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I. INTRODUCTION

More often than not, fidelity bond claim professionals also are attorneys and, as such, are potentially subject both to unfair claims practices statutes or regulations and the American Bar Association Model Rules of Professional Conduct (or the state equivalent). Similarly, ethical rules also apply to outside attorneys retained by a fidelity insurer to investigate a fidelity loss, as well as to lawyers retained by an insured to present a fidelity claim to its insurer.

This article addresses the impact of ethical considerations upon counsel’s involvement in a fidelity bond claim investigation. Since it is important to place ethical considerations in claims handling in context, this article first discusses the rationale for ethical and fair claims handling rules, and the basic principles behind the insured’s duty to cooperate with an insurer’s claim investigation. Next, this article briefly reviews the Model Unfair Claim Practices Act. Thereafter, it discusses the Model Rules of Professional Conduct, and specific ethical considerations arising during a claim investigation, including (1) the importance of determining whether the insured is represented by counsel, (2) the duty of the insured and the insurer to preserve documents and records, and (3) issues arising from contacts and communications between the insured and the insurer during the claim investigation. Finally, this article explores several interesting issues that can arise during a claim investigation, such as what claim investigation materials are protected by the attorney-client privilege, and the impact of the

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“lawyer as a witness” prohibition in coverage litigation between the insured and insurer after a claim is denied.

II. THE RATIONALE FOR ETHICAL CLAIMS HANDLING RULES AND THE INSURED’S DUTY TO COOPERATE

The rules surrounding claims handling in many types of insurance matters involve “the special relationship created by the unequal bargaining power that an insurer has over an insured,” along with any applicable professional rules of conduct.1 In the context of fidelity bond claims, however, both parties to the insurance contract frequently are sophisticated business entities with roughly equal bargaining power, and the insured often is represented by experienced outside insurance counsel. In addition, many insureds are represented in the process of purchasing a fidelity bond by sophisticated brokers (some of whom are also lawyers) specializing in fidelity insurance, who strive to negotiate the terms of the insurance policy, and who represent the insured as a claim advocate during the claim process. It also is noteworthy that the standard form Financial Institution Bond2 is the product of negotiations between the Surety and Fidelity Association of America, representing insurers, and various organizations representing insureds, such as the American Bankers Association.3 Similarly, the majority of Commercial Crime Policy products on the market are developed by either the Insurance Services Office, Inc. or the Surety and Fidelity Association of America, or are based on those products.4

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2 See Financial Institution Bond, Standard Form No. 24 (Revised to January, 1986) [hereinafter FIB], reprinted in STANDARD FORMS OF THE SURETY & FIDELITY ASSOCIATION OF AMERICA.
Given that there is equal bargaining power between fidelity insureds and insurers, ethical standards should apply to both parties. This is particularly true where both parties are represented by outside counsel. Moreover, the equal bargaining power between the parties should inform the insured and the insurer regarding the insured’s duty to cooperate. In that regard, both in-house and outside counsel need to appreciate that the very nature of a fidelity or crime claim necessitates the insured’s cooperation in the investigation of a claim, and both standard form financial institution bonds and commercial crime policies contain conditions requiring an insured to cooperate with its insurer. Specifically, cooperation between an insured and its insurer is necessary in all aspects of their relationship, from underwriting to claims to recovery of loss. An insured’s cooperation facilitates the investigation and resolution of claims under fidelity bonds and commercial crime policies. Nearly all of the essential information required to complete the investigation, such as documentation and personnel information, is within the insured’s control. Furthermore, the persons with the most knowledge concerning a loss are normally either employees of the insured or have a close relationship with the insured. Depending upon the circumstances of the loss, the insurer very often needs the insured’s assistance in understanding, among other things, how the loss occurred and how it was calculated.

Thus, counsel for the insured needs to understand that simply providing large amounts of documentation does not necessarily constitute cooperation if the documentation does not clearly demonstrate how the loss occurred or otherwise prove the insured’s claim. In addition, given privacy considerations, an insurer quite often will not be able to complete an investigation or evaluation of a claim without the insured’s assistance and cooperation. Accordingly, and because of the nature of fidelity claims, there has to be a working relationship between the insured and the insurer. The insured should act in good faith and assist the insurer as much as it can, and its counsel should eschew adversarial conduct that defeats the duty of cooperation.

As noted above, the genesis of the insured’s duty to cooperate is the fidelity policy itself. The Financial Institution Bond provides, in pertinent part:
Upon the Underwriter’s request and at reasonable times and places designated by the Underwriter the Insured shall:

(1) submit to examination by the Underwriter and subscribe to the same under oath; and

(2) produce for the Underwriter’s examination all pertinent records; and

(3) cooperate with the Underwriter in all matters pertaining to the loss.  

In certain circumstances, an insured’s breach of a “cooperation clause” precludes coverage and releases the insurer from its obligations under the policy. Many courts enforce the “cooperation clause” as written and allow the insurer to invoke the clause to deny coverage when the insured has failed to provide the insurer with important information. However, some states, including California, New York, and Illinois, require that the insurer be “substantially prejudiced” by the insured’s failure to cooperate, or that the insured’s breach of its duty to cooperate was willful. On the other hand, even in states like California, some courts have enforced cooperation clauses in the context of the insured’s submission to an examination under oath, as well as the insured’s cooperation during such an examination, because the insured’s failure to cooperate in these circumstances is deemed to be necessarily prejudicial.

III.

THE MODEL UNFAIR CLAIM PRACTICES ACT

The duty to cooperate imposed upon the insured and its counsel is tempered somewhat by the insurer’s duties under applicable unfair

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5 FIB, Conditions and Limitations § 7(d).
claim practices statutes. Accordingly, while claim professionals should insist upon the insured’s cooperation (which should include unfettered access to documents and witnesses), the attorney claim handler and outside counsel for the insurer also should be aware of the impact of any unfair claims statutes and insurance regulations in the applicable jurisdiction. Such rules are particularly important regarding the length of the insurer’s investigation and the timing of any claim denial.

Most unfair claim practice statutes and regulations are the progeny of the Model Unfair Claims Settlement Practices Act adopted by the National Association of Insurance Commissioners in 1990. At that time, a stand-alone Model Act was created separating issues concerning unfair claims settlement practices from the Model Unfair Trade Practices Act. Most states have adopted some version of the 1990 Model Unfair Claim Practices Act, and most states apply these standards to fidelity investigations, notwithstanding that the Model Act itself excepts fidelity claims from its purview, and notwithstanding that unfair claim statutes and regulations are typically designed for personal lines claims handling, where there typically is unequal bargaining power between insurers and insureds. While unfair claims settlement practices regulations vary by state, the statutes or regulations of most states list the same (or substantially the same) prohibited activities that constitute unfair claims settlement practices under § 4 of the 1990 Model Unfair Claim Practices Act. Most jurisdictions require that these guidelines be repeatedly violated as part of a pattern and practice of unethical or unfair conduct. Moreover, most jurisdictions do not allow private causes of action against insurers to enforce unfair claim practice regulations.

