.* Corbin v. Weaver, 680 P.2d 833, 840 (Ariz. Ct. App. 1984) (reviewing the factors involved in its application); Roman Catholic Diocese of Jackson v. Morrison, 905 So. 2d 1213, 1245 (Miss. 2005) ("Although we do not find the argument totally unpersuasive, we decline at this time to recognize or establish this privilege.").

[127] 377 A.2d 8, 11 n.** (Del. 1977).

[128] *Id.*

[129] No. C.A. 5106, 1981 WL 15606, at *4 (Del. Ch. Apr. 9, 1981).

[130] *Id.*

[131] S. Bell Tel. & Tel. Co. v. Beard, 597 So. 2d 873, 876 n.4 (Fla. Dist. Ct. App. 1992).

[132] 832 So. 2d 161, 164 (Fla. Dist. Ct. App. 2002). For the "other cases," *see* Good Samaritan Hosp., Inc. v. Am. Home Prods. Corp., 569 So. 2d 895, 896–97 (Fla. Dist. Ct. App. 1990); HCA of Fla., Inc. v. Cooper, 475 So. 2d 719, 720 (Fla. Dist. Ct. App. 1985).

[133] Brown v. Graham, No. 501999CA007754XXXXMPAF, 2005 WL 900722, at *7 (Fla. Cir. Ct. Mar. 18, 2005).

existing statutory prohibitions against the discoverability and admissibility of documents created in the course of self-critical analysis, particularly when such significant public policy ramifications are implicated."[134] In granting the motion, the court noted that "[h]ealth care providers are encouraged—in fact, compelled—to participate in self-critical analysis with the goal of identifying and analyzing medical errors and their causes, in order to improve patient safety."[135]

In Colorado, an appellate court noted that the privilege of self-critical analysis "has been extended only to information given in peer reviews of university faculty or of hospital personnel, affirmative action studies, and certain internal investigatory reports."[136] The court ultimately declined to recognize the privilege, noting that no other appellate decision had addressed the existence of the privilege.[137] Even so, the court laid out what it thought were the criteria for the application of this privilege, noting that "to the extent that any such privilege may be said to exist, it is a privilege against discovery of otherwise relevant information."[138] The court went so far as to discuss the criteria laid out in *Dowling v. American Hawaii Cruises, Inc.*,[139] stating that the four criteria listed in *Dowling* must exist for the privilege to apply.[140]

In 2009, the Colorado Supreme Court provided an opening to recognize the privilege in the future.[141] The court noted that privileges must be strictly construed because they are statutory in nature, and that courts must "exercise caution in determining whether the claimed protection exists."[142] However, it also remarked that "discovery of particular documents and information may be limited or prohibited in litigation based on a statutory or common law privilege" and that the party claiming the privilege has the burden of establishing its applicability.[143]

The Ohio Rules of Evidence (specifically Rule 501) authorize Ohio courts to recognize the privilege of self-critical analysis: "The privilege of a witness, person, state or political subdivision thereof shall be governed by statute enacted by the General Assembly *or by principles of common law as interpreted by the courts of this state in the light of reason*

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[134] *Id.* at *4.

[135] *Id.* at *6.

[136] Combined Commc'ns Corp., v. Pub. Serv. Co. of Colo., 865 P.2d 893, 898 (Colo. App. 1993).

[137] *Id.*

[138] *Id.* (emphasis omitted).

[139] 971 F.2d 423, 426 (9th Cir. 1992). *See supra* Section III.B.

[140] *Combined Commc'ns*, 865 P.2d at 898.

[141] DeSantis v. Simon, 209 P.3d 1069, 1073 (Colo. 2009).

[142] *Id.*

[143] *Id.*

and experience."[144] Armed with this authority, an Ohio appellate court considered whether the self-critical analysis privilege applied to performance evaluations regarding hazardous waste that the defendant had generated internally prior to the commencement of the case. Even though the court seemed to indicate that the self-critical analysis privilege could apply to these documents, it eventually ruled that defendants were not entitled to claim the privilege and avoid discovery because of "a clear legislative directive that the hazardous waste industry be subject to public scrutiny."[145]

C. *State Statutes Providing a Privilege for Self-Critical Analysis*

Some state legislatures have provided for the privilege of self-critical analysis in the state statutes. In certain areas of the law, there is a clear recognition of the privilege. Some examples include a qualified privilege for environmental audit reports,[146] protection of medical peer review committee evaluations,[147] protection of insurance compliance self-evaluative audit reports,[148] and several others.[149]

V.
The Future of the Self-Critical Analysis Privilege

Without guidance from the legislature, federal and state courts have been left to their own devices, resulting in myriad opinions on how to apply the self-critical analysis privilege. On the federal level, many of the appellate courts have never ruled definitively, if at all, regarding the privilege. Most of the holdings have come at the district court level, and the district courts have differed considerably in their application of the privilege, even within the same circuit. In much the same way, most state courts lack consistent precedent to guide their examinations of the self-critical analysis. With all of these contradictory rulings, it is little wonder confusion reigns regarding the self-critical analysis privilege.

The future of the self-critical analysis privilege is unclear. Because many courts are reluctant to step forward and acknowledge the privilege in any circumstance other than

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[144] Ohio R. Evid. 501 (emphasis added).

[145] State *ex rel.* Celebrezze v. CECOS Int'l, Inc., 583 N.E.2d 1118, 1120–21 (Ohio Ct. App. 1990).

[146] *See, e.g.,* Colo. Rev. Stat. Ann. § 13-25-126.5 (West 2005).

[147] *See, e.g.,* Iowa Code Ann. § 147.135 (West 2009).

[148] *See, e.g.,* Kan. Stat. Ann. § 60-3351 (West 2010).

[149] *See, e.g.,* Kan. Stat. Ann. § 60-3333 (West 2006) (protection of environmental audit reports); La. Rev. Stat. Ann. § 6:336 (West 2005) (privilege for self-evaluations by bank or other financial institution); Minn. Stat. Ann. § 114C.26 (West 2005) (privilege for environmental audit report and self-evaluation form); Miss. Code Ann. § 49-2-71 (2007) (qualified privilege for environmental self-evaluation report); Utah Code Ann. § 19-7-107 (2006) (qualified privilege for environmental audit report in administrative proceeding).

those acknowledged by the legislature, recognition of the privilege on a permanent basis is near stagnant. Until legislatures are willing to acknowledge the self-critical analysis privilege in a broader context, defense attorneys, whose clients need to rely on the privilege, must consistently and continuously invoke the privilege on their behalf. Hopefully, in turn the legislatures will see that defendants are relying on the privilege based on sound public policy and will realize the merit in recognizing the self-critical analysis privilege in a broader statutory sense.

Although it seems a daunting task, with the recognition the self-critical analysis privilege has received over the last forty years, its expansion is quite possible as long as parties consistently trumpet the positive societal underpinnings and benefits of the privilege and seek protection under it. Thus, defendants must continue to press the courts, their state legislatures, and Congress to take the lead and recognize this privilege once and for all.

"Sleep Tight, Don't Let the Bed Bugs Bite" The Impact of Bed Bugs On Our Daily and Legal Lives[†]

David E. Cassidy
Christopher Elko
Robert Christie
Peter M. Di Eduardo
Michael Glascott
Elizabeth M. Lorell

I.
Introduction

"Good night, sleep tight; don't let the bed bugs bite; If they do, let them chew, because they need to eat too." When the anonymous author of this poem sarcastically advised the reader to "let them chew," that poet certainly could not have anticipated the cataclysmic rise in today's bed bug population or the ensuing havoc and real turmoil that bed bugs are causing in our modern society. Unfortunately, bed bugs are back and influencing the way we live, work, and travel. With the stories of lives turned upside-down by bed bugs—fueled by a willing and able media sharing disturbing bed bug-related stories—bed bugs are getting all the attention these days and, perhaps, rightfully so. No one is safe from the bed bug epidemic that has invaded our daily and legal lives. In fact, even the methods used to kill bed bugs are causing devastating problems. There are reports that chemicals used to treat bed bugs overseas have killed tourists, while high-powered convection heaters used to kill bed bugs recently burned to the ground a house in Ohio. Hence, this Article is designed to provide factual information about bed bugs to protect our families, colleagues, and clients from these pesky little creatures and the devastation they leave behind.

[†] Submitted by the authors on behalf of the FDCC Employment Practices and Workplace Liability, Civil Rights and Public Entity, Premises and Security Liability, and International Practice and Law Sections.

David E. Cassidy is a member of Norris McLaughlin & Norris, PA and practices in its New Jersey and New York offices. He has extensive experience representing companies in labor and employment matters. He regularly litigates employment claims brought under Title VII, ADA, ADEA, FMLA, WARN, NJLAD, CEPA, NYHRL, and other employment-related statutes. He handles claims in state and federal court and before the American Arbitration Association. Mr. Cassidy has experience with claims involving commissions and bonuses, misappropriation of trade secrets, breach of non-compete covenants, breach of contract, defamation, and privacy in the workplace. He has successfully brought to verdict several bench and jury trials, arbitration matters, administrative hearings, and appeals. Mr. Cassidy advises clients during union organizing campaigns and represents clients in representation and unfair labor practice charge proceedings before the National Labor Relations Board. He is admitted to the bars of New Jersey, New York, Pennsylvania, the United States District Court for the District of New Jersey and the Southern and Eastern Districts of New York, and the United States Courts of Appeals for the Second and Third Circuits. He is also a member of the Employment Law Sections of the New Jersey State, New York State and Pennsylvania State Bar Associations. Mr. Cassidy earned his J.D., cum laude, from Western New England College of Law in 1996 and his B.A. from the Rochester Institute of Technology in 1989. He was selected as a 2007 Super Lawyers Rising Star.

Part II provides an overview of how bed bugs have re-entered our society and outlines information that everyone should know about this pest. Part III explains the history and biology of bed bugs. Part IV highlights how bed bugs have impacted the hotel industry and addresses how to keep the workplace safe to keep productivity up and liability claims down. Part V provides an overview of the growing field of bed bug litigation. Part VI discusses the relevant statutes and regulations that impact employers and protect employees from bed bugs in the workplace environment.

As a result of the increased number of claims made by bed bug victims, new questions have arisen about whether claims related to bed bugs are covered by insurance. A discussion of first- and third-party claims is provided in Part VII. Finally, as it is clear that the bed bug epidemic is here to stay, Part VIII concludes with a discussion of how to find and eliminate bed bugs. This section of "best practices" will help to detect bed bugs at an early stage to help avoid complete infestation as well as the costly methods associated with eradicating them. As there are several different methods for alleviating bed bugs, each with its own varying rates of success, a thorough list of different ways to treat bed bugs is provided.

Chris Elko is an associate in the Labor and Employment Practice Group in the New Jersey and New York offices of Norris McLaughlin & Marcus, P.A. His practice focuses on drafting and implementing employment policies that avoid employer liability. Mr. Elko also has substantial experience in defending employers against Title VII claims and FLSA claims. He has guided clients in the resolution of labor issues including negotiating collective bargaining agreements, spearheading election campaigns for employers, and defending employers against unfair labor practice charges before the National Labor Relations Board. Mr. Elko is admitted to practice in New Jersey and New York. He is a member of the New Jersey Bar Association and the Employment Section of the Morris County Bar Association, and he is an active member in the New York City Inn of Court.

II.
The Resurgence of Bed Bugs: Public and Private Responses

For decades, bed bugs were thought to be a non-issue after the introduction in the 1940s of dichlorodiphenyltrichloroethane (DDT), a well-known synthetic pesticide effective on bed bugs.[1] That harmful pesticide has since been banned, and now bed bugs have reemerged throughout the country. Bed bugs have found their way to hotels,[2] offices,[3] and movie theaters[4] as well as residential and city housing.[5] As a result of the outbreak, websites have been cre-

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[1] *See* Jerry Adler, *The Politics of Bedbugs: Conservatives Say That the Ban on DDT Is To Blame for the Recent Resurgence in Bedbugs,* The Daily Beast (Sept. 8, 2010, 11:00 AM), http://www.thedailybeast.com/newsweek/2010/09/08/conservatives-blame-environmentalists-for-bedbugs.html.

[2] Bed bug complaints in hotels include the Waldorf-Astoria in New York City. *See* Bill Sanderson, *Guest Complains of Bed Bugs at the Waldorf*, N.Y. Post (Oct. 7, 2010, 10:48 AM),

http://www.nypost.com/p/news/local/manhattan/hotel_really_bites_Euvr5OhEEYsXKElmNYK07O.

[3] Bed bugs have been found in the offices of the Wall Street Journal and Elle Magazine. *See* Caroline Howard, *Office Memo: Bed Bugs Are Back*, Forbes.com (Aug. 19, 2010, 7:00 PM), http://www.forbes.com/2010/08/19/bed-bugs-germs-office-forbes-woman-well-being-illness.html; Melanie Grayce West, *Bedbugs Suspected Inside Wall Street Journal's Office*, Wall St. J. (Oct. 4, 2010, 2:48 PM), http://blogs.wsj.com/metropolis/2010/10/04/bedbugs-strike-inside-wall-street-journals-office.

[4] Bed bugs were reported to have been found at a movie theater in Times Square, New York City. *See* Emily B. Hager, *What Spreads Faster Than Bedbugs? Fear and Social Stigma*, N. Y. Times, Aug. 21, 2010, at A1.

[5] Bed bugs also have been reported by people living in the Blayton Building, Williamsburg, Va. Brian Farrell, *Finding, Fighting Bed Bugs*, WVEC.com (Sept. 22, 2010, 12:40PM), http://www.wvec.com/news/Finding-fighting-bed-bugs-103528619.html. Additionally, residential complaints of bed bugs increased in New York City by 7% during 2010. Melanie Grayce West, *City's Problem with Bedbugs Getting Itchier,* Wall St. J., Jan. 11, 2011, at A21.

Robert Christie is the founder and president of Christie Law Group, PLLC, a boutique litigation firm in Seattle, Washington. He has thirty years of trial experience and expertise. Since 2000, Mr. Christie has been named a Washington Law & Politics Super Lawyer. Mr. Christie began his career as a law clerk to Honorable Vernon Pearson, Division II Court of Appeals. Mr. Christie has tried cases throughout Washington State and the United States District Courts in Washington and Alaska. In his appellate practice, he has argued appeals in all divisions of the Washington Court of Appeals, the Washington State Supreme Court, Ninth Circuit Court of Appeals, the Federal Circuit Court of Appeals, and United States Supreme Court (on briefs). Mr. Christie writes and lectures frequently on risk management issues and also serves as a mediator. He chairs the civil rights subcommittee to the Washington Pattern Instruction Committee. A Federation of Defense and Corporate Counsel member since 2009, he chairs the Civil Rights and Public Entity Liability Section.

ated to provide information about bed bugs,[6] exterminators have enlarged their practices to include bed bug eradication,[7] and new methods to stop bed bugs have emerged.[8] In fact, the bed bug epidemic has become such a problem that the federal government has undertaken an outreach and education project on bed bugs. The Environmental Protection Agency (EPA) hosted the National Bed Bug Summit in April 2009 in Arlington, Va., to develop recommendations on how to address the many problems posed by the bed bug resurgence. A follow-up conference was held in February 2011 in Washington, D.C. to discuss efforts made to control bed bugs in settings such as schools and public housing. The conference also examined how governments can promote effective bed bug prevention as well as how to educate elderly, disabled, and hoarding residents about bed bugs.[9] In order to determine how the bed bug epidemic became a problem, a look at their origins is helpful.

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[6] Various websites that address bed bugs include bedbugger.com, bedbugregistry.com, bedbugreports.com, and bed-bugs.org. Bedbugregistry.com provides guests with a forum to voice their complaints. *See, e.g.*, Recent Bed Bug Reports for N.Y. City, Bed Bug Registry, http://bedbugregistry.com/metro/nyc/recent/ (last visited Nov. 2, 2011).

[7] Bed bug exterminators made $258 million in 2009 from bed bug treatments, according to the National Pest Management Association. *See* Steve Hargreaves, *Why We Can't Kill Bedbugs*, CNNMoney.com (Nov. 6, 2010, 2:58 PM), http://money.cnn.com/2010/11/05/news/economy/bed_bug_cure/index.htm.

[8] *See infra* Part VIII. Additionally, the iPhone now has an app which shows reported infestations of bed bugs. More information regarding this app can be found at http://itunes.apple.com/us/app/bed-bug-alert/id397206377?mt=8.

[9] Additional information regarding the Second National Bed Bug Summit in February 2011 is available at http://www.epa.gov/oppfead1/cb/ppdc/bedbug-summit/2011/2nd-bedbug-summit.html.

Peter M. Di Eduardo is a Senior Manager with Bell Environmental Services, a full-service pest control company founded in 1963 in Parsippany, New Jersey. Bell Environmental is one of the largest providers of pest control services in the New York-Metro region and a pioneer in using environmentally-friendly methods to eliminate pests. Mr. Di Eduardo frequently presents before health care organizations, business associations, local government agencies, and not-for-profit groups on how to recognize, detect, and eliminate bed bugs at different stages of infestations. He is also the Vice Chairman of the Morristown Redevelopment Committee, which oversees multi-million dollar real estate projects, a position he has held since 2002. Prior to joining Bell Environmental in 2010, Mr. Di Eduardo had ten years of experience in commercial and residential real estate industries in New Jersey.

