Waller, Lansden, Dortch & Davis attorney Mark M. Bell discusses some of the electronic discovery concerns that arise during identification, preservation, and production of ESI in the course of insurance coverage disputes. He sets out some specific best practices for insurers and policyholders and their counsel to follow in developing their strategy for responding to discovery and presenting their case.

**The Evolving Universe of eDiscovery in Insurance-Coverage Actions**

**By Mark M. Bell**

It is no longer a surprise to anyone that electronic discovery has come to impact the lives of practicing litigators, risk managers, general counsel, company executives, and employees. Issues concerning identification, preservation, and production of electronically stored information (“ESI”) have become increasingly commonplace in disputes.

Unfortunately, evolving technologies, rules, and court decisions create an added layer of confusion for professionals working in this space who are required to respond to discovery requests. Industry-specific concerns in various sectors also serve to further exacerbate this complex dynamic.

**Unique Nature of eDiscovery in Insurance-Coverage Cases**

Insurance coverage disputes are unique for two reasons. First, the majority of the discoverable information rests with the policyholder, who is often the plaintiff in these cases.

Second, the insurer-insured relationship is one that implicates a number of attorney-client privilege concerns and unique contractual relationships.

The attorney-client privilege has been described as:

the oldest rule of privilege known to the common law. The privilege is designed to allow clients to be candid with their attorneys without fear that the information might be discovered by others. The privilege recognizes that public policy is best served when an attorney provides sound legal advice and zealous representation, which depends on the attorney being fully informed by his or her client of the facts and circumstances surrounding the case.¹

In the third-party litigation context, insurance disputes often begin after the insured tenders notice of a third-party action against the insured. Often, the insurer responds by sending a reservation of rights letter to the insured stating that the insurer neither accepts nor denies the claim, but simply reserves its right to deny coverage at a later date.

**Parties’ Interaction.** In this tri-party relationship, the insurer’s and insured’s interests may be aligned but may also be adverse at some point in the future. This creates a unique situation for insureds as they balance attorney-client confidentiality concerns with the competing duty they owe to the insurer to cooperate in the investigation and defense of the third-party claim.

Insurers may demand otherwise privileged information from the insured or the insured’s coverage counsel

for coverage memoranda, defense strategies, and internal risk assessments.

Confronted with such a request, insureds face two separate potential privilege waivers in the context of the insurer-insured relationship. First, the attorney-client privilege may be waived by sharing privileged information with the insurer. This could result in the privileged information becoming discoverable by the third party in the underlying action.

Second, disclosing confidential and privileged material to the insurer could result in subject-matter waiver of those communications, as well as other communications that could otherwise be privileged under Federal Rule of Evidence 502 for all subsequent proceedings against the insured.

Accordingly, this is an area that requires counsel for insurers and insureds to tread carefully to ensure that the attorney-client privileged communications the parties hope to keep confidential remain privileged.

**Preservation Requirements**

Preservation of ESI has remained a hot topic for years, and the law concerning preservation continues to evolve and develop. Preservation also remains a hot item for sanctions. For example, in the recent Apple v. Samsung case, the court granted motions for spoliation against both parties, which would have resulted in an adverse inference instruction to the jury.

Accordingly, parties must identify the triggers for implementing preservation procedures, establish policies concerning deletion of ESI, and understand the duties necessary to preserve ESI once the preservation obligation has been triggered.

**The Duty.** The duty to preserve ESI is generally triggered when a party knows or reasonably should know about potential litigation. This duty certainly arises once litigation has been filed, and it also arises pre-litigation if a party could have “reasonably anticipated” that litigation would follow.

There is not a clear answer in the insurance context concerning when the duty is triggered. One commentator recently explained the issue as follows:

In the insurance coverage context, it may therefore be argued that the duty to preserve does not arise when a policyholder’s notice of a claim results in active good-faith negotiations with the insurer over the scope or amount of coverage, or when the insurer agrees to advance defense costs subject to a strongly worded reservation of rights. On the other hand, one federal appeals court recently rejected the contention of a party that litigation was not reasonably foreseeable merely because some contingencies existed before litigation would occur.

**Fed. R. Civ. P. 37.** Regardless of when the trigger is pulled, the Federal Rules of Civil Procedure demonstrate that companies need to maintain document retention policies. Indeed, given the sanctions available in Fed. R. Civ. P. 37, it makes little sense for a company not to have such a policy.

Rule 37(e) provides a safe harbor against sanctions for “failing to provide electronically stored information lost as a result of the routine, good-faith operation of an electronic information system.” This Rule provides a clear incentive for companies to create document-retention policies to ensure that any inadvertent deletion is consistent with the safe-harbor requirement that deletion be a part of a routine, good-faith operation of an electronic information system.

**Third Parties.** Insureds and insurers also should be aware that they occasionally may have a duty to notify third parties of their preservation obligations. In Haskins, for example, the court held that the insurance company had a duty to issue a litigation hold to its independent title agents because litigation was reasonably foreseeable and the duty to preserve extends to third parties, as long as the documents are “within a party’s possession, custody, or control.”

Although it did not have physical possession over the documents, the insurance company controlled the agents’ documents because it had “the legal right or ability to obtain the documents from [the agents] upon demand.”

**Sanctions.** When companies fail to adequately preserve relevant ESI, they are subject to sanctions. For an in-depth breakdown of the spoliation requirements, sanctions, and penalties by circuit, see Victor Stanley, Inc. v. Creative Pipe, Inc., 269 F.R.D. 497, 542-52 (D. Md. 2010).