10 Id., prefatory note.
11 Id. § 1 (1997).
12 See, e.g., CAL. INS. CODE § 790.03(h); TEX. INS. CODE ANN. § 541.060.
14 Florida, Georgia, Kentucky, Nevada, New Mexico, Texas and West Virginia allow insureds to bring a private cause of action against insurers who violate unfair claims practices regulations. See FLA. STAT. ANN. § 624.155; GA. CODE ANN. § 33-6-34; NEV. REV. STAT. ANN. § 686A.310 ("In addition to any rights or remedies available to the Commissioner, an insurer is liable to its
IV.
THE MODEL RULES OF PROFESSIONAL CONDUCT

Counsel, of course, also must be familiar with the professional rules of conduct that exist in the jurisdiction where that lawyer practices or where the claim is handled. The Model Rules of Professional Conduct were originally adopted by the American Bar Association in 1908, and have been modified and amended numerous times since then.15 The scope of the Model Rules of Professional Conduct is expansive and covers the attorney-client relationship (section 1), the role of the counselor (section 2), the role of the advocate (section 3), transactions with persons other than clients (section 4), law firms and associations (section 5), public service (section 6), information about legal services (section 7), and maintaining the integrity of the profession (section 8). These rules have not been adopted verbatim by the states, and there are important differences between state rules and the Model Rules. Thus, claim professionals and their counsel should review the applicable rules in their own states.

Obviously, the Model Rules of Professional Conduct (or the state law equivalent) regulate the conduct of lawyers in a variety of contexts. There does not appear to be reported case law stating specifically that the rules of professional conduct apply to claim investigations. However, the Model Rules regulate virtually every type of lawyer activity, such that it is difficult for a conscientious lawyer to be involved in a claim investigation without some awareness of the rules governing professional conduct. The Model Rules of Professional Conduct arguably come into play in a claim investigation context when analyzing transactions with persons other than clients (section 4) and when looking at the role of the advocate (section 3). This article analyzes below the potential impact of Rule 4.2 (“Communication With Person Represented by Counsel”) and

Ethical Considerations in the Handling of Fidelity Claims

Rule 4.3 (“Dealing With Unrepresented Person”) when communicating with witnesses. Further, this article reviews the impact of the duty to preserve records (Rule 3.4) and a potential duty to withdraw that arises if trial counsel becomes a witness in coverage litigation (Rule 3.7).

It is important to note that the violation of an ethics rule does not give rise to a private cause of action.16 Also, the violation of an ethics rule does not itself create a presumption that a legal duty has been breached.17

V.

ETHICAL CONSIDERATIONS DURING THE CLAIM INVESTIGATION

A. Is the Insured Represented by Counsel?

A threshold issue in any claim investigation is whether the insured is represented by counsel. Specifically, there are a number of ethical rules and obligations that address the issue of communications with the insured that the investigating attorney for the insurer must consider when handling fidelity claims.

When the insured and the insurer are both represented by counsel, Rule 4.2 of the Model Rules of Professional Conduct applies. It provides:

In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order.18

This “anti-contact” rule prohibits lawyers from communicating with certain represented persons without authority from the law, the

court, or the represented person’s lawyer. The purposes of this rule are to: (1) preserve the integrity of the lawyer-client relationship; (2) protect clients from overreaching by other person’s lawyers; and (3) protect against the inadvertent disclosure of privileged material.

When the insured or a third party is not represented by another attorney, but the claim investigator for the insurer is a lawyer, Rule 4.3 of the Rules of Professional Conduct is pertinent:

In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer’s role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding. The lawyer shall not give legal advice to an unrepresented person, other than the advice to secure counsel, if the lawyer knows or reasonably should know that the interests of such a person are or have a reasonable possibility of being in conflict with the interests of the client.

A comment to this rule explains its focus:

An unrepresented person, particularly one not experienced in dealing with legal matters, might assume that a lawyer is disinterested in loyalties or is a disinterested authority on the law even when lawyer represents a client. In order to avoid a misunderstanding, a lawyer will typically need to identify the lawyer’s client and, where necessary,

\[9^9 \text{See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS} §§ 99-102 (2000).}
\[20^9 \text{Blanchard v. Edgemark Fin. Corp., 175 F.R.D. 293, 302 (N.D. Ill. 1997).}
\[21^9 \text{Id. at 302 n.10; Polycast Tech. Corp. v. Uniroyal, Inc., 129 F.R.D. 621, 625 (S.D.N.Y. 1990).}
\[22^9 \text{State v. Gilliam, 748 So.2d 622, 638 (La. Ct. App. 1999).}
\[23^9 \text{MODEL RULES OF PROF’L CONDUCT R. 4.3 (2013).}
explain that the client has interests opposed to those of
the unrepresented person. For misunderstandings that
sometimes arise when a lawyer for an organization deals
with an unrepresented constituent, see Rule 1.13(f).\textsuperscript{24}

Accordingly, Rule 4.3 clearly requires that a lawyer investigator should be forthright and candid with an unrepresented party or witness about the lawyer’s role in the claim investigation.

B. The Duty to Preserve Records

Once the insurer determines that the insured is represented by
counsel, the insurer typically sends a list of requested documents to the
insured’s counsel. While documents do not always tell the entire story,
the documents relating to a complex fidelity claim are very important to
both the insured and to the insurer. Initially, in connection with its duty
to cooperate, it is incumbent upon the insured to identify and preserve
those documents so that the insured can prove its claim.

The insured’s obligation to preserve records is heightened when
counsel is appointed. The relevant rule that directly affects the issue of
preservation of records is Rule 3.4 of the Model Rules of Professional
Responsibility, which provides in part, with respect to fairness to the
opposing party and counsel:

A lawyer shall not:

(a) Unlawfully obstruct another party’s access to
evidence or unlawfully alter, destroy or conceal a
document or other material having potential evidentiary
value. A lawyer shall not counsel or assist another
person to do any such act;

(b) Falsify evidence, counsel or assist a witness to testify
falsely, or offer an inducement to a witness that is
prohibited by law.\textsuperscript{25}

\textsuperscript{24} Id. cmt. 1.
\textsuperscript{25} Id., R. 3.4.
The insured’s duty to preserve evidence commences prior to the actual initiation of litigation, that is, at the time that it becomes aware of a potential claim. Moreover, when the insured is represented by counsel, counsel has a duty to advise the client to preserve relevant information. The American Bar Association’s Civil Discovery Standards, Standard No. 10, “Preservation of Documents”, states: “When a lawyer who has been retained to handle a matter learns that litigation is probable or has been commenced, the lawyer should inform the client of its duty to preserve potentially relevant documents and of the possible consequences for failing to do so.”

Similarly, § 118 of the American Law Institute’s Restatement of the Law Governing Lawyers provides that “a lawyer may not destroy or obstruct another party’s access to documentary or other evidence when doing so would violate a court order or other legal requirements, or counsel or assist a client to do so.” However, this obligation is somewhat undercut by the comment to § 118, which provides:

On the other hand, it would be intolerable to require retention of all documents and other evidence against the possibility that an adversary in future litigation would wish to examine them. Accordingly, it is presumptively lawful to act pursuant to an established document retention-destruction program that conforms to existing law and is consistently followed, absent a supervening obligation such as a subpoena or other lawful demand for or order relating to the material.