III.
From Caves to Hotels—The History and Biology of Bed Bugs

Bed bugs, also known as Cimex Lectularius, are part of the family of insects that feed exclusively on the blood called Cimicidae. Bed bugs are believed to have started as cave-dwelling bugs that dined on bat blood,[10] before they encountered human beings. The human-bed bug relationship then evolved with bed bugs switching from bat to human blood, and eventually the bed bugs followed humans out of the caves as we began to form today's civilized cultures.[11]

The bed bug found in the United States has five developmental stages, each requiring a blood meal to graduate to the next stage. The change from egg to adult takes approximately thirty-seven days.[12] Once an adult, the average bed bug lives for one year, with its ultimate life span dependant on how often it feasts as well as the temperature in which it lives. Recent laboratory studies have shown that starvation decreases bed bug survival.[13] On average, a bed bug deprived of a blood meal will die within seventy days, although dehydration rather than starvation is the actual cause of death.[14]

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[10] *See* Dini M. Miller & Andrea Polanco, Va. Coop. Extension & Va. Dep't of Agric. & Consumer Servs., Bed Bug Biology and Behavior 1, *available at* http://www.vdacs.virginia.gov/pesticides/pdffiles/bb-biology1.pdf (last visited Oct. 12, 2011).

[11] *See id*.

[12] *See id*.

[13] *See id.* at 4.

[14] *See id*.

Michael Glascott is a partner in the Buffalo, New York office of Goldberg Segalla LLP where he works in the firm's Global Insurance Group. His practice includes complex insurance coverage, bad faith, and commercial litigation as well as personal injury defense. Mr. Glascott has successfully represented insurer clients in courts throughout New York and other northeastern states such as Ohio, New Jersey and Delaware. Mr. Glascott is a former Assistant District Attorney for the County of Erie, and he has also successfully defended personal injury claims and litigated insurance coverage and commercial disputes while engaged by private law firms in Tulsa, Oklahoma and Buffalo, New York. Mr. Glascott, a member of the FDCC, currently serves as the Chair of the Insurance Coverage Section, the Vice Chair for the Task Force on Civil Discovery, the Eastern Coordinator for State Representatives, and the Chair of the Resolution Revision Committee.

Bed bugs commonly feed between midnight and 5 a.m.,[15] which is generally the time when humans enjoy their deepest sleep. Bed bugs find humans based on body temperatures and carbon dioxide emitted while breathing.[16] Bed bugs are known to detect their hosts from only about three feet away, so the insects might travel great distances before detecting a human.[17]

Once a potential host is located, a bed bug will use its mouth parts to find a human capillary.[18] As the first bite usually is not successful, a bed bug might take several bites before it finds a capillary to its liking. As a result, someone bitten by a bed bug will often have several bites in the same area. Once a bed bug has found a proper feeding area, it will spend five to ten minutes feeding.[19] Digestion then takes place in the crack or crevice where the bed bug lives. Commonly after eating, a bed bug will have the urge to mate. After a female has mated with a male, she can produce between five to twenty eggs from a single meal and, under the proper conditions, 97% of the bed bug eggs hatch successfully.[20] Even more problematic is that a female, after mating with a male, can continue to lay eggs without the presence of a male as long as she is able to feed. This ability equals more bed bugs in one area and the potential for a greater nuisance to those humans living nearby.

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[15] *See id.* at 1.

[16] *See id*.

[17] *See id.* at 1.

[18] *See id*. at 2.

[19] *See id*.

[20] *See id*. at 3.

Elizabeth F. Lorell is a partner in the Employment, Insurance Practice and Professional Liability groups of the New Jersey office of Gordon & Rees, LLP. Ms. Lorell defends employers and their senior personnel in employment litigation and defends lawyers, accountants and other professionals in malpractice actions. She also handles counseling and litigation for national insurers on unique and complex issues stemming from directors and officers, errors and omissions and first and third-party insurance policy disputes. Ms. Lorell is admitted to practice in New Jersey, New York, Pennsylvania and Colorado. She is currently the Chair of the FDCC Employment Practices and Workplace Liability Section and a Vice President of the FDCC. Ms. Lorell is also a member of the New Jersey Federal Bar Association and the New Jersey, New York and Colorado Bar Associations. In 2009, 2010 and 2011, Ms. Lorell was selected as a New Jersey Super Lawyer in the area of employment, professional liability and insurance litigation.

IV.
The Impact of Bed Bugs on the Hotel Industry and in the Workplace

One of the industries hardest hit by the bed bug epidemic is the hotel industry. Although hotels have become familiar with the surge of bed bug claims in recent years, the volume and nature of such claims are expected to continue to grow.[21] Bed bug infestations are reported to have increased 300% nationally between 2000 and 2001, 70% between 2001 and 2002, and 70% between 2002 and 2003.[22] Approximately 20,000 bed bug reports have been made to bedbugregistry.com since summer 2010 for hotels throughout the United States.[23]

The 2009 EPA National Bed Bug Summit requested that representatives of the hospitality industry attend to help identify options for bed bug prevention, control, management, and strategies for outreach and education.[24] Obviously, the negative consequences from bed bug infestation can be detrimental to a hotel for many reasons, including the hotel's repu-

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[21] *See* Jeff Casale, *As Bedbug Concerns Grow, Will Insurers Feel the Bite?*, Bus. Ins. (Aug. 8, 2010, 6:00 AM), http://www.businessinsurance.com/article/20100808/ISSUE01/308089979.

[22] *See* S. Carl Morello, *The Bed Bugs Are Coming! The Bed Bugs Are Coming!*, Ins. J., Aug. 20, 2007, http://www.insurancejournal.com/magazines/mag-features/2007/08/20/83351.htm (last visited Nov. 4, 2011).

[23] *See* Bed Bug Registry, Frequently Asked Questions, www.bedbugregistry.com/faq. Bedbugregistry.com is quick to point out that the bed bug reports submitted through its site are not checked for accuracy.

[24] *See* Agenda, EPA's Nat'l Bed Bug Summit, Apr. 14–15, 2009, www.epa.gov/pesticides/ppdc/bedbug-summit/final-agenda.pdf (last visited Nov. 2, 2011).

tation. The stigma that bed bugs only reside in unclean areas, although untrue, is one that lives on today. As a result, the hotel industry has resorted to bed bug action plans to avoid potential lawsuits and loss of profits. Early detection is vital for this industry. Hotels have been encouraged to train their employees to detect the signs of bed bugs and take preventive measures to find bed bugs, including annual canine scent detection.[25] Additionally, hotels should have plans in place before their guests find or complain of bed bugs, so that hotel employees know how to respond if bed bugs are detected, including compensating guests for their inconvenience. The 2011 Bed Bug Summit stressed that hotel employees should be educated on bed bug control and prevention, as the benefits to the hotels and their guests is dramatically increased when employees have sufficient understanding of how to find and control bed bugs.

As a result of the bed bug problems facing hotels, new companies have created a variety of products, including mattress shields and bed bug sprays, in addition to different self-help methods to stop infestation. Additionally, clever marketers have offered hotels shields that they can display at their front desks to alert guests that their facilities are regularly checked for bed bugs. Such methods show the hotel industry's willingness to fight bed bugs and that it is no longer turning a blind eye to the problem. Hotel operators have good reason to take such an approach. As discussed in Part V of this Article, lawsuits that could arise from bed bug infestation at a hotel include claims for negligence, breach of the implied warranty of habitability, nuisance, battery, and fraud.[26]

Other employers should take heed. The thought of bed bugs in the workplace is enough to make any employer (and employee) shudder. But the bigger issue for forward-thinking employers and their human resources personnel is the cloud of uncertainty surrounding this explosive issue. Already sensing a potential tidal wave of complaints and alarms, observant employers are not just bracing for impact, they are fighting back. While the dearth of case law and bed bug-specific statutes leads to some guesswork, guidance exists in the many federal regulations governing employers. By reviewing the cornerstone of these policies and examining comparable HR issues, employers can begin to assemble effective bed bug policies that should provide some safe harbor from liability claims and costly drops in employee productivity.

Given the uncertain legal landscape right now, employers might question whether initiating bed bug policies makes sense. The answer is a resounding "YES"! An effective bed bug policy starts with engaging and educating the workforce. Teaching employees about the

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[25] *See* Dini M. Miller, Va. Coop. Extension & Va. Dep't of Agric. & Consumer Servs, Bed Bug Action Plan for Hotels 1–2, *available at* http://www.vdacs.virginia.gov/pesticides/pdffiles/bb-hotels1.pdf (last visited Nov. 2, 2011).

[26] *See also* Daniel W. Whitney & Melissa A. Graf, *The Prosecution and Defense of Bedbugs Lawsuits,* 25 Toxics L. Rep. 37 (2010).

basic science and habits of bed bugs is relatively easy,[27] and once those employees know how to spot the bugs and know where they hide, the employer will have an additional layer of protection that can help stop an infestation before it spreads. Also, by educating employees, an employer will increase the chances that its employees will perform home inspections, which is critical, as many work-related infestations originate from an infestation in an employee's home. Finally, by dealing with the problem head on, an employer can avoid a sense of panic if bed bugs do come to the workplace. When employees know that bed bugs have limited mobility, reside in the same places, and do not transmit disease, they can cope more easily with this emotionally and financially charged issue.

After educating the workforce, employers should consider how they can solidify their reporting process. Employers should make sure their employees feel comfortable reporting possible bed bug infestations and attempt to lessen, if not remove, the stigma those employees may feel. If an employee claims that a co-worker has bed bugs, employers need to be tactful in handling the complaint. Employers must walk a fine line between diligently following up on reports[28] and possible harassment. Additionally, employers need to consider how they might handle "repeat offenders." This issue looms large as diligent reporting and extermination cannot stop an employee from bringing bed bugs from a home to the workplace, creating a vicious cycle. When considering options, employers should not offer to exterminate their employees' homes. Not only are such inspections and exterminations costly, but they will not guarantee that their employees or their families will not unwittingly continue to bring bed bugs back to their homes from other sources. Employers must also avoid disciplining employees who cannot afford to exterminate their homes, as such adverse action could potentially lead to discrimination claims under the Americans with Disabilities Act (ADA) or even under a Title VII theory of disparate impact if they somehow disproportionately affect employees of one gender.[29] Employers dealing with repeat offenders should seek counsel and identify a strategy that can most effectively bring an end to the cycle of extermination and re-infestation in the workplace.

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[27] Many different publications are available from federal and state agencies looking to stem the tide of bed bug complaints. A good educational resource was assembled by the New York City Department of Health and Mental Hygiene, which provides a comprehensive educational website as well as a downloadable guide available in seven languages. *See* N.Y. City Dep't of Health & Mental Hygiene, Preventing and Getting Rid of Bed Bugs Safely, http://www.nyc.gov/html/doh/downloads/pdf/vector/bed-bug-guide.pdf (last visited Nov. 2, 2011). ; *see also* Ctrs. for Disease Control & Prevention, Envtl. Health Servs., Bed Bugs, http://www.cdc.gov/nceh/ehs/topics/bedbugs.htm (last visited Nov. 2, 2011).

[28] *See* Thoroughgood, Inc., 1999 Occupational Safety & Health Decisions (CCH) ¶ 31,805, at 46,683 (1999).

[29] For employees who rent, landlords have certain obligations to shoulder the cost of exterminations. Under New York City's health code, when a tenant issues a complaint and the state inspection verifies that bed bugs are on the premises, the landlord may be ordered to take steps to remove the pests by the city's Department of Health and Mental Hygiene. *See* Rules of the City of N.Y., tit. 24, pt. B, § 151.02(d) (2011).

Finally, employers should have a firm and detailed plan on how to handle an infestation if and when it comes to the workplace. Any plan should begin with soliciting the help of a professional to analyze and eliminate the problem. Following such professional advice to clear the workplace of bed bugs is key, seemingly providing a legal "safe harbor" for employers so far.[30] Keep in mind, no perfect solution exists to eradicating bed bugs in the workplace, but a responsive and educated workforce is likely the best defense against a full-blown infestation.

V.
Owners and Occupiers: Emerging Bed Bug Case Law

Bed bug litigation is on the rise nationwide, although it is mostly concentrated on the East Coast and in the Chicago area. The communicable nature of bed bug infestation distinguishes it from other pests, giving rise to claims that not only originate from damages caused by staying in an infested location, but also from secondary infestations.

A significant number of reported appellate decisions have been issued with regard to this growing problem, falling into a few broad categories: punitive damage awards, claims for breach of the warranty of habitability, premises liability claims pertaining to secondary infested locations, and buyers' claims purportedly arising out of purchases of infested buildings. Additionally, some cases reported by the media have yet to find their way through the court system, and thus have not generated any published opinions.

A. *Punitive Damage Awards to Hotel Guests*

A hotel owner aware of an infestation problem faces a public relations decision with real legal consequence: warning guests of the infestation and what is being done to solve it or ignoring the problem and proclaiming surprise when a guest complains. A motel chain owner in Chicago chose the latter course of action, resulting in a relatively small $5,000 verdict for actual damages to each guest and a whopping $186,000 in punitive damages for each guest, under an Illinois statute that allows punitive damages where the conduct is willful and wanton.[31]

In *Mathias v. Accor Economy Lodging*, Judge Richard Posner wrote a decision upholding an award to a brother and sister bitten while spending the night in a $100 per day room

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[30] *See* Clark v. Beacon Capital Partners, LLC, No. 107455/2008 (N.Y. Sup. Ct. Apr. 12, 2011). While the suit did not name the employer as a defendant, the opinion lauds the efforts that the employer took to remedy the bed bug infestation. *See id.* at 10. The case gained notoriety because the employer was Fox News. *See, e.g.*, Russell Goldman, *Fox News Worker Files Bedbugs Lawsuit*, ABC News (May 30, 2008), http://abcnews.go.com/Health/story?id=4959477&page=1; Jacques Steinberg, *Bedbugs at Fox News*, N.Y. Times, Mar. 18, 2008, at E2.

[31] *See* Mathias v. Accor Econ. Lodging, 347 F.3d 672, 674 (7th Cir. 2003).

at a Motel 6.[32] In that diversity case, the Seventh Circuit, applying Illinois law, affirmed the lower court's finding that the hotel owner's "failure either to warn guests or to take effective measures to eliminate the bedbugs amounted to fraud and probably to battery as well."[33] The hotel's conduct was so egregious that the court upheld an award of punitive damages in a ratio of 37.2 to 1 over the award of general damage.[34]

Judge Posner is a great writer, and this well-written opinion contained persuasive language about the need to make an example of an establishment that tried to cover up its infestation. Declining to listen to an extermination service that recommended every room be sprayed, hotel management instructed desk clerks to refer to the bed bugs as "ticks" and place "Do not rent, bugs in room" holds on certain infested rooms.[35] This method did not work. The infestation continued and began to reach farcical proportions. A guest who complained about being bitten repeatedly by insects while asleep in his room was moved to another room only to discover insects there as well. Within eighteen minutes of being moved to a third room, he discovered insects in that room and had to be moved yet again.[36] The plaintiffs in *Mathias* were checked into a room that the motel had designated should not be rented until it could be treated. Needless to say, the room had not been treated. "Indeed, that night 190 of the hotel's 191 rooms were occupied even though a number of them had been placed on the same don't-rent status."[37]

The balance of the *Mathias* opinion contains an excellent discussion of the jurisprudence of punitive damage awards, including whether the award in this case violated fundamental rights of due process. One factor in the court's decision to uphold the award was the tenacity of the defense mounted against a relatively modest claim:

> In other words, the defendant is investing in developing a reputation intended to deter plaintiffs. It is difficult otherwise to explain the great stubbornness with which it has defended this case, making a host of frivolous evidentiary arguments despite the very modest stakes even when the punitive damages awarded by the jury are included.[38]

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[32] *See id.* at 678. Judge Posner commented that bedbugs "are making a comeback in the U.S. as a consequence of more conservative use of pesticides." *See id.* at 673. He cited two newspaper articles for this statement *See id.*

[33] *Id.* at 675.

[34] *See id.* at 678. The defense relied heavily on the Supreme Court's decisions in BMW of North America, Inc. v. Gore, 517 U.S. 559 (1996) (the "BMW paint case") and State Farm Mutual Automobile Insurance Co. v. Campbell, 538 U.S. 408 (2003), where the Court suggested that "more than four times the amount of compensatory damages might be close to the line of constitutional impropriety." *Campbell,* 538 U.S. at 425.

[35] *See Mathias*, 347 F.3d at 675.

[36] *Id.*

[37] *Id.*

[38] *Id.* at 677.

While the level of misconduct in this case might be viewed as extreme, it reflects the level of stigma perceived in being branded publicly as the "Bed Bug Inn." The court noted that under Chicago's municipal code, a hotel that permits unsanitary conditions to exist is subject to revocation of its license, without which it cannot operate. Here, Judge Posner noted that the court was "sure that the defendant would prefer to pay the punitive damages assessed in this case than to lose its license."[39]

B. *Bed Bug Infestation in an Apartment Constitutes a Breach of the Warranty of Habitability*

Another group of cases arising out of the lower courts of a raft of eastern seaboard states involves disputes in landlord–tenant situations. Most arise from actions for unpaid rent withheld by a tenant because an apartment was infested with bedbugs.