In sum, however, the spoliation test typically involves one of the three-part test set out in Judge Scheindlin’s well-known opinion Zubulake v. UBS Warburg LLC, 220 F.R.D. 212 (S.D.N.Y. 2003) which looks to three factors:

1. the party’s obligation to preserve;
2. whether the records were destroyed with culpable state of mind; and,
3. whether evidence was relevant to claim or defense.

2 Id.
5 Id.
7 http://www.law.cornell.edu/rules/frcp/rule_37 (emphasis added).
8 It bears noting, however, that Rule 37(e) is subject to intensive re-working under the proposed Federal Rule changes currently under consideration. David Cohen, New Federal Rules Could Change Discovery as We Know It, available at http://www.jdsupra.com/legalnews/new-federal-rules-could-change-discovery-69111/.
10 Id. at *1.
Production Considerations

Given the cost of production in insurance-coverage cases and the potential asymmetry of information between insurer and insured, production requires careful planning and coordination on the front end to ensure that production concerns are timely addressed rather than litigated on the back end.

As more and more insurers move to electronic claims files and electronic storage of relevant claims material, parties need to work together on the front end to ensure that ESI is produced in a readable and accessible format to prevent production costs from being unnecessarily duplicated.

Meet and Confers. Fed. R. Civ. P. 26(f) conferences present ideal times to ensure that all parties know and understand the production-specific requirements expected from each party. The Rule 26(f) conference can serve as an essential tool in minimizing discovery costs to the maximum extent possible by discussing the issues, formats, and demands at the beginning of discovery.

502 Orders. Parties may also want to consider entering into a “Rule 502(d) Order.”11 As a recent article explained, 502(d) orders are the “most effective andunderscored protection against privilege waivers.”

Federal Rule of Evidence 502(d) states that “[a] Federal court may order that the privilege or protection is not waived by disclosure connected with the litigation pending before the court—in which event the disclosure is also not a waiver in any other Federal or State proceeding.”12

This Rule was specifically passed to combat the increasing expense and burden accompanying electronic discovery.13 After the Court has entered a 502(d) order, disclosing privileged documents to the other side does not waive the privilege in other state or federal proceedings. This tool, though often overlooked, can prove to be an essential element in defending similar actions.

TAR. Depending on the volume of information to be produced and reviewed, the parties may want to consider technology-assisted review (TAR), or predictive coding tools for production.

For cases involving large data sets, studies have demonstrated that TAR can generate substantial savings while increasing the rate at which relevant documents are returned and decreasing the number of irrelevant documents captured.14

Form of Production. Regardless of the manner by which relevant documents are culled, the ESI must be produced “in a form or forms in which [the ESI] is ordinarily maintained or in a reasonably usable form or forms.”15

One issue that comes up in insurance coverage actions and other electronic discovery disputes concerns meeting the producing party’s burden under Federal Rule of Civil Procedure 34(b)(2)(E)(ii) of demonstrating that the documents are being produced “as they are kept in the usual course of business” without organizing and labeling documents to correspond to the categories in the request. A number of cases have addressed this issue and have reached different results about how a party can demonstrate that it produced documents “as they are kept in the usual course of business.”

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Valeo Electrical Systems, Inc. v. Cleveland Die & Manufacturing Co. provides a relatively detailed discussion of this issue.16 In Valeo, the producing party produced 270,000 pages of documents. The ESI was produced in the order that it was found on the hard drive of each relevant custodian. The producing party also provided two indices that further allowed the requesting party to cross-reference relevant information.

The requesting party, however, contended that the documents were not reasonably produced because the requesting party had to “manually open each and every electronic file on each of the 15 CDs produced; that it must open and review each of the thousands of individual electronic files; and, most troubling, that [the responding party] named each of the files ‘innocuously’ in an attempt to frustrate its review of the documents.”17 The Court ultimately decided that such a production was acceptable and the responding party did not need to produce any additional details or produce any additional tables or documents.

A different result was reached, however, in Synventive Molding Solutions, Inc. v. Husky Injection Molding Systems, Inc., 262 F.R.D. 365 (D. Vt. 2009). In that case, the district court held that the responding party has two options: (1) either organize the “document production such that the documents are either organized and labeled to correspond to the categories in [the requesting party’s] document requests” or (2) “provide information about each document which would include the identity of the custodian or person from whom the documents were obtained, an indication of whether they are retained in hard copy or digital format, assurance that the documents have been produced in the or-

11 http://us.practicallaw.com/5-524-7065
12 http://www.law.cornell.edu/rules/fre/rule_502
17 Id. at *2.
der in which they are maintained, and a general description of the filing system from which they were received.”

These cases, and the respective burdens imposed by each, demonstrate that parties need to understand the jurisdiction in which they are practicing to determine what will be expected of them if they cannot reach an agreement on the front end.

These cases also demonstrate the importance of Rule 26(f) conferences for addressing production concerns on the front end to avoid unnecessary litigation and costly duplicative production. The risks are particularly acute in the insurance coverage context because of the volume of ESI.

Conclusion

Complex insurance coverage actions involve unique considerations for electronic discovery. It is thus imperative that parties understand the particular risks associated with ESI in the insurance coverage context and prepare to meet those issues head on at the beginning of litigation.

Accordingly, here are a few takeaways that should be considered in all insurance coverage actions:

- Ensure that relevant documents are identified at the earliest sign of potential litigation.
- Consider relevant privilege concerns and how to best address them in the unique landscape of insurance-coverage actions.
- Develop a consistent plan for data retention to fit within the safe-harbor provision in Rule 37(e).
- Understand the preservation requirements and potential coverage triggers that lead to the preservation duties.
- Consider entering a 502(d) order to protect against inadvertent disclosure.
- Address production concerns on the front end to avoid unnecessary litigation and costly duplication of production efforts.


18 Id. at 371.