The insurer and its counsel also have a duty to maintain the documents that they have gathered during the insurer’s investigation. The claim regulations for many states expressly provide that it is the insurer’s duty to maintain records relating to the handling of claims. For example, in California, the claim regulations provide that

28 Id. cmt. c.
Ethical Considerations in the Handling of Fidelity Claims

Every licensee’s claim files shall be subject to the examination by the Commissioner or by his appointed designees. These files shall contain all documents, notes and work papers (including copies of all correspondence) which reasonably pertain to each claim in such detail that pertinent events and dates of the events can be reconstructed and the licensee’s actions pertaining to the claim can be determined.\(^{29}\)

C. Contacts and Communications with the Insured during the Claim Investigation

1. Timing Issues: When to Commence the Investigation

When an insured provides notice of a claim, some insureds and their counsel assume that a fidelity insurer should immediately commence an investigation of the facts of that claim. This is not necessarily the case. One problem with most investigations is that it may be difficult for the insurer to understand the nature of the claim until the insured has provided its detailed proof of loss. Moreover, since a fidelity claim often involves a claim that an employee has committed dishonest acts, in such cases a sworn proof of loss protects the insurer from any claim that it is itself making statements that the employee may deem to be defamatory.

There is no hard and fast rule about when a claim investigation should commence because such is driven by many circumstances, such as how much information is provided to the insurer, when such information is provided, the nature of that information, and whether there is other information readily available from the public record or third parties (recognizing that the insurer does not have subpoena power).

a. Requests for Extensions of Time to Submit Proof of Loss

Since lawyers frequently prepare fidelity proofs of loss, counsel for insureds frequently request extensions of time to submit a proof of loss to the insurer. Moreover, sometimes this request is made in

\(^{29}\) CAL. CODE REGS. tit. 10, § 2695.3.
conjunction with a request to toll any limitation period contained in the commercial crime policy or financial institution bond.\textsuperscript{30}

Most commercial crime policies require that the insured submit its proof of loss within 120 days after discovery of loss, while financial institution bonds typically require a proof of loss within six months of discovery.\textsuperscript{31} Requests for extensions of time can be made for many reasons, including the time required to marshal the evidence in support of the claim, and the presence of related, pending litigation. Insureds and their lawyers, however, sometimes request extensions to submit proof of loss or to toll for tactical reasons. Consequently, there are situations when the insurer will grant the extension, and there are other circumstances that may cause the insurer to decline that request.

\textbf{b. Sufficiency of the Proof of Loss}

Another issue that can arise is the sufficiency of the insured’s proof of loss. Some proofs of loss are highly detailed, while others are lacking in basic information. Insureds and their counsel need to take to heart the requirement of most fidelity policies that the proof of loss provide “full particulars” of the claim. Many attorney claim professionals and outside counsel are understandably concerned if an insured’s counsel presents a bare bones proof of loss that, in essence, forces the insurer to prove/disprove the insured’s claim.

Most courts, however, seem to follow a “substantial compliance” rule that makes it unwise for the insurer to reject the proof of loss completely, or to refuse to conduct an investigation.\textsuperscript{32} Even so, it is not unfair or unwise in such a situation to advise the insured how and why that the information provided is insufficient, and to request that the

\textsuperscript{30} Some states automatically toll the contractual limitations period in the policy until the claim is denied. \textit{See}, \textit{e.g.}, Prudential-LMI Commercial Ins. \textit{v.} Superior Court, 798 P.2d 1230 (Cal. 1990).

\textsuperscript{31} Commercial Crime Policy, CR 00 22 07 02, ¶ E (“Conditions”) (ISO Props., Inc. 2001); FIB, Conditions and Limitations § 5(b).

\textsuperscript{32} \textit{See}, \textit{e.g.}, Bituminous Cas. Corp \textit{v.} Vacuum Tanks, Inc., 75 F.3d 1048 (5th Cir. 1996); Hartford Fire Ins. Co. \textit{v.} Himelfarb, 736 A.2d 295 (Md. 1999).
insured revise its proof of loss accordingly or to provide the information and documentation necessary to complete the investigation.

c. Confidentiality

Before providing claim information, counsel for insureds frequently request some type of confidentiality agreement to protect documents submitted with the proof of loss, or to protect the information requested by the insurer. In principle, confidentiality should not be a real world issue for the insurer, who is likely required to protect the insured’s information anyway.

In practice, however, confidentiality agreements are sometimes a device to restrict the insurer’s ability to investigate the claim in the manner it deems fit. It also is somewhat common for the insured to contend that it is entitled to a return of the claim documents at the conclusion of the insurer’s investigation. This can be problematic if there is subsequent coverage litigation, or if the information provided by the insured is deemed part of the insurer’s claim file. Indeed, many claims regulations arguably require that the insurer maintain the integrity of its claim files.

What, then, is the fair and ethical approach if an insured’s attorneys insist upon a confidentiality agreement that contains objectionable terms, even after protracted negotiations? Should the insurer execute the agreement and reserve its right to contend that the restrictions in the agreement are unreasonable? Should the insurer cite the cooperation clause and refuse to sign? From the insurer’s perspective, there is no clear answer to such a conundrum, and the insurer’s response may depend upon many factors, including the overall relationship with the insured, the size of the claim, and the nature of the anticipated defenses to the claim.

2. Responses to the Insured’s Queries During the Pendency of the Claim Investigation

Once the insurer determines from whom it may seek information, it should endeavor to respond reasonably promptly upon receipt of the claim and to subsequent queries from the insured or the insured’s counsel. The meaning of “reasonably promptly” can vary by
jurisdiction and by the facts of the specific claim or query. When acknowledging a claim or responding to a query from the insured or the insured’s counsel about the claim, the insurer may wish to point out potentially applicable policy provisions of the crime policy or standard form financial institution bond. The insurer’s ability to identify applicable policy provisions, of course, is highly dependent upon the facts and circumstances of the claim, and the nature of the information provided by the insured or its counsel. In addition, and in order to avoid claims of waiver, the initial claim acknowledgment (and all future correspondence) ideally should include a broad reservation of rights. Frequently, insurers make this reservation joint so that it is clear that the rights of the insured under the policy are also reserved.

As noted above, there are claim regulations and statutes that can be used, depending upon the circumstances of the claim, to guide the claim professional/attorney in her communications with the insured. Also as previously mentioned, while many unfair claim practices statutes seem designed to protect unsophisticated insureds making personal lines claims, the Model Unfair Claims Practices Act nevertheless discourages insurers from: (1) knowingly misrepresenting to claimants and insureds relevant facts or policy provisions relating to coverages at issue; (2) failing to acknowledge with reasonable promptness pertinent communications with respect to claims arising under its policies; (3) not attempting in good faith to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear; (4) failing to affirm or deny coverage of claims within a reasonable time after having completed an investigation related to such claim or claims; (5) unreasonably delaying the investigation or payment of claims by requiring both a formal proof of loss form and subsequent verification that would result in duplication of information and verification appearing in the formal proof of loss form; (6) failing in the case of claims denials or offers of compromise settlement to promptly provide a reasonable and accurate explanation of the basis for such actions; and (7) failing to provide forms necessary to present claims within fifteen calendar days of a request with reasonable explanations regarding their use.