In a 2004 decision by the Civil Court of New York City, *Ludlow Properties, LLC v. Young*,[40] the judge noted that whether bed bugs can form the basis for a breach of the warranty of habitability defense was a matter of first impression.[41] That is no longer true. It is now well-established that an infestation, even if not initially caused by the landlord, can form the basis for a claim of rent abatement. The *Young* court predicted as much when it noted that the

> prevalence of cases in which bedbugs are involved is sure to increase to an epidemic as the foothold that bedbugs have obtained in the urban setting of the City of New York grows ever larger. However, in fixing what is a proper abatement the Court is also mindful that the condition may not be attributable to a landlord, and that the landlord may attempt multiple exterminations to little or no avail due the resiliency of bedbugs from eradication.[42]

Landlords' efforts at eradication detailed in these rent-dispute opinions are the stuff of legends. So too are the efforts on the part of tenants to avoid getting bitten while attempting to sleep in their infested units. The courts struggle in these cases to find a balance between these two concerns, but generally rule in favor of the tenant based on statutory language imposing near strict liability on landlords for failing to keep premises free from unsafe and unhealthy conditions.

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[39] *Id.* at 678.

[40] 780 N.Y.S.2d 853 (Civ. Ct. 2004).

[41] *See id.* at 856.

[42] *Id.*

The landlord–tenant cases[43] are replete with snippets of expert testimony from exterminators. Some of the facts that have emerged include the following: (1) bed bug infestation does not vary seasonally; (2) if three weeks pass without an individual being bitten, the bedbug problem is likely resolved; and (3) 90% of men do not manifest bedbug bites, and women are more commonly bitten because of their higher body temperatures. As colorfully described in a New York Law Journal article from 2006, "[t]hese opportunistic parasites are known as proficient hitchhikers. They travel from one place to another in luggage and clothing, jumping off at homes and hotels. What is worse is that these resilient pests have been known to survive 500 days without feeding."[44] May the exterminators help us survive an infestation of this perfectly evolved pest.

C. *Damages from a Premises Liability Claim May Extend to a Secondarily Infested Location*

Following a four-day business trip to the Radisson Lake Buena Vista Hotel in Florida, Mr. Prell brought home a bed bug infestation that he unknowingly shared with his wife and their minor son. The resulting District Court opinion in *Prell v. Columbia Sussex Corp.*[45] is an example of a premises liability suit where the plaintiff became infested at a hotel and then created a secondary infestation in his family home. His damages included personal injury damages and property damage to his own residence from the transported infestation.

In its denial of the defendant's summary judgment motion, one issue concerned whether expert testimony was necessary to support the infestation claim. The court ruling rejected a requirement for expert testimony. Citing the doctrine of *res ipsa loquitur,* the court instead held that there was adequate evidence of damages from a secondary infestation to survive summary judgment:

> [Mr. Prell] repeatedly observed small, reddish-brown, tick-like insects in the Hotel of Defendant in Florida; he repeatedly saw identical insects in Pennsylvania within a few weeks of returning from Florida; he had never seen such insects before seeing them in the Hotel; he had never before seen such insects in his home; he researched the insects and came to believe they were bed bugs; an exterminator came twice to his home and confirmed the insects were bed bugs.[46]

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[43] Other cases in this group include *Valoma v. G-Way Mgmt*., No. SCK 3545/10-1,2,3, 2010 N.Y. Misc. LEXIS 5521 (Civ. Ct. Nov. 3, 2010), *Bender v. Green,* 874 N.Y.S.2d 786, 790–91 (Civ. Ct. 2009), *Zayas v. Franklin Plaza,* No. 3316/2008, 2009 N.Y. Misc. LEXIS 698 (Civ. Ct. Apr. 6, 2009), and *Lewis v. 525-527 Main St. EH. LLC,* No. HCH562, 2009 Conn. Super. LEXIS 3097 (Super. Ct. Nov. 13, 2009).

[44] Timothy M. Wenk & Howard S. Shafer, *Outside Counsel; Good Night, Sleep Tight, Don't Let the Cimex Lectularis Bite*, N.Y. L. J., Jan. 26, 2006, at 24.

[45] Civil No. 07-2189, 2008 U.S. Dist. LEXIS 84536 (D. Pa. Oct. 20, 2008).

[46] *Id.* at *23.

The case also contains a good discussion on the issue of whether the hotel owner should have been on notice of its infestation problem:

> Defendant contends that here, it had mere "general," nonspecific notice of "bugs" in Mr. Prell's room—not enough to alert it to the presence of the dangerous condition at issue, bed bugs. . . . A juror could reasonably find defendant had actual notice of the condition if he or she inferred that the Hotel's cleaning crew or other staff looked into the complained-of problem as promised and observed the same insects seen daily by Mr. Prell. A reasonable juror could likewise find that Defendant had constructive notice of the bedbugs in the room by finding that after Mr. Prell reported the insects, Defendant had a duty to make reasonable inquiry by examining Mr. Prell's room (whether or not it actually did so), and that such inquiry would have revealed the condition at issue and obligated Defendant to take steps to identify and remedy it.[47]

Constructive notice to the hotel has now become a matter of public knowledge through such websites as bedbugregistry.com. Property owners may rely on this same website to argue that Mr. Prell should have been on notice that its property was infested—truly a last resort.

D. *Caveat Emptor Protects Seller of an Apartment Building*

Bed bugs are considered a latent defect that does not provide a basis for a purchaser of an apartment building to rescind the transaction after discovering an infestation. That was the recent holding of the New York Supreme Court in *85-87 Pitt Street LLC v. 85-87 Pitt Street Realty Corp.*[48] That court rejected the buyer's claim "that the infestation is a latent defect not reasonably discoverable with due diligence."[49] It also rejected the buyer's alternative claim for compensatory, punitive, and loss of reputation damages.[50] The contract of sale at issue established unequivocally that the building was being sold "as is" and that the buyer had engaged in a full inspection. The court stated,

> The fact that Buyer is unsatisfied with the presence of bedbugs in the Building, that Buyer is losing tenants, and that Buyer is spending unanticipated amounts of money to remediate the problem, is not sufficient to demonstrate a breach of contract because defendants failed to disclose the presence of bedbugs to Buyer.[51]

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[47] *Id.* at *16–18.

[48] No. 601341/09, 2010 N.Y. Misc. LEXIS 1692 (Sup. Ct. Apr. 6, 2010).

[49] *Id.* at *3.

[50] *Id.* at *15.

[51] *Id.* at *9.

For sophisticated parties in commercial transactions, an undisclosed bed bug infestation will not likely undo a sale. Given the growing infestation problem, any sound purchaser (and that purchaser's counsel) should consider including a bed bug inspection as a routine part of pre-closing due diligence.

VI.
Employers and Employees: Federal Employment Laws

While the hotel industry has the benefit of case law to determine what not to do as it relates to bed bug claims, employees and employers in other industries and professions have statutes and regulations that can provide similar guidance.

A. *Occupational Safety and Health Act of 1970*

The Occupational Safety and Health Administration is the federal agency charged with administering and enforcing the Occupational Safety and Health Act of 1970 (OSHA).[52] OSHA broadly requires an employer to "furnish to each of his employees . . . a place of employment . . . free from recognized hazards that are causing or are likely to cause death or serious physical harm to his employees."[53] That "general duty clause" provides a broad requirement that is narrowed and defined by the many regulations left for the Secretary of Labor to promulgate.[54] These voluminous regulations create comprehensive safety standards for a variety of workplace hazards, including a regulation on vermin control as well as a regulation that protects the rights of whistleblowers.

1. The General Duty Clause

Before addressing the specific regulations, employers should ask whether their responsibilities under OSHA's general duty clause are triggered by the mere presence of bedbugs in the workplace. Put another way: Can bed bugs in the workplace be classified as a "recognized hazard" that could cause "serious physical harm" to employees? First, the fact that bed bugs can go undetected by employees and employers does *not* preclude their classification as a recognized hazard.[55] In fact, not only are employers responsible for hazards they know about,[56] but employers who are unaware of hazards are also required to take reasonable precautions to avoid hazards generally recognized in the industry.[57]

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[52] *See* U.S. Dep't of Labor, About OSHA, http://www.osha.gov/about.html (last visited Nov. 2, 2011).

[53] Occupational Health & Safety Act of 1970 § 5(a)(1), 29 U.S.C. § 654(a)(1) (2006).

[54] *See id.* § 6, 29 U.S.C. § 655(a).

[55] *See* Am. Smelting & Refining Co. v. Occupational Safety & Heath Review Comm'n, 501 F.2d 504, 511 (8th Cir. 1974) (stating that a "recognized hazard" is not limited to one that can be recognized directly by human senses without assistance of any technical instruments).

[56] *See* Usery v. Marquette Cement Mfg. Co., 568 F.2d 902, 910 (2d Cir. 1977).

[57] *See* Nat'l Realty & Constr. Co. v. Occupational Safety & Health Review Comm'n, 489 F.2d 1257, 1265 n.32 (D.C. Cir. 1973).

Nevertheless, bed bugs still may not trigger employer obligations under the general duty clause because they would need to pose more of a threat than the mere potential for injury to qualify as a "recognized hazard."[58] The general duty clause's requirement that a hazard be likely to cause death or serious physical harm to employees also should disqualify bed bugs. Serious physical harm is limited to injuries where "a part of the body is damaged so severely that it cannot be used or cannot be used very well."[59] The impact of bed bugs on one's body is normally a red welt, suggesting that to assert the loss of an entire body part would be a stretch. Although employers should remain watchful for trends as the spike in bed bug reporting continues, on its face it appears the general duty clause of the OSHA will not apply in the bed bug context.

2. The Vermin Control Clause

In addition to the general duty clause, several regulations promulgated by the Secretary of Labor address specific threats to the health and physical well-being of employees. Most relevant to the bed bug epidemic is 29 C.F.R. § 1910.141(a)(5), which states: "Every enclosed workplace shall be so constructed, equipped, and maintained, so far as reasonably practicable, as to prevent the entrance or harborage of rodents, insects, and other vermin. A continuing and effective extermination program shall be instituted where their presence is detected."

Even though bed bugs do not transmit disease or cause serious physical damage, the Occupational Safety and Health Review Commission (OSHRC)[60] is likely to consider this regulatory clause as governing bed bug occurrences in the workplace. Indeed, given the regulation's broad reference to "insects, and other vermin" as well as bed bugs' propensity to multiply at rapid rates,[61] an OSHA violation may be upheld if an employer fails to properly address an ongoing infestation.[62] That said, the mere existence of bed bugs is probably insufficient to violate OSHA.[63] In deciding a challenge to a citation in *Thoroughgood Inc.*,

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[58] *See* Pratt & Whitney Aircraft v. Sec'y of Labor, 649 F.2d 96, 98 (2d Cir. 1981).

[59] *See* U.S. Dep't of Labor, Occupational Safety & Health Admin., Imminent Danger Requirements, http://www.osha.gov/as/opa/worker/danger.html (last visited Nov. 2, 2011).

[60] The OSHRC is an independent federal agency that resolves disputes over citations or penalties from OSHA inspections of American workplaces. The Review Commission, therefore, functions as an administrative court, with established procedures for conducting hearings, receiving evidence, and rendering decisions through its Administrative Law Judges (ALJs). *See* Occupational Safety & Health Review Comm'n, About the Commission, http://www.oshrc.gov (last visited Nov. 2, 2011).

[61] *See supra* notes 23, 24.

[62] *See Thoroughgood, Inc.*, 1999 Occupational Safety & Health Decisions (CCH) ¶31,805, at 46,683–84 (1999)

[63] *See id*. at 46,683 (noting that "it may not always be reasonable for . . . an older facility to be completely vermin free where food is prepared and where numbers of people live in close quarters").

the OSHRC focused more on how the employer reacted to an infestation and less on the presence of vermin. In that case, the Azalea Court residential care home hired a pest control specialist, SAB Environmental Services, to inspect the grounds and offer opinions on how to handle the infestation. The employer ignored the expert's advice, and the OSHRC ruled that

> [i]t was reasonably practicable for Azalea to follow SAB's recommendations on how to lessen its vermin infestation. Because Azalea repeatedly ignored the recommendations of its own vermin control contractor, and because vermin were continually observed during the period at issue, it is concluded that Azalea neither prevented the harborage of vermin nor instituted an effective vermin control program. Azalea violated the terms of the standard.[64]

Hence, ultimately, the question is not *whether* an employer has an infestation, but rather how the employer *addresses* and *combats* the infestation.[65] Employers can find safe harbor from OSHA claims if they remain responsive to signs of infestations and follow the advice of professionals.[66]

If the OSHRC *does* find a violation, the commission must give "'due consideration' to the size of the employer's business, the gravity of the violation, the employer's good faith, and history of past violations in determining an appropriate penalty."[67] Given the prevalence of the bed bug resurgence, good faith can go a long way in determining whether a violation has occurred. If a violation is substantiated, the likelihood of infection will be a major consideration when determining the gravity of the claim.

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[64] *Id.* at 46,683.

[65] *See* Clark v. Beacon Capital Partners, LLC, No. 107455/2008, at 3–5 (N.Y. Sup. Ct. Apr. 12, 2011) (describing the various approaches undertaken by an employer to combat a bedbug infestation in the workplace, including calling in an exterminator, employing a bed bug-sniffing dog, hiring a board-certified entymologist, and visiting an employee's home). This recent decision gained notoriety, both because it was one of the first instances of an employee bringing suit against a *commercial* landlord and also because the employer was Fox News. *See* Goldman, *supra* note 30; Steinberg, *supra* note 30. Ultimately, the court dismissed the claims against defendants, based largely on the fact that "the property defendants could not have taken any measures beyond those taken by [the employer]." *Clark*, No. 107455/2008, at 10.

[66] Worthy of note is that, under OSHA, employers can be their own worst enemies when attempting to combat infestations. Chemical treatments are considered by some to be ineffective by professional exterminators. *See infra* Part VII.B.2. If those chemicals are still used and create hazards to employees, either under the general duty clause or under the more specific "hazardous chemicals" section of OSHA, their presence in the workplace will only exacerbate an employer's OSHA liability. *See* Occupational Safety & Health Act of 1970 § 6(b)(7), U.S.C. § 655(b)(7) (2006) ("hazardous chemical" section). Employers should always contact professionals when exterminating.

[67] Thoroughgood, Inc., 1999 Occupational Safety & Health Decisions (CCH) ¶31,805, at 46,684 (1999) (quoting J.A. Jones Constr. Co., 1993 Occupational Safety & Health Decisions (CCH) ¶29,964, at 41,033 (1993)).

3. The Whistleblower Clause

If bed bugs make their way into the workplace, employers must remain calm and avoid alienating employees who may have brought the infestation there, discovered the infestation, or flagged the issue as a concern. OSHA's whistleblower clause provides certain protections for employees who report what they believe to be violations of the law.[68] Thus, employers must be delicate in their handling of complaints and reports, especially in self-reporting scenarios, by balancing the need to maintain a safe and productive workplace with the legal requirement to treat the reporting party fairly and in a non-discriminatory manner.

To bring a successful whistleblower claim, an employee need only prove that (1) the employee participated in protected activity; (2) the employer took subsequent adverse action; and (3) a causal connection tied the employer's action to the protected activity.[69] An internal complaint is "protected" under section 11(c) of OSHA if it arises under or is related to a health or safety hazard and if it is made in good faith.[70] An employee can establish the requisite causal connection by showing that a protected activity was a substantial reason for an adverse employment action.[71]

The OSHA whistleblower statute creates a dilemma for employers. When employees report they have discovered bed bugs in their home, office, or on their bodies, how should their employers act? At the outset, employers must focus on being sensitive and discreet. Employers should avoid any actions that could be considered intimidation,[72] including pressure to have a home extermination completed quickly or other actions that could be considered discipline, such as reassignment, reduced pay, or fewer hours.[73] Balancing those obligations against the desire to isolate and contain the infestation is not easy, and while a "perfect" protocol has not yet been established, an employer that has a published policy in place will certainly be better prepared to deal with this potential issue should the need arise.

B. *The National Labor Relations Act*

Most employers are aware of the National Labor Relations Act (NLRA)[74] but believe it applies only to situations involving labor organizations. In reality, the NLRA covers much more ground, protecting employees' "rights to join together to improve their wages and work-

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[68] *See* Occupational Safety & Health Act of 1970 § 11(c), 29 U.S.C. 660(c).

[69] *See* Schweiss v. Chrysler Motors Corp., 987 F.2d 548, 549 (8th Cir. 1993).

[70] *See* 29 C.F.R. § 1977.9(c) (2010).

[71] *Id.* § 1977.6.

[72] *See, e.g.*, Conn. Dep't of Envtl. Prot. v. Occupational Safety & Health Admin., 356 F.3d 226, 229 (2d Cir. 2004) (employee alleged her employer committed violations of OSHA whistleblower provisions by taking away her job and duties because she had engaged in protected activity).

[73] *See* Occupational Safety & Health Admin., Whistleblower Prot. Program, http://www.whistleblowers.gov/index.html (last visited Nov. 5, 2011).