For example, when communicating with the insured, the claim professional/attorney should endeavor to quote the language of the policy directly (rather than paraphrase or summarize the content) to minimize
the risk that an insured will accuse the insurer of misrepresenting the coverage offered by the policy. Similarly, depending upon the circumstances of the claim, maintaining regular communication during the course of the investigation, and keeping the insured apprised of the developments in and the progress of the investigation, sometimes can help to avoid miscommunications with the insured. While many state regulations place a duty to affirm or deny coverage within certain time periods,33 these requirements may be flexible if the insured has failed to provide requested documents or information.34 If the insurer is unable, for legitimate reasons, to render a position within the time frame required by a claim regulation, the insurer may be able to extend the period by advising the insured of its need for more time and the reasons that more time is needed.35

3. Contacting Current and Former Employees of the Insured

Documentary evidence and written communications, such as the notification of loss, proof of loss, and the documents furnished by an insured in support of its claim, are typically at the heart of a fidelity claim investigation. While the claim professional or outside attorney investigating the claim will devote significant time and attention to analyzing these materials, interviews and other oral and written communications with both current and former employees of the insured also may be necessary to investigate the claim and verify the account of the loss provided by the insured.

In this context, the claim professional or outside lawyer investigating the claim must be aware of Rule 4.2 of the Model Rules of Professional Conduct, the “anti-contact” rule set forth earlier in this paper. When the insured is an organization, such as a corporation, and is represented by counsel, this rule does not prohibit contact by the claim

33 See, e.g., CAL. INS. CODE § 790.03(h) (prohibiting a “failure[e] to affirm or deny coverage of claims within a reasonable time after proof of loss requirements have been completed and submitted by the insured”).
35 See CAL. CODE REGS. tit. 10, § 2695.7.
professional or lawyer for the insurer with all current employees of the insured. Rather, as explained in comment 7 to the rule:

In the case of a represented organization, this Rule prohibits communications with a constituent of the organization who supervises, directs or regularly consults with the organization’s lawyer concerning the matter or has authority to obligate the organization with respect to the matter or whose act or omission in connection with the matter may be imputed to the organization for purposes of civil or criminal liability. Consent of the organization’s lawyer is not required for communication with a former constituent. If a constituent of the organization is represented in the matter by his or her own counsel, the consent by that counsel to a communication will be sufficient for purposes of this Rule. Compare Rule 3.4(f). In communicating with a current or former constituent of an organization, a lawyer must not use methods of obtaining evidence that violate the legal rights of the organization. See Rule 4.4.36

36 MODEL RULES OF PROF’L CONDUCT R. 4.3 cmt. 7 (2013).

a. **Former Employees**

Before analyzing application of this rule to current employees of the organization, it is important to note that the above Comment was amended in 2002 to, among other things, add the second sentence, which states: “Consent of the organization’s lawyer is not required for communication with a former constituent.” Accordingly, the rule as currently constituted does not apply to former employees of the organization. As a result, communication with a former employee of the organization, including an allegedly dishonest employee, by the claim professional or outside lawyer investigating the claim for the insurer is allowed under this rule without the need for obtaining the consent of counsel for the insured organization.37
Before the 2002 amendments to the comments for Rule 4.2, however, there was some controversy over whether Rule 4.2 or similar state ethical rules applied to former employees. To clarify the issue of whether an attorney ethically may contact a former employee, the ABA issued a formal opinion in 1991, which concluded in relevant part as follows:

While the Committee recognizes that persuasive policy arguments can be and have been made for extending the ambit of Model Rule 4.2 to cover some former corporate employers [sic], the fact remains that the text of the Rule does not do so and the comment gives no basis for concluding that such coverage was intended.

. . . .

Accordingly, it is the opinion of the Committee that a lawyer representing a client in a matter adverse to a corporate party that is represented by another lawyer may, without violating Model Rule 4.2, communicate about the subject of the representation with an unrepresented former employee of the corporate party without the consent of the corporation’s lawyer.38

Partly based on the committee’s inclination not to interfere with the informal discovery process, the ABA reaffirmed its position on the interpretation of Rule 4.2 in a 1995 opinion, which states in pertinent part:

[T]he anti-contact rules provide protection of the represented person against overreaching by adverse counsel, safeguard the client-lawyer relationship from interference by adverse counsel, and reduce the

2008) (holding that Virginia equivalent of Rule 4.2 does not prohibit ex parte interviews of former employees of corporation); Muriel Siebert & Co. v. Intuit, Inc., 868 N.E.2d 208 (N.Y. 2007) (under applicable New York ethical rule, former employees may be contacted without consent of organization lawyer).

likelihood that clients will disclose privileged or other
information that might harm their interests.39

Since the ABA issued that opinion, the majority of courts that
considered the issue before the 2002 amendments adopted the ABA’s
position and ruled that an attorney can communicate with a former
employee of a corporate party about the subject matter of the
representation without the consent of the party.40

A minority of jurisdictions that addressed the issue before the
2002 amendments restricted contact with former employees in various
circumstances.41 For example, Minnesota courts noted that the key
factor in evaluating the propriety of a lawyer’s contact with a former
unrepresented employee of an adverse party is the likelihood that
privileged information will be disclosed to an opponent in litigation.42
These cases, however, focus more on the improper disclosure of
privileged information rather than the purpose of Rule 4.2. On the other
hand, a New Jersey court put a bar on ex parte contacts with former
employees if those employees were previously members of a “control

2d 1157, 1167 (D. Nev. 1998); Sharpe v. Leonard Stulman Enters. Ltd. P’ship,
12 F. Supp. 2d 502, 507-08 (D. Md. 1998); Orlowski v. Dominick’s Finer
County, 148 F.R.D. 246, 252 (N.D. Ind. 1993); Valaiss v. Samelson, 143 F.R.D.
118, 123 (E.D. Mich. 1992); In re Domestic Air Transp. Antitrust Litig., 141
41 See Toni Scott Reed, Legal, Ethical, and Practical Considerations
for an Insurer’s Witness Interviews in the Context of a Fidelity Bond or
Commercial Crime Policy Claim Investigation, VII FID. LAW ASS’N J. 1, 30-31
1995).
2d 1190, 1195 (D. Minn. 2001); Olson v. Snap Prods., Inc., 183 F.R.D. 539, 544
(D. Minn. 1998).
group” that had “significant involvement” in making final decisions regarding the company’s conduct of the litigation or the company’s policies at issue.43

Assuming, however, that Rule 4.2, or a similar rule, applies to the investigation, comment 7 to the rule makes it clear that the rule as currently constituted does not apply to former employees of the organization, removing any doubt about the scope of the rule as applied to such employees.

In conducting an interview of a former employee of an insured, the lawyers for the insurer investigating the claim should consider other ethical rules, such as Model Rule 4.4, which provides, in pertinent part:

In representing a client, a lawyer shall not use means that have no substantial purpose other than to embarrass, delay, or burden a third person, or use methods of obtaining evidence that violate the legal rights of such a person.44

Significantly, in 2002 a phrase was added to comment 1 to this rule, specifying “privileged relationships” as among the third-party rights protected by this rule. Comment 1 provides:

Responsibility to a client requires a lawyer to subordinate the interests of others to those of the client, but that responsibility does not imply that a lawyer may disregard the rights of third persons. It is impractical to catalogue all such rights, but they include legal restrictions on methods of obtaining evidence from third persons and unwarranted intrusions into privileged relationships, such as the client-lawyer relationship.45

Even before that amendment, the ABA, in its 1991 opinion, concluded that adverse counsel may interview former employees of an

opponent but must disclose their role in the matter and whom they
represent, and (based upon Rule 4.4) must not induce the former
employees to disclose privileged communications, such as privileged
attorney-client communications.46

b. Current Employees

Courts have formulated several different tests to determine
whether Rule 4.2 (or a similar rule applicable in the specific jurisdiction)
applies to a particular employee of the organization. Many of the cases
interpreting this rule were decided before the 2002 amendments to the
above comment and, to the extent these cases interpret the rule as
applying to former employees of the organization, the second sentence of
comment 7 changes that result. Accordingly, the following discussion
focuses upon current employees of the organization.

In order to understand the bases for several of these tests, it is
helpful to review the history of the development of comment 7 to Rule
4.2. In 1983, the original text of what is now comment 7 was designated
comment 2, and provided as follows:

In the case of an organization, this Rule prohibits
communications by a lawyer for another person or entity
concerning the matter in representation with persons
having a managerial responsibility on behalf of the
organization, and with any other person whose act or
omission in connection with that matter may be imputed
to the organization for purposes of civil or criminal
liability or whose statement may constitute an admission
on the part of the organization. If an agent or employee
of the organization is represented by his or her own
counsel, the consent by that counsel to a communication
will be sufficient for purposes of this Rule. Compare
Rule 3.4(f) [concerning propriety of a lawyer’s request

46 ABA Comm. on Ethics and Prof’l Resp., Formal Op. 91-359 (1991);
See Muriel Siebert, 868 N.E.2d at 210-11; see also Valassis v. Samuelson, 143
opponent’s former employee in an ex parte interview to disclose attorney-client
privileged information).
that a person other than a client refrain from voluntarily giving information].

In 1995 revisions, comment 2 was renumbered comment 4, but the text did not change. The 2002 amendments (in which comment 4 was renumbered comment 7) revised the text by, among other things, deleting the “managerial responsibility” language and the “admission” language and adding the language “supervises, directs or regularly consults with the organization’s lawyer concerning the matter or has authority to obligate the organization with respect to the matter.” These revisions undermine the validity of certain of the tests, as noted below.

At one end of the spectrum is the “blanket” test, which prohibits all contact with any current or former employees of the insured. This extreme test, adopted by one federal district court, was then superseded by a rule amendment. For this reason alone, it does not appear to be a viable test as to current employees. In addition, it is not a viable test under Rule 4.2 because it is much more restrictive than comment 7.

A second test in the spectrum is the “party-opponent admission” test. This test “encompasses within the ethical rule any employee whose statement might be admissible as a party-opponent admission under FRE 801(d)(2)(D) and its state counterparts.” It is based upon the conclusion that the reference in the former comment to “admissions” was meant to incorporate the rules of evidence concerning admissions. Since the “admissions” language in the former comment was deleted in comment 7 as part of the 2002 amendments, the rationale for this test no longer exists, and so it also no longer appears to be a viable test under Rule 4.2 as to current employees.

In the middle of the spectrum is the “managing-speaking agent” test. The development of this test has been described as follows:

47 MODEL RULES OF PROF’L CONDUCT R. 4.2 cmt. 2 (1983).
50 Palmer, 59 P.3d at 1243.
The managing-speaking agent test appears to have evolved . . . in response to a United States Supreme Court case discussing the scope of the attorney-client privilege as applied to an organizational client. In *Upjohn Co. v. United States*, the Court held that the privilege was not restricted to an organization’s “control group.” Rather, the Court held that mid- and even low-level employees could have information necessary to defend against a potential claim, and thus communications between such employees and counsel were protected by the privilege. While acknowledging that the *Upjohn* opinion did not expressly apply to the no-contact rule, the courts adopting the managing-speaking agent test in *Upjohn’s* wake reasoned that the protection afforded an organization under the no-contact rule should be commensurate with that afforded by the attorney-client privilege. At the same time, relying on dicta in *Upjohn* stating that confidential communications, not facts, were entitled to protection, these courts determined that the rule should not be expanded so broadly that informal investigation through ex parte interviews was restricted too severely.51

The *Palmer* court, after observing that no court has adopted precisely the same statement of this test, described the test as follows:

In all its formulations, the managing-speaking agent test restricts contact with those employees who have “speaking” authority for the organization, that is, those with legal authority to bind the organization. Which employees have “speaking” authority is determined on a case-by-case basis according to the particular employee’s position and duties and the jurisdiction’s agency and evidence law. This is the essence of the test as set forth in the most-cited case adopting it, the

51 Id. at 1244 (footnotes omitted).
Washington Supreme Court’s opinion in *Wright by Wright v. Group Health Hospital.*\(^{52}\)

This test appears similar to the second standard in comment 7 to Rule 4.2, that the employee “has authority to obligate the organization with respect to the matter.” It should be noted, of course, that comment 7 also includes two other standards, those current employees who supervise, direct, or regularly consult with the organization’s lawyer concerning the matter, and those current employees whose act or omission in connection with the matter may be imputed to the organization for purposes of civil or criminal liability.

Another test is the “control group” test, which is derived from an Illinois Supreme Court decision involving the attorney-client privilege,\(^ {53}\) and “is defined as those top management persons who had the responsibility of making final decisions and those employees whose advisory roles to top management are such that a decision would not normally be made without those persons’ advice or opinion or whose opinions in fact form the basis of any final decision.”\(^ {54}\) This test has reportedly fallen into disfavor in light of the decision in *Upjohn Co. v. United States*\(^ {55}\) because the test is narrower than the attorney-client privilege rule approved in *Upjohn*.\(^ {56}\) In addition, comment 7 to Rule 4.2 imposes different standards for its application than the “control group” test.

\(^{52}\) *Id.* at 1244-45 (footnotes omitted); see also Nat’l Ass’n for the Advancement of Colored People v. Fla. Dep’t of Corr., 122 F. Supp. 2d 1335 (M.D. Fla. 2000) (lawyer for plaintiff allowed to interview lower-level prison employees as it was unlikely that their statements could bind their employer or that their acts or omissions would be imputed to the employer); Featherstone v. Schaeerrer, 34 P.3d 194 (Utah 2001) (since statements of secretary-treasurer of defendant corporation could bind the corporation, he is considered a represented person); Wright v. Group Health Hosp., 691 P.2d 564 (Wash. 1984).

\(^{53}\) Consolidation Coal Co. v. Bucyrus-Erie Co., 432 N.E.2d 250 (Ill. 1982).


A small number of courts have adopted a “case-by-case balancing” test.\(^{57}\) This test “weighs (1) whether the employee’s statements are likely to be admissible against the employer, (2) the employer’s need to have counsel present in the particular circumstances of the case, and (3) the plaintiff’s need for informal discovery.”\(^{58}\) This test has been criticized as having been applied only when an attorney seeks prospective guidance from a court, and offers little guidance to a lawyer in the pre-litigation stage.\(^{59}\) In addition, Comment 7 to Rule 4.2 imposes different standards for its application than this test.