[74] 29 U.S.C. §§ 151–167 (2006).

ing conditions, with or without a union."[75] Put another way, the NLRA protects "concerted activity," which the statute defines as "the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection."[76] Notably, these protections extend to all employees, regardless of whether they are in a union.[77] The salient inquiry is not whether a union is present, but whether the employees are engaged in concerted activities.

Thus, even non-union employers must carefully craft a bed bug policy that does not infringe on their employees' right to "concerted activity." Again, an employer that is attempting to avoid a panic is placed in a difficult position, as the NLRA frequently blurs, if not erases, the line between rumor-mongering and "concerted activity."[78] The National Labor Relations Board has repeatedly struck down policies that prohibit the spreading of rumors by employees[79] under the belief that such action threatens to chill employees' rights to concerted activity.[80] Employers should train their managers to be open and transparent about bed bug issues and avoid attempts to stifle communication between the employees about outbreaks, whether real or imagined. Such a transparent approach is the best method for dealing with an employee who is outspoken about the presence, or the potential presence, of bed bugs.

For employers operating under collective bargaining agreements, awareness of the threats presented by bed bugs and having policies in place are even more critical. At least one union has already warned its members about the potential of bed bugs in the workplace and advised seeking union assistance in the absence of management action.[81] In addition to providing valuable tips on how to avoid bringing bed bugs home, the safety guide from

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[75] *See* Nat'l Labor Relations Bd., Rights We Protect, Employee Rights, http://www.nlrb.gov/rights-we-protect/employee-rights (last visited Nov. 2, 2011).

[76] Nat'l Labor Relations Act § 7, 29 U.S.C. § 157.

[77] *See* Nat'l Labor Relations Bd. v. Phoenix Mut. Life Ins. Co., 167 F.2d 983, 988 (7th Cir. 1948) ("A proper construction is that the employees shall have the right to engage in concerted activities for their mutual aid or protection even though no union activity be involved, or collective bargaining be contemplated.").

[78] *See* Meyers Indus., Inc., 281 N.L.R.B. 882, 887 (1986) (finding that a conversation involving an employee can constitute "concerted activity" if it at least has some relation to possible group action for the employees' interest); *see also* Elston Elecs. Corp., 292 N.L.R.B. 510, 511 (1989).

[79] *See* Lafayette Park Hotel, 326 N.L.R.B. 824, 833 (1998) (striking down hotel policy against "making false, vicious, profane, or malicious statements toward or concerning the [hotel] or any of its employees"); Great Lakes Steel, 236 N.L.R.B. 1033, 1037 (1978) (striking down company policy against handing out literature that was "libelous, defamatory, scurrilous, abusive or insulting or any literature which would tend to disrupt order, discipline or production").

[80] *See* Fiesta Hotel Corp., 344 N.L.R.B. 1363, 1369–70 (2005) (dissent, Liebman, member).

[81] *See* Teamsters Local 237, Keeping Our Members Safe, A Safety & Health Guide for Teamsters Local 237, at 19–20 (June 2009).

Teamsters Local 230 specifically cites to the vermin control clause of OSHA.[82] The guide tells union members that "the law says your employer must have a good clean-up and extermination program if you have bed bugs in your workplace."[83] While no law specifically requires employers to maintain bed bug policies, OSHA regulations implicate vermin and insect infestations, and employers would be hard-pressed to claim ignorance or justify a lack of a policy.

C. *FMLA and ADA Concerns*

Thus far, this Article has focused on employment concerns directly raised by the existence of bed bugs in the workplace. But employers also should be aware of the impact bed bugs have on employees—such as loss of sleep, the bites, and psychological effects—and possible requests for leave or other accommodations under federal statutes. In many of these instances, employees will need to go undergo medical evaluations, and employers will need to determine whether the effect of the bed bugs entitles employees to leave or to legal protections.

By now, most employers are familiar with the various federal laws that protect sick or injured employees. The Family and Medical Leave Act (FMLA) provides up to twelve work weeks of job-protected leave for eligible employees.[84] For an employee to be eligible due to that employee's own illness, the employee must have a "serious health condition" that makes the employee unable to perform the functions of the job.[85] There is no summary answer as to whether a bed bug infestation can justify leave under the FMLA. But, based on the language of the enacting regulation and the treatment of recent epidemics,[86] an infestation alone probably would not create a "serious health condition" among employees or their families suitable to justify leave.

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[82] *See id.* at 20. The materials technically cite to a New York State analog of the OSHA vermin clause, 29 C.F.R. § 1910.141(a)(5), which parrots the federal language.

[83] *See* Teamsters Local 237, *supra* note 81, at 20.

[84] *See* 29 U.S.C. §§ 2601–19 (2006).

[85] Family & Medical Leave Act of 1993 § 102, 29 U.S.C. § 2612(a)(1)(D). The law defines "serious health condition" as "an illness, injury, impairment, or physical or mental condition that involves (A) inpatient care in a hospital, hospice, or residential medical care facility; or (B) continuing treatment by a health care provider." *Id.* § 101(11), 29 U.S.C. § 2611(11).

[86] Despite its contagious nature, seasonal flu will not permit leave under FMLA absent a showing that the elements of a "serious health condition" are met. 29 C.F.R. § 825.113(d) (2010) ("Ordinarily, unless complications arise, the common cold, the flu, ear aches, upset stomach, minor ulcers, headaches other than migraine, . . . *etc.*, are examples of conditions that do not meet the definition of a serious health condition and do not qualify for FMLA leave."). However, during the H1N1 outbreak in 2009, the U.S. Department of Health and Human Services' Centers for Disease Control and Prevention (CDC), issued guidance to employers that strongly recommended leave policies that would stem the outbreak by permitting employees to stay home when an H1N1 issue arose within their families. *See* Ctrs. for Disease Control & Prevention, H1N1 Flu, Guidance for Businesses and Employers to Plan and Respond to the 2009–2010 Influenza Season (Feb. 2, 2010, 1:00 PM), http://www.cdc.gov/h1n1flu/business/guidance/. Similar guidance regarding bed bugs may be forthcoming. *See generally* Ctrs. for Disease Control & Prevention, *supra* note 27.

Employees are also protected under the ADA, which provides leave and accommodations for disabled employees as defined by the statute.[87] The ADA defines "disability" as "(A) a physical or mental impairment that substantially limits one or more of the major life activities of an individual; (B) a record of such an impairment; or (C) being regarded as having such an impairment."[88] Major life activities protected by the ADA include sleeping[89] and working. Under the ADA, employees' ability to work is substantially limited when they are "significantly restricted in the ability to perform either a class of jobs or a broad range of jobs in various classes as compared to the average person having comparable training, skills, and abilities."[90] Three more "major life activities" joined the list of major life activities in May 2011: sitting, reaching, and interacting with others.[91] There is no blanket answer as to whether the fallout from bed bug infestations will trigger ADA protections. This likely will be a case-sensitive determination. Employers will need to conduct independent analyses to determine whether their employees qualify for ADA protections and work with any eligible employees to accommodate their disabilities.[92] Although questions remain about whether infestations constitute either "physical or mental impairment" under the statute, employees who can prove such infestations might allege that their sleep habits, work habits, and even their ability to interact with co-workers have all been compromised.

VII.
Insurance Coverage for Bed Bug Claims

As homeowners and business owners continue to deal with bed bug claims, one consideration for all infestation victims will be whether their insurance covers first and third-party claims.

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[87] 42 U.S.C. §§ 12101–12213 (2006).

[88] Americans with Disabilities Act of 1990 § 3(2), 42 U.S.C. § 12102(2).

[89] *See* Colwell v. Suffolk County Police Dep't, 158 F.3d 635, 643 (2d Cir. 1998) (stating that sleeping is "undoubtedly" a major life activity). Particularly instructive is the case of *Haynes v. Williams*, 392 F.3d 478 (D.C. Cir. 2004), where the court considered whether an employee's claim of idiopathic pruritus ("severely incapacitating skin itching") sufficiently limited his ability to sleep. Because the claimant alleged that the condition was brought on by his surroundings and exacerbated by his particular office, the court found that a change in location could resolve the issue and found no limitation of a major life activity under the ADA. *See id.* at 485.

[90] 29 C.F.R. § 1630.2(j)(3)(i). *But see* Giordano v. City of New York, 274 F.3d 740, 748 (2d Cir. 2001) (distinguishing between being able to work and being able to perform certain duties in a particular job).

[91] *See* 29 C.F.R. § 1630.2(i)(1)(i) (2011).

[92] Employers should also be aware that the new ADA regulations require employers to focus on providing accommodations, as opposed to questioning whether someone is disabled. *See* 76 Fed. Reg. 16,978, 17,000 (Mar. 25, 2011). This regulatory change may require a shift in the approach employers take when processing ADA claims.

Bed bugs are on the list of emerging issues facing the insurance industry, not only for hotels, but also for retail, apartment, and residential health care sectors.[93] The costs associated with removing bed bugs can be significant, and owners of businesses and homes will surely seek coverage under insurance policies, which they maintain to limit exposure and to control costs. Unfortunately for some policyholders, such claims may not fall within the coverage of most homeowner or liability policies.[94]

There are compelling reasons to expect that coverage litigation will develop with regard to bed bug claims. Indeed, as industry experts and business owners continue to study the bed bug issue and attempt to stave off the rising tide of claims, insurance coverage could be the focus of future battles.

A. *First-Party Claims*

Most standard commercial property insurance policies have specific vermin exclusions for loss due to insects.[95] Similarly, most standard homeowner and renter insurance policies exclude losses pertaining to vermin. But will such exclusions preclude coverage for bed bug claims? The insurance industry perspective is that the cost of getting rid of bed bugs is part of home maintenance and, therefore, should not be covered by standard homeowners' and renters' insurance policies.[96] A standard homeowners' insurance policy may include the following provision: "We do not insure . . . for a loss . . . [c]aused by . . . [b]irds, vermin, rodents, or insects."[97]

The insurance industry may rely on this language in asserting that beg bug claims are excluded. Although some decisional authority favors the industry view, the term "vermin" is notably not defined in most homeowners' policies. Moreover, a court has not yet considered the specific issue of whether a bed bug claim falls within the vermin exclusion.

Generally, where a policy of insurance is worded as to leave room for two constructions, the terms will be interpreted against the insurer.[98] A court's willingness to construe ambiguity in a policy provision against an insurer is especially true with respect to exclusions because it is the insurer's burden to show that a particular exclusion applies.[99] Although a

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[93] *See Don't Let the Bed Bugs Bite: An Insurance and Risk Management Perspective*, White Paper (Beecher Carlson), Oct. 2010, at 1.

[94] *See Home Insurance and Bedbug Invasions*, N.Y. Times (May 6, 2011, 1:09 PM), http://bucks.blogs.nytimes.com/2010/05/06/home-insurance-and-bedbug-invasions/.

[95] *See* Casale, *supra* note 21.

[96] *See* Alistair Barr, *Bed Bugs May Bite Insurers, But Won't Dog Industry*, MarketWatch (Sept. 2, 2010, 7:27 PM), http://www.marketwatch.com/story/bed-bugs-may-bite-insurers-but-wont-dog-industry-2010-09-02.

[97] Homeowners 3–Special Form, No. HO 00 03 10 00, Ins. Servs. Office, Inc., 1999, at 8–9.

[98] *See* Barry R. Ostrager & Thomas R. Newman, Handbook On Insurance Coverage Disputes, §1.03[b][1] (11th ed. 2002).

[99] *See id.*

court has not yet considered this issue with regard to a bed bug claim, one court conducted a potentially illustrative analysis of the vermin exclusion from a homeowner's policy in a case involving carpet beetles.

Policyholders brought an action seeking coverage under an "all risk" personal property insurance policy in *Sincoff v. Liberty Mutual Fire Insurance Co.*,[100] upon discovering that carpet beetles damaged a pair of antique armchairs, an eighteenth century Aubusson tapestry, and an expanse of imported broadloom carpeting. The insurer denied coverage on the ground that damage from carpet beetles fell within the vermin exclusion.[101]

During the trial, experts testified about the meaning of the term "vermin," relying on several dictionary sources. One expert testified that, while carpet beetles and moths are members of the insect world, only certain categories of insects are vermin.[102] Significantly, the court observed there were conflicting opinions as to what constituted vermin and that "experts well versed in entomology disagree as to the meaning of the word, and ... dictionaries contain varying connotations, some indicating that vermin includes all bothersome insects, others limiting the term to parasitic insects."[103]

Although the parasitic/non-parasitic distinction in this analysis would favor a finding that a bed bug claim falls within the vermin exclusion, the *Sincoff* court's observation regarding the uncertainty over the meaning of the term "vermin" raises some question as to whether the parasitic/non-parasitic distinction will suffice for all courts that consider the vermin exclusion. Significantly, the court also noted that

> [t]he risk, presumably known to the insurer, could have been excluded by a less vague term, as for example, damage by "moths" specifically was excluded. Direct reference to "carpet beetles" would have been preferable but even a simple statement excluding "insects" or "household pests" would have sufficed. It should be noted that moths were treated separately, and such a separate treatment would have been unnecessary under the construction the insurer seeks to place upon the word "vermin."[104]

Ultimately, the court denied application of the exclusion by focusing on the "all risk" nature of the policy, which provides coverage for any risk that is not excluded, and the burden of the insurer to show that an exclusion applies to a particular claim. The court explained,

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[100] 230 N.Y.S.2d 13 (Ct. App. 1962).

[101] *See id.* at 14.

[102] *See id.*

[103] *Id.* at 15.

[104] *Id.* at 16.

> It was not sufficient for the defendant to demonstrate that a purchaser of the policy involved herein might have construed "vermin" to include carpet beetles. Defendant, to derive any benefit from the exclusory clause, was obliged to show (1) that it would be unreasonable for the average man reading the policy to conclude that nonparasitic carpet beetles were not vermin and (2) that its own construction was the only one that fairly could be placed on the policy. This the defendant was unable to do.[105]

Although insurers may wish to rely, perhaps reasonably, upon the parasitic/non-parasitic distinction within the vermin exclusion, insurers should be wary of the court's observation in *Sincoff* about the conflicting definitions of the term "vermin." Notably, the court observed that specific mention of "moths" in the exclusion conflicted with the insurer's broader interpretation of the vermin exclusion.

The standard homeowner's policy exclusion noted above refers to both vermin and insects, which is especially interesting in light of the court's discussion in *Sincoff* that only certain categories of insects are vermin. Such inconsistency in the use and interpretation of the term "vermin" may invite policyholders to challenge the application of a vermin exclusion, especially when a significant loss is claimed.

Another court considered the term "vermin" in an "all risks" policy, albeit with respect to damage caused by squirrels, in *Jones v. American Economy Insurance Co.*[106] There, the court stated that

> *Webster's New Collegiate Dictionary*, 1301 (1974) defines "vermin" as "small common harmful or objectionable animals (as lice or fleas) that are difficult to control . . . birds and mammals that prey on game . . . an offensive person." The word is derived from, or related to, the Latin word, "vermis," for "worm." Squirrel is defined, *Webster*, 1130, as "any of small or medium-sized rodents . . . as . . . any of numerous new or old World arboreal forms having long bushy tails and strong hind legs." The Joneses maintain that "vermin" is not a particular class of animals, such as rodents, to which squirrels belong. It is apparent that the definition of "vermin" is very broad, covering entities as diverse as insects, animals, and persons. The few cases we have found in other jurisdictions are divided on this question. We conclude that the term does not have a simple, plain, and generally accepted meaning and that it is susceptible of more than one reasonable interpretation; therefore, we hold that the term is ambiguous.[107]

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[105] *Id.* at 15–16.

[106] 672 S.W.2d 879 (Tex. Ct. App. 1984).

[107] *Id.* at 880 (alteration in original).

Therefore, although insurers may have a compelling argument that the parasitic/non-parasitic distinction favors application of the vermin exclusion for bed bug claims, policyholders can point to decisional authority in other jurisdictions finding the term "vermin" to be ambiguous.

In addition to loss claims due to bed bugs, businesses also might seek insurance coverage for other types of losses. For example, insurance coverage for business interruption could be triggered if a business is forced to close due to bed bug infestation and cannot reopen until after a fumigation.[108] For hotels, "loss of attraction" coverage could help make up for money lost from customer cancellations or lost bookings due to such infestations.[109] Although the specific terms of a business interruption policy must be analyzed to determine if coverage applies, the essential purpose of such coverage is to place the insured in the position it would have occupied if the interruption had not occurred.[110] As its name implies, business interruption coverage indemnifies an insured for losses caused by the inability to continue to use covered premises.[111] Under the circumstances, such coverage would likely be available unless the perils set forth in the policy do not include such infestation claims.

B. *Third-Party Claims*

If a tenant, guest, or other person is bitten by bed bugs, a third-party liability claim may be brought against the responsible party. Although the limited opportunity to allege damages may prevent most incidents from evolving into a suit, as discussed in Part V, such suits have been filed and will surely continue to be pursued.

Bed bug bites leave itchy red welts and, depending on possible allergic reactions, some resulting injuries may be worse than others. Although causation issues are likely to be key, determining whether a claim falls within the insuring clause of a liability policy also is likely to be at issue. If a complaint alleges that a plaintiff suffered bites and red welts due to a business owner's negligence, a claim can likely be alleged for bodily injury as that term is defined in most general liability policies.