New York’s high court developed its own test, often referred to as the “alter ego” test, in *Nieseg v. Team I*.\(^{60}\) This test is expressly not derived from the comments to Model Rule 4.2 in effect when the decision was rendered,\(^{61}\) but is based upon policy considerations in construing the applicable New York ethical rule.\(^{62}\) After examining several tests, the court formulated the alter ego test applicable to current employees:

The test that best balances the competing interests, and incorporates the most desirable elements of the other approaches, is one that defines “party” to include corporate employees whose acts or omissions in the matter under inquiry are binding on the corporation (in effect, the corporation’s “alter egos”) or imputed to the corporation for purposes of its liability, or employees

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\(^{58}\) *Baisley*, 708 A.2d at 933.

\(^{59}\) *Palmer*, 59 P.3d at 1246.

\(^{60}\) 558 N.E.2d 1030 (N.Y. 1990).

\(^{61}\) *Id.* at 1036 n.6.

\(^{62}\) The state ethical rule construed in *Nieseg* is Disciplinary Rule 7-104(A)(1) of the New York Code of Professional Responsibility, which provided in relevant part: “During the course of [the] representation of a client a lawyer shall not * * * [c]ommunicate or cause another to communicate with a party [the lawyer] knows to be represented by a lawyer in that matter unless [the lawyer] has the prior consent of the lawyer representing such other party or is authorized by law to do so.”
implementing the advice of counsel. All other employees may be interviewed informally.

.In practical application, the test we adopt thus would prohibit direct communication by adversary counsel “with those officials, but only those, who have the legal power to bind the corporation in the matter or who are responsible for implementing the advice of the corporation’s lawyer, or any member of the organization whose own interests are directly at stake in a representation.” [citation omitted] This test would permit direct access to all other employees, and specifically—as in the present case—it would clearly permit direct access to employees who were merely witnesses to an event for which the corporate employer is sued.63

This test has been adopted by a number of courts.64

Perhaps the most important lesson to be learned from the various tests formulated by the courts is that the claims professional or outside lawyer for the insurer investigating a fidelity claim must determine the specific ethical rule in effect in the applicable jurisdiction and verify the scope of such rule as applied to current employees. In any event, the most prudent practice is to refrain from communicating with current officers and employees of the insured with management responsibility without making arrangements through the insured or its counsel. This is especially true when interviewing senior or executive employees.

It should be noted that the investigating attorney for the insurer cannot avoid his or her ethical obligations by delegating such tasks to

63 *Nieseg*, 558 N.E.2d at 1035-36.
laypersons, such as investigators, as courts have ruled that interviews conducted by investigators retained or controlled by attorneys are subject to the same rules. Model Rule 8.4 states in pertinent part: “A lawyer shall not . . . induce another to engage in conduct, or give assistance to another’s conduct, when the lawyer knows that the conduct will violate these Rules.”

4. Conducting Interviews or Examinations Under Oath

Conducting third-party witness interviews can be one of the most important aspects of the investigation of a fidelity claim by the insurer. Since witness interviews can be so critical, there are a number of ethical considerations for the investigating attorney to consider. As with former employees, when interviewing non-employee third-party witnesses during the course of a fidelity investigation, the permission of, or notice to, the insured generally is not required. However, if interviews/examinations under oath are taken without notice to and/or the participation of the insured, the insured likely later will argue that all relevant areas were not covered, or that the questions were skewed in the direction of the insurer’s interests (i.e., toward the denial of the claim). Accordingly, the insurer must carefully weigh its interest in the candid and unrehearsed testimony of the third-party witness versus the impact of later arguments that the questioning was incomplete or unfair.

In addition, the attorneys for the insured and for the insurer should take care to comply with Model Rules 4.2 and 4.3 when communicating with the third-party witness. As mentioned earlier, if the attorney becomes aware that the third-party witness is represented by a lawyer, she should cease communications with the witness immediately and communicate only with counsel.

A more difficult situation arises when the third party seems to misunderstand the nature of the claim or the attorney’s role in investigating the claim. In such a case, the attorney should describe her representation and the identity of her client clearly. Moreover, in

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accordance with Rule 4.3, the attorney should clarify any misapprehensions that the third party may have.\textsuperscript{67} This is particularly important where the third party may have interests adverse to the insurer—when, for example, he may be a subrogation target if the insurer pays the claim. When the attorney is clear about her role in the matter and whose interests she represents, however, there should be little to no opportunity for misunderstandings by third parties.

Finally, Rule 3.4 of the Model Rules of Professional Conduct, which addresses “Fairness to the Opposing Party and Counsel,” provides that a lawyer shall not:

(f) request a person other than a client to refrain from voluntarily giving relevant information to another party, unless:

(1) the person is a relative or an employee or other agent of a client; and

(2) the lawyer reasonably believes that the person’s interests will not be adversely affected by refraining from giving such information.\textsuperscript{68}

This rule is potentially a very useful tool for the insurer, as it should work to prevent the insured’s lawyer from counseling third-party witnesses to refuse to cooperate with the insurer.

5. Providing the Proof of Loss to the Claim Principal and Other Witnesses

Another situation that presents potential pitfalls is the use and dissemination of the proof of loss during an investigation. Generally, the contents of the proof of loss may be shared by the insurer with the principal and his attorney, since the insurer is entitled to examine the principal to learn his side of the story, and to obtain information and documents from the principal that may be relevant to adjusting the claim. Contact with the principal should allow further constructive discussions

\textsuperscript{67} \textit{Model Rules of Prof’l Conduct} R. 4.3 (2013).
\textsuperscript{68} \textit{Id.}, R. 3.4
of the coverage issues and/or the contents of the proof of loss between the insured and the claims investigator/attorney, to clarify or reconcile disputed issues.

Disclosing the contents of the proof of loss to other witnesses, however, can be more problematic. The insurer has a legitimate interest in investigating the insured’s allegations, and advising witnesses of the allegations and obtaining their statements is likely to aid the investigation. The claim professional/attorney, however, should share a proof of loss only with a limited circle of people with knowledge of the transactions at issue, and such disclosure should be conditionally privileged. Accordingly, the claim professional/attorney should: (1) make sure that the insured has sworn to the contents of the proof of loss, to establish that the insured has a good faith belief in its claim, (2) be careful to share only that information that is necessary to its reasonable investigation of the claim, (3) require the witness to sign a confidentiality agreement, and (4) generally avoid any behavior intended to harm the claim principal. Deciding which portions of a proof of loss are to be shared should be evaluated on a case-by-case basis, after weighing the need for disclosure against the potential harm that would result by doing so.

D. Privilege Issues that Arise Before the Investigation is Concluded

1. Attorney-Client Privilege Issues Arising During a Claim Investigation

As part of its claim investigation, a fidelity bond insurer often requests from the insured documents or information from the insured’s own investigation of the claimed loss, such as investigator notes from witness interviews and reports prepared by the insured’s investigator. Assuming that the insured’s investigator is also an attorney, the insured may resist producing such documents or allowing the investigator to be questioned about the witness interviews on the basis of the attorney-client privilege. However, the insurer may have a legitimate interest in investigating the claims allegations and advising witnesses of the allegations and obtaining their statements, which is likely to aid the investigation. The claim professional/attorney should: (1) make sure that the insured has sworn to the contents of the proof of loss, to establish that the insured has a good faith belief in its claim, (2) be careful to share only that information that is necessary to its reasonable investigation of the claim, (3) require the witness to sign a confidentiality agreement, and (4) generally avoid any behavior intended to harm the claim principal.