Most commercial general liability coverage forms contain a clause similar to the following:

a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies.

b. This insurance applies to "bodily injury" and "property damage" only if:

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[108] *See* Casale, *supra* note 21.

[109] *See id.*

[110] *See* Polymer Plastics Corp., v. Hartford Cas. Ins. Co., 389 F. App'x. 703, 705 (9th Cir. 2010).

[111] *See* Keetch v. Mut. of Enumclaw Ins. Co., 831 P.2d 784, 786 (Wash. Ct. App. 1992).

(1) The "bodily injury" or "property damage" is caused by an "occurrence" that takes place in the "coverage territory"[112]

Applicable definitions for such a clause include the following:

"Bodily injury" means bodily injury, sickness or disease sustained by a person, including death resulting from any of these at any time.

. . .

"Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.

. . .

"Property Damage" means:

a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or

b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the "occurrence" that caused it.[113]

Most commercial liability policies do not contain a "vermin" exclusion; however, other exclusions might apply to some or all such claims, depending on the particular allegations of the plaintiff. The "Expected or Intended Injury" exclusion contained in a standard commercial general liability coverage policy bars coverage pursuant to the following terms: "'Bodily injury' or 'property damage' expected or intended from the standpoint of the insured. This exclusion does not apply to 'bodily injury' resulting from the use of reasonable force to protect persons or property."[114]

This exclusion would bar coverage if a policyholder knew of a bed bug infestation before a plaintiff was injured. Of course, if the policyholder knew or expected that a business invitee would be subjected to bed bug bites, such a claim would not have been caused by an "occurrence" because the exposure is not likely to be deemed accidental. Even if a plaintiff does not allege initially that a policyholder knew of an infestation problem, discovery could reveal prior incidents or that the policyholder knew of the infestation. For example, evidence of prior knowledge of an infestation at a hotel could be shown if employees or guests report (1) receiving bites; (2) observing bloodstains on the sheets or mattress of a hotel; or (3) finding bed bug fecal matter on a mattress, box spring, or headboard.[115]

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[112] Commercial General Liability Coverage Form, No. CG 00 01 10 01, Ins. Servs. Office, Inc., 2000.

[113] *Id.* at 13–15.

[114] *Id.* at 2.

[115] *See* Jeff Eisenberg, The Bed Bug Survival Guide: The Only Book You Need to Eliminate or Avoid this Pest Now 26 (2011).

Although hotel guests could be bitten without their knowledge, because not all bed bug victims are aware when they have been bitten,[116] hotel or business staff may be trained to recognize the signs of bed bugs. Such prior knowledge could form the basis for declining coverage.

The same analysis would apply to businesses such as offices, theaters, restaurants, doctors' offices, gyms, and shopping malls.[117] For example, large corporations have been forced to close their offices to clean up bed bug infestations.[118]

The otherwise limited compensatory damages resulting from a bed bug claim could be significantly enhanced if the plaintiff also alleges a claim for punitive damages. If a policyholder failed to act responsibly toward a business invitee, for example, that policyholder could face claims alleging more than negligence, which would be the expected claim for most bed bug problems. As discussed in Part V.A, in *Mathias v. ACCOR Economy Lodging, Inc.*, the Seventh Circuit upheld a jury award to each plaintiff for compensatory damages of $5,000 and punitive damages in the amount of $186,000.[119] In holding that the award was not excessive, the court accepted without argument that "deliberate exposure of hotel guests to the health risks created by [bed bug] infestations exposes the hotel's owner to sanctions under Illinois and Chicago law that in the aggregate are comparable in severity to the punitive damages award in this case."[120]

In *Livingston v. H.I. Family Suites, Inc.*, plaintiffs alleged the defendants knew that a hotel was infested with bed bugs, "yet concealed this information despite the fact that they had a duty to disclose such information due to their position of influence and superiority over Plaintiffs."[121] The plaintiffs sought punitive damages based on the intentional nature of the alleged claims for intentional infliction of emotional distress, fraudulent concealment, and gross negligence against the defendants.[122] In addition to the other coverage defenses, which are self-evident from the knowing conduct alleged by plaintiffs that traditionally would not be covered by an insurance policy, an insurer might also disclaim coverage for the punitive damages sought by the plaintiffs through standard exclusion clauses for punitive damages.[123]

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[116] *See id.* at 28.

[117] *See id.* at 101–109.

[118] *See* Barr, *supra* note 96 (noting that Abercrombie & Fitch closed its store in Soho for extermination efforts).

[119] 347 F.3d 672, 678 (7th Cir. 2003).

[120] *Id.*

[121] No. 6:05-cv-860-Orl-19KRS, 2005 U.S. Dist. LEXIS 41435, at *4 (M.D. Fla. Aug. 29, 2005) (upholding plaintiffs' claim for gross negligence toward a business invitee and denying defendants' motion to dismiss).

[122] Complaint ¶¶ 4, 22, 26, 33, 38 *Livingston v. H.I. Family Suites, Inc.*, No. 6:05-cv-860-Orl-19KRS, 2005 U.S. Dist. LEXIS 41435 (M.D. Fla. Aug. 29, 2005), 2005 U.S. Dist. Ct. Pleadings LEXIS 13659.

[123] *See* Ostrager & Newman, *supra* note 98, at § 14.02[a].

VIII.
Bed Bugs Best Practices

While the scourge of bed bugs has led to new types of litigation and raised novel insurance coverage issues that attorneys may encounter in their daily practice, the most common way a bed bug will impact daily life is when a bed bug invades a home or office. Therefore, this Article concludes with practical advice about how to detect bed bugs and, if they are found, how to eliminate them. There are several different methods to eliminate bed bugs, each with its own rate of success as well as certain limitations based on the type of area to be treated.

A. *How Do You Detect a Bed Bug?*

There is a common belief that the best way to determine if you are sharing space with a bed bug is if you wake up with an unexplained bite. However, studies have shown that while bites may be the first sign of a bed bug, it is not the best way to identify a potential bed bug infestation.[124] Because human reaction to bites varies, an individual may be bitten without manifesting a reaction for days. By the time the bite is apparent, the individual may have returned home, bringing the bug there too, or spread the bug to others. Additionally, a bed bug bite does not always equal home infestation. Rather, it could be an isolated exposure while at a movie theater or friend's home. In some rare cases, an individual may not even show signs of a bed bug bite.

To find bed bugs, one must know what they look like. Fortunately, humans can see adult bed bugs. When an adult bed bug has eaten, it blows up like a blimp and elongates into a torpedo-shaped bug. If the bug has not fed in a while, it appears as a flat disc.[125] Adults are reddish brown in color, without wings, and are about the size of an apple seed. Humans can also see younger bed bugs. They are mostly a translucent whitish-yellow. Unfortunately, it is difficult to find the nymph, which is a bed bug at its youngest stage. A nymph is pale white or yellowish and turns bright red after it has ingested its latest meal.[126] Equally difficult to find is a bed bug egg, given that the egg is the size of the head of a pin.

Another way to find a bed bug is to look for its exoskeleton, which is often shed as a bed bug goes through the five stages of its life. The molting process results in a translucent shell that can be detected by the naked eye. The shell can be different sizes depending on which stage the bed bug is in. It is suggested that one looks along mattress seams, behind head boards, in ceiling junctions, in wall junctions, along baseboards, and attached to personal belongings.[127]

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[124] Dini M. Miller, Va. Coop. Extension & Va. Dep't of Agric. & Consumer Servs., How to Identify a Bed Bug Infestation 1 *available at* http://www.vdacs.virginia.gov/pesticides/pdffiles/bb-identify1.pdf (last visited Nov. 2, 2011).

[125] *Id*. at 2.

[126] *Id*.

[127] *Id*.

After bed bugs eat, they spend a majority of their time digesting and excreting their meal, which results in excess liquid being left behind.[128] The liquid is black and spots of it are often found in groups of ten or more.[129] The best place to look for fecal spots are along mattress seams and tags, on the wood frame of the box spring, behind the head board, along the top of a baseboard, near the edge of carpeting, behind pictures hanging on the wall, near ceiling and wall junctions, at electrical outlets, and in curtain seams located closest to the rod.[130]

Yet another way to find bed bugs is by looking for bed bug aggregations, that is, locations where bed bugs live together. The most frequent place for such aggregations are under mattress tags, along mattress seams, behind the headboard, in the holes for set-in screws, along a bed frame, near creases in the bed springs, in the area where the box spring fabric is stapled to the frame, behind loose wallpaper, under the base of an air conditioner, behind chipped paint, along the interior of closet doors, inside and behind baseboard heaters, inside curtain rods, and on top of pleated curtains.[131]

B. *Methods to Kill Bed Bugs*

Prompt action is needed after discovering bed bugs. Additionally, the treatment employed should not only be effective but also safe, as recent examples of improper treatments have led to disastrous consequences. In Cincinnati, Ohio, homeowners hired an exterminator to kill bed bugs that had taken over their home. Six propane powered convection heaters, which were designed to heat the home to 135 degrees to kill the bed bugs, caught the living room carpet on fire. The home was a complete loss.[132] Sadly, the deaths of seven tourists, including an American woman, were linked to the Downtown Inn in Chiang Mai, Thailand, between January and March 2011.[133] Traces of cholrpyrifos and pyrophus were found in

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[128] *See id.* at 2.

[129] *Id.* at 3.

[130] *Id*.

[131] *Id*. at 4.

[132] *See Carthage Home Destroyed by Bed Bug Treatment,* OhioStandard.Com, May 16, 2011, http://story.ohiostandard.com/index.php/ct/9/cid/90d24f4ad98a2793/id/45448253/.

[133] *See 'Bed Bug pesticide poisoning' Killed Californian Woman and Six Other Tourists in Thailand*, Mail Online (May 10, 2011, 5:18 PM), http://www.dailymail.co.uk/news/article-1385518/Bed-bug-pesticide-poisoning-caused-death-California-woman-tourists-Thailand.html. It should be noted that bed bugs are not known to transmit disease and there are no reported deaths linked from a bed bug transmitting disease. *See* Ctrs. for Disease Control & Prevention, U.S. Envl. Prot. Agency, Joint Statement on Bed Bug Control in the United States from the U.S. Centers for Disease Control and Prevention (CDC) and the U.S. Environmental Protection Agency (EPA) (2010). However, a recent study found that Methicillin-resistant Staphylococcus aureus (MRSA), an antibiotic-resistant bacterial infection, in bed bugs. *See* Dan Bowens, *Study: Bed Bugs Could Carry MRSA*, MyFoxNY.com (May 11, 2011, 11:05 PM), http://www.myfoxny.com/dpp/health/study-bed-bugs-could-carry-MRSA-20110511.

the hotel.[134] Cholrpyrifos is an insecticide used on bed bugs while pyrophus is a potentially lethal toxin that has been banned from indoor use in many countries.[135]

Improper treatment can be avoided by instead employing several different methods to eliminate bed bugs. A treatment should be selected that best matches the level of infestation as well as the area of treatment. Recommended treatments include:

1. Heat Treatments

Heat used at high temperatures can be a very effective method in killing bed bugs and their eggs. However, heat treatments pose inherent limitations due to the damage that heat may cause and the need to ensure that all areas are raised to a temperature necessary to kill the bugs.

Many pest control companies use steam heat as part of their services. Steam can also be effective, but this method may be unable to treat electronics, computers, fine furnishings, and art work due to potential damage. As bed bugs often hide in wall hangings and are attracted to heat emitted by electronics, the effectiveness of steam treatment may be limited to certain areas.

To treat bed bugs with radiant fry heat, the service provider needs to raise the temperature of the room to 140 degrees for up to two hours, 130 degrees for one to three hours for a slower kill, or above a minimum 113 degrees for two to seven hours. This type of treatment takes more than eight hours to complete and often times must be done on a room-to-room basis, which may make large residences more difficult to treat.

2. Conventional Pesticide Treatments

Due to bed bugs' inherent resistances to pesticides as well as their ability to mutate quickly to become immune to the lasting effects of these materials, some commentators assert that pesticide treatments have limited value against bed bugs. Often times, bed bug treatments that use pesticides are sold at stores and do not require the need for a trained professional to effectuate the treatment. While the treatments are less expensive, improper use of pesticides could harm people more than bed bugs. For example, studies have found that children whose mothers are exposed to high amounts of certain pesticides while pregnant appear to have lower IQs than their school-age peers.[136] Therefore, one must be cautious when using this type of treatment.

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[134] *See* Mail Online, *supra* note 133.

[135] *See id.*

[136] *See Pesticides During Pregnancy May Hurt IQ*, Huffington Post (Apr. 23, 2011, 10:56 AM, updated June 23, 2011, 5:12 a.m.),

http://www.huffingtonpost.com/2011/04/23/pesticides-pregnancy_n_852785.html.

3. HEPA Vacuum Treatments

A High-Efficiency Particulate Air (HEPA) vacuum is a viable method to eliminate large scale visible infestations. They are also useful in the pre-treatment preparation process. That may be less effective for low-level infestations or for treatment of bed bugs in hard to reach areas.

4. Spot Treatments

In residences, spot treating in areas where bed bugs are found is another method to eliminate bedbugs. As bed bug treatments require detailed preparation that could involve laundering items, dismantling furniture, and getting rid of excess clutter and debris, it is common for bed bugs to be disturbed by this process and sent looking for new hiding spots, thereby reducing the effectiveness of a spot treatment where the bed bug was initially found.

5. Bed Bug Sniffing Dogs

Well-trained dogs can detect bed bugs or their eggs with near-perfect accuracy, researchers have found.[137] Bed bug dogs are being used more often due to their ability to find bed bugs in hidden areas. However, the price for an inspection by a bed bug-sniffing dog may be in the four-figure range.

6. Carbon Dioxide "Dry Ice" Snow

This method freezes the bed bugs without the need for chemicals or pesticides. When using carbon dioxide, treatment of a room often is completed within hours and does not require evacuation. This method also circumvents a bed bug's resistance to pesticides.[138]

IX.
Conclusion

The re-emergence of beg bugs presents a complex set of challenges that impacts our daily and legal lives. The threat of encountering bed bugs in the workplace or at travel spots and bringing them into our homes is very real. While the possibility of being exposed to a bed bug can never be eliminated, following the best practices provided in this Article can protect homes and families. By knowing what to look for and where to look, one can reduce the chance of infestation and the costly cleanup that follows. As the case law and statutes discussed in this Article are just the start of a rapidly evolving field of litigation, one must continually stay updated as to new court decisions to identify trends and the additional

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[137] Penelope Green, *He'll Scratch Your Itch*, N.Y. Times, Mar. 11, 2010, at D1.

[138] Peter DiEduardo, a contributor to this article, is employed by Bell Environmental, Inc. which uses carbon dioxide as their primary method for treating bed bug infestation.

responsibilities placed on those with the ability to control bed bugs. Litigation relating to bed bugs is clearly on the rise and the next case could be related to the catastrophic damage caused by these pests.

Finally, the bed bug problem should not be dismissed as an issue that will happen to someone else or a problem only for those who live and work in unsanitary conditions. Bed bugs affect people of all socioeconomic means, including our families, our clients, our colleagues, our neighbors, and even ourselves. As new issues, trends, and knowledge about bed bugs are disseminated by those who recognize the growing problems associated with bed bugs, we all now have the ability to properly educate ourselves. So, do so! In closing, let us disregard the poet's advice to let the bed bugs "chew," and instead, let us focus our efforts, as Shrek would say, on keeping the bed bugs "far, far away."

Consumer Class Actions for Products Lawyers: Recent Developments on Certification and Related Issues[†]

David T. Biderman
Hillary O'Connor Mueri

I.
Introduction

For the products liability lawyer, the possibility of class-action lawsuits must seem easy to disregard. After all, this type of lawyer handles cases in which someone was injured and does so by working with witnesses, developing themes, divining juries' intentions, and trying cases.

Class actions pose a different set of issues altogether. No one is hurt, at least not in the traditional sense of products liability. The cases are all about briefing and motions. Testimony is rarely offered. Trials almost never happen.

But products liability lawyers should care about class actions because their most important clients are likely to get sued by plaintiffs acting on behalf of a class. In recent years, plaintiffs' lawyers have turned to product-related class actions for obvious reasons: The recoveries are potentially large, and the threshold for bringing a case is low. In fact, the cases don't require an injury or even a defective product— just a marketing practice that a plaintiff can allege is deceptive.

Multiple consumer class actions are filed every day, and the exposure to defendant companies can be great. The clients of products liability lawyers will inevitably find themselves on the receiving end of these cases. Therefore, every products liability lawyer needs to be prepared to advise on and defend against these types of actions.

[†] Submitted by the author on behalf of the FDCC Class Action and Multidistrict Litigation section.