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70 Id.
71 Id.
client privilege and the work product doctrine. While a complete discussion of attorney-client privilege and work product issues in the context of a fidelity claim investigation is beyond the scope of this paper, the following discussion is intended to provide a brief analysis of certain of these issues.\textsuperscript{72}

A well-recognized statement of the elements of the attorney-client privilege is contained in United States v. United Shoe Machinery Corp.:\textsuperscript{73}

The privilege applies only if (1) the asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the bar of a court, or his subordinate and (b) in connection with the communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers (c) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client.\textsuperscript{74}

A key element of the privilege is that “the person to whom the communication was made . . . in connection with the communication is acting as a lawyer.” Courts presented with this issue often consider whether the attorney in question was acting in her legal capacity for the purpose of providing legal advice, or in some other capacity.\textsuperscript{75} As

\textsuperscript{72} See Toni Scott Reed, supra note 41, at 42-49.
\textsuperscript{73} 89 F. Supp. 357 (D. Mass. 1950).
\textsuperscript{74} Id. at 358-59.
\textsuperscript{75} See Dawson v. N.Y. Ins. Co., 901 F. Supp. 1362, 1367 (N.D. Ill. 1995) (since outside attorneys for corporation were acting “more as ‘couriers of factual information’ rather than ‘legal advisers,’ communications between attorneys and employees of corporation were not protected by attorney-client privilege); N. Am. Mortg. Investors v. First Wisc. Nat’l Bank, 69 F.R.D. 9, 11 (E.D. Wis. 1975) (“For the privilege to exist, the lawyer must not only be
applied to an attorney hired by the insured to investigate a fidelity bond claim, the attorney’s main responsibility would likely be to investigate the facts surrounding the loss and provide that information to the insured, thus functioning as a courier of factual information rather than a legal advisor, and the attorney’s communications with the insured would not be privileged. Thus, the insured should provide notes of the attorney’s interviews of witnesses (particularly where facts from such interviews are part of the proof of loss) to the insurer and make the attorney available for interview by the insurer concerning the attorney’s investigation without objection based upon the attorney-client privilege.

Similar issues potentially arise when the insurer utilizes a lawyer to investigate or analyze the claim, but with a different result. In looking at the issue of whether the insurer’s lawyer was retained to provide legal advice, or to act as an investigator merely to gather facts, most courts have found that a lawyer retained to provide coverage advice, which may involve investigation activities, may properly assert that his or her notes and communications with the insurer are privileged. As noted by the
Ethical Considerations in the Handling of Fidelity Claims

Fourth Circuit in *In re Allen*, “the relevant question is not whether [an attorney] was retained to conduct an investigation, but rather, whether this investigation was ‘related to the rendition of legal services.’”77 Consequently, the attorney has no obligation to hand over his or her reports and notes since the privilege should apply to the analysis of the claim.78

As explained by the California Court of Appeal in *Aetna v. Superior Court*,79 when the insurer retains outside counsel to investigate the claim and make a determination as to coverage, the privilege applies:

This is a classic example of a client seeking legal advice from an attorney. The attorney was given a legal document (the insurance policy) and was asked to interpret the policy and to investigate the events that resulted in damage to determine whether Aetna was legally bound to provide coverage for such damage.

In *Hartford Financial Services Group, Inc. v. Lake County Park and Recreation Board*,80 an Indiana appellate court followed this reasoning in applying the privilege to the same circumstances: “Simply put, Hartford retained counsel to investigate [the insured’s] claim, render legal advice and make a coverage determination under the policy.”

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77 106 F.3d 582, 604 (4th Cir. 1997).
78 Id.
A key issue is the dominant purpose of the relationship between the insurer and its attorneys, whether outside counsel or in-house attorneys. If the dominant purpose of the relationship is one of attorney-client, the privilege likely would apply to all communications, including any reports of factual material. If the relationship is one of claims adjuster-insurance corporation, the privilege likely would not apply.81

A minority of courts, however, construe the attorney-client privilege more narrowly, emphasizing the actions of the investigating attorney rather than the relationship between the attorney and the insurer. In such jurisdictions, courts hold that, if the attorney is performing an investigation that can be generally considered part of the insurer’s ordinary business practices, or merely acted as an outside claims adjuster, the attorney is not acting as a lawyer and an insurer cannot shield the results of that investigation simply by having an attorney conduct the investigation.82 However, the question of whether the lawyer is performing a legal or business function can be a fact intensive inquiry, with no clear result.

E. Work Product Issues Arising During a Claim Investigation

The insured may also resist providing documents and information from its own investigation of the claim to the fidelity insurer during the insurer’s investigation on the basis of the work product

82 St. Paul Reinsurance Co. v. Commercial Fin. Corp., 197 F.R.D. 620, 641-42 (N.D. Iowa 2000) (lawyer found to have acted as claims adjuster); Goodyear Tire & Rubber Co. v. Chiles Power Supply, Inc., 190 F.R.D. 532, 535 (S.D. Ind. 1999) (noting that there is no bright-line rule for courts deciding whether an attorney is acting in his or her capacity as such); Mission Nat’l Ins. Co. v. Lilly, 112 F.R.D. 160, 163-65 (D. Minn. 1986) (insurer hired an outside law firm to investigate a fire loss claim; court allowed discovery because it found that attorneys were acting in claim adjuster role); Dakota, Minn. & E. R.R. Corp. v. Acuity, 771 N.W.2d 623, 638 (S.D. 2009) (where insurer completely delegated its claims function to outside counsel, counsel acted as claims adjuster and privilege not applicable); In re Texas Farmers Ins. Exch., 990 S.W.2d 337, 341 (Tex. App. 1999) (attorney retained solely to take examination under oath of insureds acting as investigator, not lawyer).
Ethical Considerations in the Handling of Fidelity Claims

... doctrine. For the following reasons, however, the work product doctrine should not be applicable in this situation.

The work product doctrine generally protects from disclosure in litigation all documents prepared by an attorney “in anticipation of litigation.” The burden of establishing that the work product doctrine applies is on the party seeking its protection.

Unless an insured can establish that litigation was anticipated at the outset of its own investigation, the work product protection should not preclude disclosure of information and documents from the insured’s investigation. In most cases, the insured will engage in its investigation in the early stages of a claim, well before any coverage litigation with the insurer could be anticipated. For this reason, the insured generally will not be able to meet its burden of establishing that the doctrine applies in such circumstances.

F. The Lawyer as Witness in Coverage Litigation

Coverage litigation between a fidelity insurer and its insured most often ensues when the insured sues the insurer after a denial of coverage for the claimed loss, but occasionally the insurer commences a declaratory relief action to resolve coverage issues before taking a formal position on coverage. Whenever coverage litigation occurs between the insured and insurer, the insured may be tempted to file a motion to disqualify the insurer’s trial counsel from acting as such if counsel was involved in the investigation of the fidelity claim, on the ground that counsel will be a witness for the insurer regarding the facts obtained during the insurer’s investigation.