David T. Biderman is a partner in the San Francisco and Los Angeles offices of Perkins Coie, LLP. He heads the firm's Mass Tort/Toxic Tort Defense group. Mr. Biderman has represented a variety of companies at all stages of litigation for over thirty years. Recently, he successfully tried a major consumer fraud class action on behalf of one of the world's major search engine companies in a case challenging the posting of on-line gambling advertisements. For that same client, he negotiated a favorable settlement of a class action challenging the pricing practices of its advertising program. He also successfully represented a major coffee retailer in defeating a class action case at the earliest stage and he recently obtained a dismissal on behalf of a leading food company charged with inaccurate nutritional statements in one of its food products. Mr. Biderman has regularly been listed as a "Super Lawyer" and was listed in the 2012 edition of The Best Lawyers in America. He has also been recognized by the Minority Corporate Counsel Association and Los Angeles Business Journal as a "Top Rainmaker." Mr. Biderman is a member of the State Bar of California and is also admitted to practice before all U.S. District Courts in California as well as the U.S. Court of Appeals for the Fourth and Ninth Circuits. He is a member of numerous professional organizations including the Federation of Defense and Corporate Counsel, Defense Research Institute, and the Japanese American Bar Association and he is currently a member of the Advisory Council of the Asian/Pacific Bar of California. Mr. Biderman has served the courts and the judiciary, including work on the Civil Litigation Subcommittee of the California Judicial Council, on special committees formed by the state courts to address toxic tort litigation issues, and as a member of the American Bar Association's American Jury Project.

To assist in this preparation, this Article will cover the types of class-action cases being filed, review the basics on class action requirements, and cover some new developments on class certification and related issues.

II.
Class Actions—Background

Class-action lawsuits are aggregated claims designed to foster the efficiency of the judicial process and to assure that rights are vindicated for those who would not otherwise choose to sue as individuals. There are a variety of justifications for the use of the class-action procedure. The most common justifications, however, include avoiding unnecessary

Hillary O'Connor Mueri is an associate in the Los Angeles office of Perkins Coie, LLP. She is a member of the firm's Product Liability practice group. Ms. Mueri earned her Bachelor of Science degree in Aviation Engineering in 1999 from The Ohio State University. After graduating, she served as a Naval Flight Officer for the United States Navy, flew the F-14D Tomcat, F/A-18B/D/F Hornet, and F-16 Fighting Falcon, and was awarded the Air Medal & Navy Commendation Medal with Combat Distinguishing Device. While a Naval Flight Officer, Ms. Mueri was a Legal Officer, an Integrated Weapons Team and Aviation Electrician Branch Officer, an Air-to-Air Weapons Training Officer, a Dynamic Strike Manager, and a Strike Flight Instructor. In 2010, Ms. Mueri received her J.D. from University of San Diego School of Law where she was a member of the Phi Delta Phi honors fraternity. Ms. Mueri is a member of the State Bar of California.

and inconsistent decisions, enabling those who have suffered small wrongs to recover, and preventing a wrongdoer from avoiding responsibility for imposing a small harm on many.

Specifically, when cases involve common issues of law and fact, class actions permit the consolidation of those claims to avoid the necessity for multiple trials over the same issues.[1]

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[1] *See* Gen. Tel. Co. of the Sw. v. Falcon, 457 U.S. 147, 155 (1982) ("Class relief is 'peculiarly appropriate' when the 'issues involved are common to the class as a whole' and when they 'turn on questions of law applicable in the same manner to each member of the class.' For in such cases, 'the class-action device saves the resources of both the courts and the parties by permitting an issue potentially affecting every [class member] to be litigated in an economical fashion under Rule 23.'" (quoting Califano v. Yamasaki, 442 U.S. 682, 700–01 (1979))); Am. Pipe & Constr. Co. v. Utah, 414 U.S. 538, 550 (1974) ("A federal class action is . . . a truly representative suit designed to avoid, rather than encourage, unnecessary filing of repetitious papers and motions."); Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 259 F.3d 154, 192 (3d Cir. 2001) ("'Class certification enables courts to treat common claims together, obviating the need for repeated adjudications on the same issue.'" (quoting *In re* Gen. Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig. 55 F.3d 768, 783 (3d Cir. 1995))); Jenkins v. Raymark Indus., 782 F.2d 468, 473 (5th Cir. 1986) (stating that a judge's certification of a class is "clearly superior to the alternative of repeating, hundreds of times over, the litigation of the state of the art issues with, as [the] experienced judge [in the court below] says, 'days of the same witnesses, exhibits and issues from trial to trial'").

In addition, class actions permit the pursuit of claims that would not be litigated alone because the small potential recovery outweighs the cost of litigation.[2] This theory is often cited as a basis for preventing a wrongdoer who inflicts minor harm over a large group from escaping the need to answer for the actions taken.[3]

III.
Consumer Class Actions

Class actions have traditionally run far afield from the territory covered by a typical products liability lawyer. They have often involved securities claims where a large number of individual buyers or sellers suffered losses from similar conduct [4] or antitrust claims where a large number of purchasers of a product suffered losses from the same conduct.[5]

Recently, however, a new category of class actions has expanded dramatically: consumer class actions. These cases are typically brought under state consumer protection laws against manufacturers for (1) similar failures or defects in a product or (2) marketing or sales practices that are allegedly deceptive, misleading, or simply unfair.

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[2] *See* Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 617 (1997) ("'The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor.'" (quoting Mace v. Van Ru Credit Corp., 109 F.3d 338, 344 (7th Cir. 1997))); Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 161 (1974) ("A critical fact in this litigation is that petitioner's individual stake in the damages award he seeks is only $70. No competent attorney would undertake this complex antitrust action to recover so inconsequential an amount. Economic reality dictates that petitioner's suit proceed as a class action or not at all.").

[3] *See* Deposit Guar. Nat'l Bank v. Roper, 445 U.S. 326, 338–39 (1980) (recognizing the "increasing reliance on the 'private attorney general' for the vindication of legal rights" via class actions and that "[t]he aggregation of individual claims in the context of a classwide suit is an evolutionary response to the existence of injuries unremedied by the regulatory action of government").

[4] *See* Blackie v. Barrack, 524 F.2d 891, 903 (9th Cir. 1975) (noting the "substantial role that the deterrent effect of class actions plays in accomplishing the objectives of the securities laws"); *see, e.g.*, Consolidated Class Action Complaint at 58–85, *In re* Toyota Motor Corp. Sec. Litig., No. 10-CV-00922 (C.D. Cal. Oct. 4, 2010) (alleging issuance of materially false and misleading statements regarding operations and business and financial results and outlook); Class Action Complaint for Violation of Federal Securities Laws at 23, W. Wash. Laborers-Employers Pension Trust v. Panera Bread Co., No. 08-CV-00120 (E.D. Mo. Jan. 25, 2008) (alleging issuance of materially false and misleading statements and failure to disclose, among other things, negative business trends causing rising expenses and slow growth).

[5] *See Amchem Prods., Inc.*, 521 U.S. 591 (requirements for class certification are "readily met in certain cases alleging . . . violations of the antitrust laws"); *see also In re* Hydrogen Peroxide Antitrust Litig., 552 F.3d 305, 326–27 (3d Cir. 2009) (vacating class certification and remanding due to insufficient Rule 23 evaluation with respect to price fixing claims by direct and indirect purchasers of hydrogen peroxide); *In re* Ethylene Propylene Diene Monomer (EPDM) Antitrust Litig., 256 F.R.D. 82, 84 (D. Conn. 2009) (certifying a class for a class action alleging price fixing of EPDM synthetic rubber).

Most states have enacted some form of consumer fraud statute that can serve as the basis for a class-action suit. For example, California has adopted the Unfair Competition Law.[6] The UCL is a Depression-era enactment originally intended to reinforce common-law proscriptions against trade-name infringement. Recently, however, it has become California's most sweeping consumer protection statute with broad application.

As is typical of most statutes, the UCL prohibits unfair competition, which it defines as "any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising."[7]

California also has adopted the False Advertising Law, which prohibits deceptive, false, and misleading advertising,[8] and a Consumers Legal Remedies Act (CLRA), which prohibits deceptive conduct in connection with the sale of consumer products.[9]

Other states have adopted similar statutes.[10] For example, the Illinois Consumer Fraud and Deceptive Practices Act (ICFA),[11] prohibits "any deception, fraud, false pretense, false promise, misrepresentation or the concealment, suppression or omission of any material fact . . . in the conduct of any trade or commerce."[12] The Uniform Deceptive Trade Practices Act (UDTPA), which has been adopted by twenty states, also prohibits deceptive trade practices, defined as "represent[ing] that goods or services have sponsorship, approval, characteristics, ingredients, uses, benefits, or quantities that they do not have."[13]

Based on these statutes as well as claims stemming from federal law, numerous class-action lawsuits have been filed against manufacturers of products for a variety of reasons. These include claims

- against olive oil manufacturers that their "extra virgin" olive oil did not meet the extra-virgin requirements;[14]
- against Cheerios that its "heart healthy" claims were deceptive;[15]

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[6] Cal. Bus. & Prof. Code §§ 17200–17210 (West 2008).

[7] *Id.* § 17200.

[8] *Id.* §§ 17500–17509.

[9] Cal. Civ. Code §§ 1750–1756 (West 2009).

[10] *See* Ariz. Rev. Stat. Ann. § 44-1521 to -1534 (2003 & Supp. 2010); Fla. Stat. Ann. § 501.201– .213 (West 2010); N.J. Stat. Ann. § 56:8-1 to -181 (West 2001 & Supp. 2011).

[11] 815 Ill. Comp. Stat. Ann. 505/1–505/12 (West 2008 & Supp. 2011).

[12] *Id.* § 505/2.

[13] Unif. Deceptive Trade Practices Act § 2(a)(5).

[14] *See* Class Action Complaint at 2, Martin v. Carapelli USA, LLC, No. 30-2010-00395464 (Cal. Super. Ct. Aug. 2, 2010).

[15] *See* Class Action Complaint at 10, Myers v. Gen. Mills, Inc., No. 2:09-cv-02413 (D.N.J. May 19, 2009).

- against Ford Motor Company that its certified pre-owned vehicle program was a sham to increase prices of standard used cars;[16]
- against Fiji water that its claim to be "carbon negative" was false and misleading;[17]
- against "rocker bottom footwear" that its toning and fitness claims were improper;[18]
- against Aurora Organic Dairy that its products were not "organic;"[19]
- against Mission Guacamole and Bean Dip that its product contained deceptively high percentages of artificial transfats;[20]
- against Nutella that it misled consumers about the health quality of its products;[21]
- against the manufacturer of Fiber One products claiming that the fiber used in the product was not natural fiber;[22] and
- against General Mills claiming that it misstated the digestive benefits of its Yo-Plus Yogurt.[23]

The significance for products liability lawyers is that in each of these cases, no one was hurt. In fact, allegations of personal injury will most likely defeat a class action because the individualized nature of personal injury claims can ruin the commonality required for class certification.

IV.
Requirements of Certification

Federal Rule of Civil Procedure 23 sets forth the requirements for class certification. To bring a class action, a plaintiff must demonstrate the four requirements specified under Rule 23(a) early in the proceedings: numerosity, commonality, typicality, and adequacy.

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[16] *See Kearns v. Ford Motor Co.*, No. CV05-5644, 2007 WL 5110308, at *1 (C.D. Cal. Mar. 22, 2007).

[17] *See* Class Action Complaint at 2, Worthington v. Fiji Water Co., No. CV10-9795 (C.D. Cal. Dec. 20, 2010).

[18] *See* First Amended Class Action Complaint at 1–2, Grabowski v. Skechers U.S.A., Inc., No. 3:10-cv-01300 (S.D. Cal. Feb. 18, 2011).

[19] *See In re* Aurora Dairy Corp. Organic Milk Mktg. & Sales Practices Litig., No. 4:08-MD-01907, 2009 WL 1576928, at *2 (E.D. Mo. June 3, 2009), *partially aff'd*, 621 F.3d 781(8th Cir. 2010).

[20] *See* Henderson v. Gruma Corp., No. CV 10-04173, 2011 WL 1362188, at *1 (C.D. Cal. Apr. 22, 2011).

[21] *See* Complaint at 3, Hohenberg v. Ferrero U.S.A., Inc., No. 11-cv-00205 (S.D. Cal. Feb. 1, 2011).

[22] *See* Class Action Complaint at 3, Turek v. Gen. Mills, Inc., No. 09-cv-7038 (N.D. Ill. Nov. 9, 2009).

[23] *See* Fitzpatrick v. Gen. Mills, Inc., 263 F.R.D. 687, 692 (S.D. Fla. 2010), *aff'd in part*, 635 F.3d 1279 (11th Cir. 2011).

These requirements are only threshold matters, and other considerations, such as whether the claims are preempted by federal law or whether class members have standing to bring a case, also have to be met before a court will certify a class and allow a class-action lawsuit to go forward.

A. *Numerosity*

Federal Rule of Civil Procedure 23(a)(1) requires that there be numerous members in the proposed class for a lawsuit to proceed as a class action.[24] Courts have denied certification for failure to provide proof of the number of persons in a proposed class as well as failure to demonstrate the feasibility of ascertaining the members of the class.

For example, in *Pelman v. McDonald's Corp.*,[25] the plaintiffs alleged on behalf of New York consumers that McDonald's deceptively marketed its food as fit to consume on a daily basis.[26] In the suit, the plaintiffs characterized the class that they represented as

> New York State residents, infants, and consumers who were exposed to Defendant's deceptive business practices and, as a result thereof, purchased and consumed the Defendant[']s] products in New York State stores/franchises, directly causing economic losses in the form of financial costs of the Defendant's goods, causing significant or substantial factors in the development of diabetes, coronary heart disease, high blood pressure, obesity, elevated levels of [LDL], and/or detrimental and adverse health effects and/or diseases as medically determined to have been causally connected to the prolonged use of Defendant's certain products.[27]

The court found, however, that plaintiffs did not present specific evidence about the number of persons exposed to the marketing at issue who regularly ate at McDonald's and then developed the same medical injuries.[28] This failure proved fatal to their class certification attempt under the numerosity prong.

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[24] *Compare* Vega v. T-Mobile USA, Inc., 564 F.3d 1256, 1267 (11th Cir. 2009) (reversing certification of class because plaintiff "has not cited, and we cannot locate in the record, any evidence whatsoever (or even an allegation) of the number of retail sales associates . . . who would comprise the membership of the class") *with* Cook County Coll. Teachers Union, Local 1600 v. Byrd, 456 F.2d 882, 885 (7th Cir. 1972) (certification improper because class composed of nine teachers was "not too large to have made joinder impracticable").

[25] 272 F.R.D. 82 (S.D.N.Y. 2010).

[26] *See id.* at 88.

[27] *See id.* at 90 (punctuation in original).

[28] *See id.* at 99–100.

Moreover, in *Weiner v. Snapple Beverage Corp*., the court found that not only did plaintiffs fail to demonstrate they paid a premium due to the "All Natural" label on the popular drink, but they failed to prove that it would be feasible to ascertain the members of such a class.[29]

Finally, the Eleventh Circuit reversed a class certification in *Vega v. T-Mobile USA*,[30] because the plaintiff "ha[d] not cited, and [the court could not] locate in the record, any evidence whatsoever (or even an allegation) of the number of retail sales associates . . . who would comprise the membership of the class."[31]

These examples demonstrate that plaintiffs must clearly define the need for and scope of a class.

B. *Commonality*

The commonality requirement of Federal Rule of Civil Procedure 23(a)(2) specifies that the members of the class must share common questions of law or fact, although not necessarily in all aspects.[32] Furthermore, Rule 23(b)(3) provides that "common questions of law and fact . . . predominate over individualized issues."[33] Courts have been firm in requiring both that that the common issues of a proposed class predominate over individual issues posed by subsets of the class and that a suitable methodology is available to prove causation and injury across the entire class, using an inability to satisfy either rule as an excuse to deny class certification.[34]

The commonality requirement has often translated into a proof problem for plaintiffs' attorneys. For example, the court in *Weiner v. Snapple Beverage Corp.*, a case in which the beverage company was alleged to have misled consumers by using an "All Natural" label, articulated this issue simply by evaluating the differences in circumstances among already-

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[29] No. 07 Civ. 8742, 2010 WL 3119452, at *5 (S.D.N.Y. Aug. 5, 2010).

[30] 564 F.3d 1256 (11th Cir. 2009).

[31] *Id.* at 1267.

[32] *See* Califano v. Yamasaki, 442 U.S. 682, 701 (1979) (finding determinative whether "differences in the factual background of each claim will affect the outcome of the legal issue"); Dukes v. Wal-Mart, Inc., 474 F.3d 1214, 1225 (9th Cir. 2007) ("The commonality test is qualitative rather than quantitative—one significant issue common to the class may be sufficient to warrant certification."); *In re* Bridgestone/Firestone Tires Prods. Liab. Litig., 288 F.3d 1012, 1015 (7th Cir. 2002) ("No class action is proper unless all litigants are governed by the same legal rules. Otherwise the class cannot satisfy the commonality and superiority requirements of Fed. R. Civ. P. 23(a), (b)(3)."); Hanlon v. Chrysler Corp., 150 F.3d 1011, 1019 (9th Cir. 1998) ("Rule 23(a)(2) has been construed permissively. All questions of fact and law need not be common to satisfy the rule.").

[33] *See* Picus v. Wal-Mart Stores, Inc., 256 F.R.D. 651, 656 (D. Nev. 2009).

[34] *See* Knapp v. AT&T Wireless Services, Inc. 124 Cal. Rptr. 3d 565, 573 (Ct. App. 2011).

named plaintiffs.[35] There, the court noted that that one plaintiff purchased the drink "because of Snapple's humorous promotions, flavor offerings, and because Snapple beverages were refreshing and thirst-quenching," while another named plaintiff stated that he preferred the drink because it came in a glass bottle rather than aluminum can, the company was based in New York, and he liked the "Snapple Facts." Each plaintiff bought the product at different times, in different places, and for potentially different monetary amounts.[36] Thus, the court concluded that "plaintiffs [failed to show] that they could prove at trial using common evidence that putative class members in fact paid a premium for Snapple beverages as a result of the 'All Natural' labeling."[37]

Other cases based on deceptive advertisement claims also have run into commonality issues. The court in *Pelman v. McDonald's Corp*., which also had problems with numerosity, determined that the development of medical conditions such as obesity, elevated levels of cholesterol, diabetes, and high-blood pressure depended heavily on factors unique to individuals, so it was improper to generalize causation to deceptive marketing by the fast-food chain.[38] Among the factors that the court determined would require individual inquiries were the extent to which the plaintiffs ate the defendant's products and the extent to which they relied on the defendant's allegedly misleading advertisements.[39]

Even when a class seems cohesive, extensive involvement of the court in determining appropriate plaintiffs could be fatal to certification due to the commonality requirement. The Fifth Circuit overturned a district court decision granting certification to plaintiffs who alleged violations of the Telephone Consumer Protection Act's prohibition on unsolicited advertising for sending fax advertisements to persons who did not consent to their receipt.[40] Because individual consent was an issue in determining membership in the class, the possibility of too many "mini-trials" helped defeat certification.[41]

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[35] *See* No. 1:07-cv08742, 2010 WL 3119452, at *2 (S.D.N.Y. Aug. 5, 2010).

[36] *See id.* at *2–3.

[37] *Id.* at *6.

[38] 272 F.R.D. 82, 94 (S.D.N.Y. 2010).

[39] *See id.* at 95.

[40] *See* Gene & Gene LLC v. Biopay LLC, 541 F.3d 318, 322–23 (5th Cir. 2008).

[41] *Id.* at 329.

C. *Typicality*

For a class to be established, Federal Rule of Civil Procedure 23(a)(3) mandates that the claims or defenses of the individual class representatives be typical of the claims or defenses of the whole class.[42] Typicality is usually found "'when each class member's claim arises from the same course of events, and each class member makes similar legal arguments to prove the defendant's liability.'"[43] The goal of typicality is to ensure "'the named plaintiff's claims are so interrelated that the interests of the class members will be fairly and adequately protected in their absence.'"[44] The denial of class certification for lack of typicality appears to manifest in one of two ways—either the named plaintiff did not experience the same damages as the class, or the varying possible rationales leading to the alleged damages were too varied and uncertain to say the entire class had the same rationale as the named plaintiff.

Thus, in *Peviani v. Natural Balance Inc*., in which a woman claimed that "Cobra Sexual Energy" male aphrodisiac was ineffective and created health risks, the court held that the female plaintiff was not typical of a class of purchasers because she had not actually taken the product and was not at risk of the symptoms involved in the claim.[45] Instead, her only injury would have been the money she spent on the product. "In this significant respect, Plaintiff's interests [we]re not aligned with the claims of male consumers, specifically those males experiencing the serious health consequences alleged by Plaintiff," the court wrote.[46]

In *Fine v. ConAgra Foods, Inc*., where the plaintiff alleged that "No Added Diacetyl" packaging for microwave popcorn was misleading, another California court determined that the plaintiff had failed to adduce facts suggesting other class members had assumed the product contained no Diacetyl due to the label.[47] Because the plaintiff had sought to certify a class including people with varying reasons for buying the popcorn, she failed to establish she was a typical representative of the class, according to the court.[48]

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[42] Beck v. Maximus, Inc., 457 F.3d 291, 300 (3d Cir. 2006) ("To defeat class certification, a defendant must show some degree of likelihood a unique defense will play a significant role at trial. If a court determines an asserted unique defense has no merit, the defense will not preclude class certification."); Deiter v. Microsoft Corp., 436 F.3d 461, 466–67 (4th Cir. 2006) ("The representative party's interest in prosecuting his own case must simultaneously tend to advance the interests of the absent class members. For that essential reason, plaintiff's claim cannot be so different from the claims of absent class members that their claims will not be advanced by plaintiff's proof of his own individual claim."); Marisol A. v. Giuliani, 126 F.3d 372, 376 (2d Cir. 1997); *In re* Am. Med. Sys., Inc., 75 F.3d 1069, 1082 (6th Cir. 1996) ("A necessary consequence of the typicality requirement is that the representative's interests will be aligned with those of the represented group, and in pursuing his own claims, the named plaintiff will also advance the interests of the class members.").

[43] *Marisol A*., 126 F.3d at 376 (quoting *In re* Drexel Burnham Lambert, 960 F.2d 285, 291 (2d Cir. 1992)).

[44] *Id.* (quoting Gen. Tel. Co. of the Sw. v. Falcon, 257 U.S. 147, 157 n.13 (1982)).

[45] No. 3:10-cv-02451, 2011 WL 1648952, at *4 (S.D. Cal. May 2, 2011).

[46] *Id.* at *3.

[47] No. CV 10-01848, 2010 WL 3632469, at *3 (C.D. Cal. Aug. 27, 2010).

[48] *See id.*

D. *Adequacy*

Finally, Federal Rule of Civil Procedure 23(a)(4) considers whether (1) any substantial conflicts exist between the representative plaintiffs and the class and (2) a named plaintiff will adequately prosecute the claims alleged in the class action.[49] The adequacy requirement has also been used by courts to deny class certification, in at least one instance, when the court determined the named plaintiff was simply not interested in pursuing a consumer class action. In a case over a lip gloss that was alleged to have falsely claimed appetite suppression qualities, the court found the named plaintiff "had no interest in vindicating her own consumer rights, let alone protecting the rights of any other consumer. . . . [S]he was not a person who would willingly assume the fiduciary responsibility to prosecute a UCL action on behalf of absent class members."[50] The court based this assessment on the fact that the plaintiff had only contacted a lawyer at a friend's suggestion and claimed "laziness" to explain why she had not tried to return the product to the store instead.[51]

Most other cases involving a denial of class certification, however, are based on a determination that the named plaintiff had differing interests from the proposed class.[52] The Texas Supreme Court, for example, declined certification in a case that involved a business trying to recover on behalf of clients for overbilling by a telephone company. In *Southwestern Bell Telephone Co. v. Marketing on Hold Inc*., the court found that the company failed the adequacy test because the plaintiff "ha[d] a materially lesser interest in making itself and the class whole because it was never personally aggrieved by Southwestern Bell's alleged overcharging, and its maximum recovery [wa]s less than half the value of any individual claim for damages."[53]

E. *Other Considerations in Class Certifications*

In addition to the requirements spelled out by Rule 23(a), courts consider a number of other factors when deciding whether to certify a class. As already noted, Rule 23(b) imposes additional requirements depending upon the relief sought. Specifically, plaintiffs seeking certification of a class action seeking money damages must also satisfy the predominance standard of 23(b)(3), which requires that common issues of law and fact in a class action "predominate" over individual issues.

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[49] *See* Amchem Prods, Inc. v. Windsor, 521 U.S. 591, 594 (1997) (stating that the adequacy inquiry under Rule 23(a)(4) "serves to uncover conflicts of interest between named parties and the class they seek to represent"); Berger v. Compaq Computer Corp., 257 F.3d 475, 482–83 (5th Cir. 2001) (stating that adequacy requires class representatives "to possess a sufficient level of knowledge and understanding to be capable of 'controlling' or 'prosecuting' the litigation"); Pickett v. Iowa Beef Processors, 209 F.3d 1276, 1280 (11th Cir. 2000).

[50] Farokhzadeh v. Too Faced Cosmetics, Inc., No. B213306, 2010 WL 1645817, at *4 (Cal. Ct. App. Apr. 26, 2010).

[51] *See id.* at *1.

[52] *See* Peviani v. Natural Balance Inc., No. 3:10-cv-02451, 2011 WL 1648952, at *3 (S.D. Cal. May 2, 2011).

[53] 308 S.W.3d 909, 925–26 (Tex. 2010).

Furthermore, preemption of claims by federal statute and a plaintiff's inability to meet Article III standing requirements by demonstrating injury also can prevent a class from forming. Federal preemption, particularly under the Airline Deregulation Act of 1978[54] and Food and Drug Administration labeling requirements,[55] has been an often-used ground for denying class certification.

Courts also carefully evaluate Article III standing requirements when determining whether to grant class certification. To gain standing to bring a case, a plaintiff often will have to show that he suffered an "injury in fact." Denial of a class, therefore, most often results from the plaintiff and putative class's failure to demonstrate any injury as a result of a claimed violation of consumer laws.[56]

Finally, some courts appear to be willing to throw out facially-frivolous class-action claims on common-sense grounds. In *Werberl v. PepsiCo, Inc*.,[57] the court concluded that a plaintiff's claim on behalf of consumers allegedly misled into believing that "Cap'n Crunch's Crunch Berries" cereal derived some of its nutritional value from real berries or fruit was "[n]onsense."[58] The court found it was obvious from the packaging that no reasonable consumer would believe the cereal derived nutritional value from fruit. Stated the court,

> As an initial matter, the term "Berries" is not used alone, but always preceded by the word "Crunch," to form the term, "Crunch Berries." The image of the Crunch Berries, which is "ENLARGED TO SHOW TEXTURE," shows four cereal balls with a rough, textured surface in hues of deep purple, teal, chartreuse green and

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[54] *See* Hickcox-Huffman v. US Airways, Inc., No. C10-05193, 2011 WL 1585560, at *6 (N.D. Cal. Apr. 27, 2011) (finding claim that $15 luggage fee created a duty for airline to deliver the baggage in a timely manner preempted by Airline Deregulation Act of 1978); Nat'l Fed'n of the Blind v. United Airlines, Inc., No. C 10-04816, 2011 WL 1544524, at *8 (N.D. Cal. Apr. 25, 2011) (dismissing suit by National Federation of the Blind over accessibility of airport ticketing kiosks as preempted by the Air Carrier Access Act and the Airline Deregulation Act).

[55] *See* Yumul v. Smart Balance, Inc., No. CV 10-00927, 2011 WL 1045555, at *9–10 (C.D. Cal. Mar. 14, 2011); Peviani v. Hostess Brands, Inc., 750 F. Supp. 2d 1111, 1117–18 (C.D. Cal. 2010); Chacanaca v. Quaker Oats Co., 752 F. Supp. 2d 1111, 1119–24 (N.D. Cal. 2010) (analyzing and finding some of plaintiff's claims preempted by the Food, Drug, and Cosmetics and Nutritional Labeling and Education Acts).

[56] *See* Rule v. Ford Dodge Animal Health, Inc., 607 F.3d 250, 253 (1st Cir. 2010); Herrington v. Johnson & Johnson Consumer Cos., No. C 09-1597, 2010 WL 3448531, at *3 (N.D. Cal. Sept. 1, 2010); Degelmann v. Advanced Med. Optics, Inc., No. C 07-3107, 2010 WL 55874, at *4 (N.D. Cal. Jan. 4, 2010); Koronthaly v. L'Oreal USA, Inc., No. 07-CV-5588, 2008 WL 4723862, at *4–5 (D.N.J. Oct. 24, 2008), *aff'd*, 374 F. App'x 257, 259 (3d Cir. 2010); DeBenedetto v. Denny's Inc., No. A-4135-09T1, 2011 WL 67258, at *3 (N.J. Super. Ct. App. Div. Jan. 11, 2011).

[57] No. C 09-04456, 2010 WL 2673860 (N.D. Cal. July 2, 2010).

[58] *Id.* at *3.

> bright red. These cereal balls do not even remotely resemble any naturally occurring fruit of any kind. There are no representations that Crunch Berries are derived from real fruit nor are there any depictions of any fruit on the cereal box. To the contrary, the packaging clearly states that product is a "SWEETENED CORN & OAT CEREAL."[59]

Because the court found no reasonable consumer would be deceived into believing the cereal would deliver nutritional benefits by containing fruit, it dismissed the plaintiffs' causes of action based on California's consumer protection statutes.[60]

V.
New Developments in Class-Certification Requirements

The developing requirement that plaintiffs overcome a heightened standard of proof as to the four elements under Rule 23(a) may create a seismic shift in class certification issues. Moreover, the requirements relating to expert testimony at the certification stage are also becoming more stringent. If a plaintiff seeks to introduce expert testimony at the certification stage, he or she is now required to demonstrate that the expert's analyses designed to help meet certification standards overcome the *Daubert* thresholds, which require such evidence to be based on scientifically valid reasoning and to be relevant to the case, at the outset of the proceedings.[61]

A. *A More Rigorous Examination of Rule 23 Requirements*

Formerly, plaintiffs were required to make only "some showing" that the Rule 23 requirements were met. Courts were specifically told not to consider the merits of a case in making a certification decision.[62] But recently, many courts have moved dramatically away from this rule. This change is specifically demonstrated by the Third Circuit's decision in *In re Hydrogen Peroxide Antitrust Litigation*.[63] There, the court held that a trial court must

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[59] *Id.*

[60] *See id.* at *5.

[61] *See* Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579, 592–93 (1993) ; *see also* Sher v. Raytheon Co., 419 F. App'x 887, 890–91 (11th Cir. 2011) (reversing lower court's decision that a *Daubert* issue need not be resolved before certifying the class); Am. Honda Motor Co. v. Allen, 600 F.3d 813, 815–16 (7th Cir. 2010) (mandating that trial courts rule must on expert testimony admissibility at the certification stage of litigation when such testimony is critical to certification); Blades v. Monsanto Co., 400 F.3d 562, 575 (8th Cir. 2005) (holding that the court may be required to resolve expert disputes during certification). *But see In re* Zurn Pex Plumbing Prods. Liab. Litig., 267 F.R.D. 549, 557 (D. Minn. 2010) (certifying a class based in part on arguably inadmissible expert testimony).

[62] Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 177–78 (1974).

[63] 552 F.3d 305 (3d Cir. 2008).

conduct "a rigorous analysis" to determine whether a proposed class satisfies the requirements of Rule 23.[64] Additionally, the court determined that a party seeking class certification must demonstrate the Rule 23 requirements by a preponderance of the evidence and that specific factual determinations must be made when a court decides whether the standard is met.[65] Finally, the court held that if expert testimony is offered at the class certification stage, the court must not "uncritically" accept such testimony but must weigh the testimony and resolve credibility issues that might normally be left to a jury.[66] All of these requirements served to make it more difficult for the plaintiff to certify the suggested class.

Other circuits have imposed similarly rigorous requirements on certification. The Fifth Circuit, in *Oscar Private Equity Investments v. Allegiance Telecom, Inc*., required an empirically valid demonstration of loss causation,[67] a concept unique to securities class-action lawsuits that requires the plaintiff show a defendant's alleged fraudulent activity has affected a stock price such as to cause a significant economic loss. The First and Tenth Circuits have held that some inquiry into the merits at the class certification stage is not only permissible but appropriate to the extent that the merits overlap the Rule 23 criteria.[68] Where a statute of limitations defense had the effect of precluding a Rule 23(a) typicality finding, the Third Circuit rejected the proposition that the court could not evaluate the merits of class claims at the certification stage.[69] Finally, the Fourth Circuit determined that "while an evaluation of the merits to determine the strength of plaintiffs' case is not part of a Rule 23 analysis, the factors spelled out in Rule 23 must be addressed through findings, even if they overlap with issues on the merits."[70] In fact, the Supreme Court in *Wal-Mart Stores, Inc. v. Dukes*[71] may have effectively overturned its previous rule cautioning against a merit-based review at the class certification stage.

B. *Commonality and Typicality in Wal-Mart v. Dukes*

The *Wal-Mart* Court held that Rule 23 does not set forth a mere pleading standard. Instead, the rule requires that the party seeking certification affirmatively demonstrate compliance with the rule's certification standards and that courts therefore need to conduct a "rigorous analysis" to determine that the rule's prerequisites have been satisfied.[72] Applying this requirement to the facts of the *Wal-Mart* case, the Supreme Court thus defined

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[64] *Id.* at 318.

[65] *Id.* at 320.

[66] *Id.* at 323.

[67] 487 F.3d 261, 265 (5th Cir. 2007).

[68] *See* Vallario v. Vandehey, 554 F.3d 1259, 1266 (10th Cir. 2009); *In re* New Motor Vehicles Canadian Exp. Antitrust Litig., 522 F.3d 6, 17, 24 (1st Cir. 2008).

[69] *See In re* Community Bank of N. Va., 622 F.3d 275, 293 (3d Cir. 2010).

[70] *See* Gariety v. Grant Thornton, LLP, 368 F.3d 356, 366 (4th Cir. 2004).

[71] 131 S. Ct. 2541 (2011).

[72] *See* Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541, 2551 (2011).

the outer limits of commonality and typicality for class certification. The Court's ruling in *Wal-Mart* overturned the Ninth Circuit's en banc decision certifying the largest employment class in history. That class encompassed "[a]ll women employed at any Wal-Mart domestic retail store at any time since December 26, 1998, who have been or may be subjected to Wal-Mart's challenged pay and management track promotions policies and practices."[73]

As noted in the massive chain-store retailer's brief to the Supreme Court, such a class certification posed myriad problems:

> The certification order is flatly inconsistent with Rule 23(a)'s prerequisites. The class members—potentially millions of women supervised by tens of thousands of different managers and employed in thousands of different stores throughout the country—assert highly individualized, fact-intensive claims for monetary relief that are subject to individualized statutory defenses. The named plaintiffs' claims cannot conceivably be typical of the claims of the strangers they seek to represent. These intractable problems are compounded by a virtually boundless class definition that produces an across-the-board class pervaded by conflicts among its members. This kaleidoscope of claims, defenses, issues, locales, events, and individuals makes it impossible for the named plaintiffs to be adequate representatives of the absent class members.[74]

In reversing the class certification decision, the Court held that (1) plaintiffs had failed to establish commonality under Federal Rule of Civil Procedure 23(a)(2); and (2) certification under Rule 23(b)(2) was improper where plaintiffs sought monetary relief through individualized claims for back pay.[75]

There are four specific takeaways from the decision: courts now must look beyond the pleadings to determine class certification in the initial stages of litigation; commonality issues should be subjected to a higher standard than they have been in the past; expert support for class certification must meet *Daubert* standards; and individualized monetary claims will preclude class certification under Rule 23(b)(2). Each of these areas is discussed here in more detail.

1. Courts Must Look Beyond the Pleadings to Determine Class Certification

The *Wal-Mart* Court's requirement that the party seeking certification must affirmatively demonstrate compliance with the rule puts the onus on the plaintiff "to prove that there are *in fact* sufficiently numerous parties, common questions of law or fact, etc."[76] In doing

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[73] Dukes v. Wal-Mart, 509 F.3d 1168 (9th Cir. 2007).

[74] Brief for Petitioner at 1, Wal-Mart Stores, Inc. v. Dukes, No. 10-277 (U.S. Jan. 20, 2011).

[75] *See Wal-Mart*, 131 S. Ct. at 2557.

[76] *Id.* at 2551.

so, the Court effectively overturned *Eisen v. Carlisle & Jacquelin*,[77] which eschewed any inquiry into the merits in deciding class certification issues. The *Wal-Mart* majority decision acknowledged the Rule 23(a) commonality analysis would "entail some overlap" with the merits of a suit, but stated that this was no different than court considerations in other threshold matters such as jurisdiction and venue.[78]

Wal-Mart lends further support to courts that wish to examine the merits in deciding class certification issues. It also suggests that it may be more difficult to bifurcate discovery on class issues from discovery on merits issues for parties to class-action suits.

2. Heightened Standard for Commonality Under Rule 23

In order to establish commonality under Rule 23(a)(2), the Court held that plaintiffs must demonstrate that the class members "'have suffered the same injury.'"[79] The Court clarified that "[t]his does not mean merely that they have all suffered a violation of the same provision of law," but rather that class members' claims "must depend upon a common contention—for example, the assertion of discriminatory bias on the part of the same supervisor."[80] Moreover, the Court held that "[t]hat common contention . . . must be of such a nature that it is capable of classwide resolution—which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke."[81]

The Court's ruling, therefore, increased the commonality requirements necessary for plaintiffs' to certify a class. Justice Ruth Bader Ginsburg charged in a dissent to that aspect of the Court's majority opinion that the Court had conflated the Rule 23(a)(2) requirements with the more demanding standard of Rule 23(b)(3).[82] As a result, she stated that the Rule 23(a)(2) would be "no longer 'easily satisfied.'"[83]

3. Expert Support for Class Certification Must Meet *Daubert* Standards

The Court did not directly rule on the applicability of *Daubert* to expert challenges at the class certification stage, but it indicated in dicta that a *Daubert* standard would apply.[84] The Court decided, however, that the expert relied upon by the plaintiffs who determined that Wal-Mart's culture and practices made it vulnerable to gender discrimination did not

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[77] 417 U.S. 156 (1974).

[78] *See Wal-Mart*, 131 S. Ct. at 2551–52.

[79] *Id*. at 2551 (quoting Gen. Tel. Co. of the Sw. v. Falcon, 457 U.S. 147, 157 (1982)).

[80] *Id*.

[81] *Id*.

[82] *See id.* at 2565 (Ginsburg, J., dissenting).

[83] *See id.* (quoting 5 James Wm. Moore, Moore's Federal Practice § 23.23[2], at 23-72(3d ed. 2011)).

[84] *See id.* at 2553–54.

help advance a class commonality argument; thus, the Court avoided directly addressing the issue.[85]

4. Individualized Monetary Claims May Preclude Class Certification

Finally, the Court held that individualized monetary claims cannot be resolved in a class allowed under Rule 23(b)(2), which applies when "the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole."[86] According to the Court, Rule 23(b)(2) "does not authorize class certification when each individual class member would be entitled to a *different* injunction or declaratory judgment against the defendant . . . [or] when each class member would be entitled to an individualized award of monetary damages."[87]

Instead, the Court determined that classes including members with individualized monetary claims would be better certified under Rule 23(b)(3).[88] Rule 23(b)(3) allows certification of monetary claims, but with greater procedural protections, including notice of the action and opt-out rights for class members; on the other hand, Rule 23(b)(2) applies to indivisible injunctive relief and therefore creates mandatory classes with fewer procedural protections for individual class members.[89] Because Rule 23(b)(2) relief benefits all class members at once, the rule does not lead to case-specific inquiries into whether the questions of law and fact raised in the class action predominate over questions for individual class members or whether the class action is superior to other adjudicatory methods.[90]

C. *Reliance and Causation Issues that May Prevent Class Certification*

Recent court rulings and statutory changes also have imposed additional hurdles to class certification when plaintiffs cannot demonstrate critical elements of their claims at the certification stage. In deceptive marketing claims, for instance, some courts now require that plaintiffs show an actual reliance on the false advertising as part of class certification. Furthermore, while the Supreme Court has rejected the need for plaintiffs to demonstrate "loss causation" for class certification in securities cases, it is unclear whether courts will adopt a similar causation stance in consumer class actions.

1. Reliance

In addition to the heightened requirements imposed by the Court in *Wal-Mart*, a split appears to be forming between circuit courts as to whether plaintiffs can depend on an in-

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[85] *See id.* at 2554.

[86] Fed. R. Civ. Proc. 23(b)(2).

[87] Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct. 2541, 2557 (2011).

[88] *See id.* at 2558.

[89] *See id.*

[90] *See id.*

ference that class members relied on deceptive marketing to support a related class-action claim. Some courts have determined that an inference of such reliance is appropriate if the persons who supposedly relied upon misrepresentations acted in a manner consistent with such reliance. Some do not even require that much of a showing at the class-certification stage.[91] Other courts have continued to insist upon proof of reliance on the allegedly deceptive marketing by individual class members to include them in the action.[92]

California residents may have settled the reliance issue in their state. In November 2004, California voters passed Proposition 64 by a margin of 59% to 41%.[93] The ballot measure amended California's Business and Professions Code to limit private enforcement of business laws. Prior to Proposition 64, private parties could sue on behalf of the general public without meeting standard class-action requirements and often without proof of actual injury. The revised Code requires a person pursuing representative claims to meet certain standing requirements, newly defined to be limited to one "who has suffered injury in fact and has lost money or property as a result of such unfair competition."[94] Proponents claimed the new Code was designed to reduce "shakedown lawsuits,"[95] in which a private attorney could file suit against a business "even though they have no client or evidence that anyone was damaged or misled."[96] This ended the ability of a private plaintiff to file a "private attorney general" lawsuit.

Following the passage of Proposition 64, defendants began arguing that the "as a result of" language in the Code created a requirement that a plaintiff prove reliance to bring a deceptive marketing or advertising claim. No longer would it be sufficient that the plaintiff demonstrate he "lost money," he would need to show he relied upon the allegedly unfair advertisements in deciding to purchase the product, these defendants argued.[97]

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[91] *See* Fitzpatrick v. Gen. Mills, Inc., 635 F.3d 1279, 1283 (11th Cir. 2011) (adopting presumption of reliance as to purported health benefits of yogurt sufficient to certify a class); Wolph v. Acer Am. Corp., 272 F.R.D. 477, 488 (N.D. Cal. 2011) (finding that individualized reliance on specific misrepresentations not required because classwide reliance is presumed with a material misrepresentation).

[92] *See* McLaughlin v. Am. Tobacco Co., 522 F.3d 215, 223 (2d Cir. 2008) (stating that reliance on misrepresentation made as part of a nationwide marketing strategy "cannot be the subject of general proof").

[93] *See* Cal. Secretary of State, Statement of Vote & Supplemental Statement of Vote, Nov. 2, 2004, Presidential Gen. Election, State Ballot Measures 45 (2004), http://www.sos.ca.gov/elections/sov/2004_general/ formatted_ballot_measures_detail.pdf.

[94] Cal. Bus. & Prof. Code § 17204 (West 2008); *see also* Cal. Secretary of State, Official Voter Information Guide, Cal. Gen. Election Nov. 2004, Text of Proposed Laws, Proposition 64, at 1, http://vote2004.sos.ca.gov/voterguide/propositions/prop64text.pdf.

[95] Cal. Secretary of State, Official Voter Information Guide, Cal. Gen. Election Nov. 2004, Arguments and Rebuttals, Proposition 64, http://vote2004.sos.ca.gov/voterguide/propositions/prop64-arguments.htm.

[96] *Id*.

[97] *See, e.g.*, *In re* Tobacco II, 47 Cal. Rptr. 3d 917, 926 (Ct. App. 2006), *rev'd,* 207 P.3d 20, 41 (Cal. 2009); Pfizer, Inc. v. Super. Ct., Cal. Rptr. 3d 840, 847 (Ct. App. 2006), *overruled by* 146 P.3d 1250 (Cal. 2006).

2. Causation

The Supreme Court recently rejected a "loss causation" requirement, which would have required plaintiffs to show that defendants' misrepresentation caused their economic losses in order to certify securities class actions, resolving a split between the Fifth Circuit and the Second, Third, and Seventh Circuits.[98] In doing so, the Court indicated that plaintiffs need not show that their reliance on a misrepresentation caused their injury at the class-certification stage; rather, such reliance is an issue to be argued at the trial. The fallout of this securities class action ruling on consumer class action certifications is not yet clear. One circuit court, however, recently rejected certification for a purported consumer class in part due to the plaintiffs' failure to show but-for causation in doctors' prescription of certain pharmaceuticals based on a drug-maker's disputed claims.[99]

D. *Stricter Pleading Requirements for Class Actions*

In Kearns v. Ford Motor Co., the Ninth Circuit held that claims brought under the "fraudulent" prong of California's consumer protection statute, the UCL, must be pled with particularity under Federal Rule of Civil Procedure 9(b).[100] According to the Circuit, when a claimant relies on a particular advertisement, he must "articulate the who, what, when, where, and how of the misconduct alleged" to bring a fraud claim.[101]

Courts have broadly accepted *Kearns* to block fraud suits where plaintiffs have not alleged in their pleadings that they relied on a defendant's marketing. For example, in *Goldsmith v. Allergan, Inc*., the district court applied *Kearns* in dismissing a lawsuit over the false marketing of Botox because the plaintiff did not allege that he had seen or relied on any ads for Botox.[102] The court also held that the plaintiff had failed to allege how any of the advertisements were false or misleading.[103]

Other courts have dismissed complaints for false marketing that did not adequately describe what the plaintiff had seen and relied upon[104] or that did not describe the contents of omitted information or examples of advertisements that the plaintiff previously had relied upon.[105]

At the same time, plaintiffs who can provide sufficient details to support their claims at the pleading stage can avoid dismissal under *Kearns*. *Von Koenig v. Snapple Beverage Corp*. was another case in which plaintiffs alleged that Snapple's drink labels falsely represented

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[98] *See* Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179, 2183 (2011).

[99] *See* UFCW Local 1776 v. Eli Lilly & Co., 620 F.3d 121, 133–34 (2d Cir. 2010).

[100] 567 F.3d 1120, 1122 (9th Cir. 2009).

[101] *See id.* at 1126.

[102] No. CV 09-7088, 2011 WL 147714, at *7 (C.D. Cal. Jan. 13, 2011).

[103] *See id.*

[104] Yumul v. Smart Balance, Inc., 733 F. Supp. 2d 1117, 1124 (C.D. Cal. 2010).

[105] Marolda v. Symantec Corp., 672 F. Supp. 2d 992, 1002 (N.D. Cal. 2009).

that its beverages were "All Natural" and "100% Natural" when they contained high-fructose corn syrup.[106] The court found that the plaintiffs had satisfied the *Kearns* requirement when the complaint specified the "All Natural" and "100% Natural" representations.[107] Plaintiffs in the case, which alleged that the labels deceived consumers because high-fructose corn syrup is not "all natural," had submitted labels from sixty drink bottles that contained the representations.[108]

VI.
Successful Class Certifications

Despite the stricter approach adopted by some courts in certification actions, recent class certifications suggest that narrowly defined classes and claims with demonstrable damages will continue to find favor with the courts. Plaintiffs have been particularly successful when they have been able to define classes with broad commonality but different specified qualifications for class membership.

For example, a California court recently granted a class of "[a]ll persons or entities in the United States who entered into a loan agreement with Chase [Bank], whereby Chase promised a fixed [annual percentage rate] until the loan balance was paid in full, and (i) whose minimum monthly payment was increased by Chase to 5% of the outstanding balance, or (ii) who were notified of a minimum monthly payment increase by Chase and subsequently closed their account or agreed to an alternative change in terms offered by Chase."[109] In so doing, the court in *In re Chase Bank USA,* rejected arguments that differences in language used in the various form letters from the bank to class members created a lack of commonality.[110] The court found that, because each of Chase's letters offered class members the same basic terms, the differences did not defeat a finding of commonality necessary to certify the class.[111]

Such a dual qualification class was also permitted by an Illinois district court. In *Saltzman v. Pella Corp*., the court certified two classes of plaintiffs in a case alleging wood rot problems in the defendant's windows: (1) all owners of "Pella ProLine" windows manufactured since 1991 whose windows have not yet manifested the alleged defect and those whose windows have some wood rot but have not yet been replaced and (2) all owners of "Pella ProLine" windows manufactured since 1991 whose windows manifested the alleged defect and whose windows had already been replaced.[112] The Seventh Circuit affirmed the certification, find-

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[106] No. 2:09-cv-00606, 2011 WL 43577, at *1 (E.D. Cal. Jan. 6, 2011).

[107] *See id.* at *2.

[108] *See id.*

[109] *In re* Chase Bank USA, N.A. "Check Loan" Contract Litig., 274 F.R.D. 286, 293 (N.D. Cal. 2011).

[110] *See id.* at 291.

[111] *See id.*

[112] 257 F.R.D. 471, 475 (N.D. Ill. 2009).

ing that the class upheld the principles behind class-action lawsuits.[113] "This is not a case where the issues are so complex, and Pella does not claim that the consequences are so high, that a decentralized process of multiple trials is necessary for an accurate evaluation of the claims," explained the court.[114]

The amount of harm that courts will require plaintiffs to show to justify the certification of a class most likely will vary depending on the law that the defendant is alleged to have violated. For example, in *In re Mercedes-Benz Tele Aid Contract Litigation,* a New Jersey district judge measured whether plaintiffs had been harmed by an "ascertainable loss" standard set by New Jersey's consumer fraud statute.[115] Thus, the court considered the harm done to the plaintiffs by Mercedes' sale of vehicles equipped with emergency response systems that were rendered obsolete in 2008, determining the harm to be the difference in the value of a car equipped with such a system and one without the system.[116] "Simply put, the sum of each class member's loss is the amount necessary to fulfill his or her expectation of a functioning Tele Aid system," the court wrote.[117]

VII.
Conclusion

Although courts in the wake of *Wal-Mart v. Dukes* are likely to require that plaintiffs meet a higher standard to proceed with class-action lawsuits, products liability lawyers would do well to be wary of possible claims filed against their clients. Pleadings that specify claims with particularity and classes that are narrowly defined are likely to find favor with courts, despite a lack of injury or showing of reliance on a false misrepresentation. This approach comports with the view that barriers should remain low at the class-certification stage.

At the same time, the Supreme Court's requirement in *Wal-Mart* that commonality not be restricted to one alleged fact but to multiple and predominating issues could spell doom for many classes that might previously have easily received certification. Moreover, courts' willingness to subject expert evidence on class certification to the *Daubert* standard and requirements for actual reliance on misrepresentations could prevent class actions from going forward. Products liability lawyers should be aware of these recent trends as they could save their clients a great deal of grief, especially if this knowledge can be used to dispatch a lawsuit in the early stages of litigation.

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[113] Pella Corp. v. Saltzman, 606 F.3d 391, 396 (7th Cir. 2010), *cert. denied*, 131 S. Ct. 998 (2011).

[114] *Id.* at 394.

[115] 257 F.R.D. 46, 73 (D.N.J. 2009).

[116] *See id.*

[117] *Id.*

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