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84 Hodges Grant & Kaufman v. United States Gov’t, 768 F.2d 719, 721 (5th Cir. 1985).
85 See EDO Corp. v. Newark Ins. Co., 145 F.R.D. 18, 24 (D. Conn. 1992) (since insured “lacked a reasonable basis to anticipate litigation” with its insurers before denial of claim, work product not applicable to insured’s investigation documents).
Such a disqualification motion is often based upon Rule 3.7 of the Model Rules (or its state equivalent), which concerns the “Lawyer as Witness”. This rule provides:

(a) A lawyer shall not act as an advocate at a trial in which the lawyer is likely to be a necessary witness unless:

(1) the testimony relates to an uncontested issue;

(2) the testimony relates to the nature and value of legal services rendered in a case; or

(3) disqualification of the lawyer would work substantial hardship on the client.

(b) A lawyer may act as advocate in a trial in which another lawyer in the lawyer’s firm is likely to be called as a witness unless precluded from doing so by Rule 1.7 or Rule 1.9.86

The logic of this rule is explained in the following comments to the rule:

Combining the roles of advocate and witness can prejudice the tribunal and the opposing party and can also involve a conflict of interest between the lawyer and client.87

The tribunal has proper objection when the trier of fact may be confused or misled by a lawyer serving as both advocate and witness. The opposing party has proper objection when the combination of roles may prejudice that party’s rights in the litigation. A witness is required to testify on the basis of personal knowledge, while an advocate is expected to explain and comment on

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86 MODEL RULES OF PROF’L CONDUCT R. 3.7 (2013).
87 Id., cmt. 1.
Evidence given by others. It may not be clear whether a statement by an advocate-witness should be taken as proof or as analysis of the proof.88

Disqualification motions based on the advocate-witness rule, however, are disfavored:

“Because of the potential for abuse by opposing counsel, ‘disqualification motions should be subjected to particularly strict scrutiny.’” [citations omitted] “A party’s right to select its own counsel is an important public right and a vital freedom that should be preserved; the extreme measure of disqualifying a party’s counsel of choice should be imposed only when absolutely necessary.” 89

Disqualification under the advocate-witness rule is generally limited to the attorney acting as trial counsel. The rule does not appear to apply to lawyers that performed pretrial work, or to appellate counsel.90

An initial issue that may be presented by a disqualification motion arises under paragraph (a) of Rule 3.7: whether the insurer’s trial counsel is “likely to be a necessary witness” at the trial of the coverage action. Courts have held that if the testimony of the lawyer sought to be disqualified can be obtained through other witnesses or other means, the

88 Id., cmt. 2.
89 Macheca Transp. Co. v. Philadelphia Indem. Ins. Co., 463 F.2d 827, 833 (8th Cir. 2006) (citations omitted); Franklin v. Clark, 454 F. Supp. 2d 356, 364 (D. Md. 2006) (the movant bears “a high standard of proof to show that disqualification is warranted” because it is such a drastic measure”); Klupt v. Krongard, 728 A.2d 727, 740 (Md. Ct. Spec. App. 1999) (“When an opposing party moves for disqualification of the other party’s counsel, the court will take a hard look at such a motion. The concern is that the opposing party will use such a motion to block, harass, or otherwise hinder the other party’s case. Such ‘tactical abuse’ of the disqualification process is to be guarded against” [citations omitted]).
lawyer is not a “necessary” witness. In most fidelity bond claims in which outside counsel has conducted the investigation of the claim, the insurer’s claims professional has been involved in the investigation and received the information and documents obtained by outside counsel during the investigation. Accordingly, the claims professional is an alternative witness who can testify as to the facts obtained during the investigation, such that the insurer’s trial counsel is not a “necessary witness” within the scope of paragraph (a) of Rule 3.7 and thus may act as trial counsel in the coverage action.

If the insurer’s claims professional conducted the investigation without any involvement of outside counsel, and does not hire outside counsel until the coverage lawsuit is filed, there would be no basis for a disqualification motion because such counsel would not be a witness as to the information and documents obtained during the investigation.

Even if trial counsel for the insurer who conducted the investigation is “likely to be a necessary witness,” the third exception to the advocate-witness prohibition in Rule 3.7 allows counsel to be a witness if disqualification “would work substantial hardship on the client.” This exception is explained in the comments to the rule:

> Paragraph (a)(3) recognizes that a balancing is required between the interests of the client and those of the tribunal and opposing party. Whether the tribunal is likely to be misled or the opposing party is likely to suffer prejudice depends on the nature of the case, the importance and probable tenor of the lawyer’s testimony, and the probability that the lawyer’s testimony will conflict with that of other witnesses.

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91 Maheca Transp., 463 F.2d at 833; Harter v. Univ. of Indianapolis, 5 F. Supp. 2d 657, 665 (S.D. Ind. 1998) (“A necessary witness is not the same thing as the ‘best’ witness. If the evidence that would be offered by having an opposing attorney testify can be elicited through other means, then the attorney is not a necessary witness.”); United Food & Commercial Workers v. Darwin Lynch Adm’rs, Inc., 781 F. Supp. 1067 (M.D. Pa. 1991) (when evidence concerning interpretation of disputed documents was available from other sources, no disqualification of lawyer who negotiated agreements and drafted documents).
Even if there is a risk of such prejudice, in determining whether the lawyer should be disqualified, due regard must be given to the effect of disqualification on the lawyer’s client. It is relevant that one or both parties could reasonably foresee that the lawyer would probably be a witness. The conflict of interest principles stated in Rules 1.7, 1.9 and 1.10 have no application to this aspect of the problem.92

Courts have applied the substantial hardship exception under varying circumstances.93

Paragraph (b) of Rule 3.7 also allows an attorney who is a “necessary witness” to testify at trial. As explained in the comments:

Because the tribunal is not likely to be misled when a lawyer acts as advocate in a trial in which another lawyer in the lawyer’s firm will testify as a necessary witness, paragraph (b) permits the lawyer to do so except in situations involving a conflict of interest.94

Courts have held that this part of the rule allows other lawyers in the firm of the lawyer who is a “necessary witness” to act as trial counsel, even though the “necessary witness” will testify at trial.95

93 See Brown v. Daniel, 180 F.R.D. 298 (D.S.C. 1998) (in complex case on which firm worked for eight years and with which firm was very familiar, disqualification of entire firm based on partner’s likely testimony would cause substantial hardship); McElroy v. Gaffney, 529 A.2d 889 (N.H. 1987) (where lawyer represented plaintiff for six years in two other related actions and had intimate knowledge of case, no disqualification under “unreasonable hardship” test); D.J. Inv. Group, L.L.C. v. DAE/Westbrook, L.L.C., 147 P.3d 414 (Utah 2006) (exception applied when disqualification memo filed two and one-half years after action filed, counsel had performed significant work and disqualification would result in “exorbitant” costs to client).
94 MODEL RULES OF PROF’L CONDUCT R. 3.7 cmt. 5 (2013).
Paragraph (b) of Rule 3.7 does not apply if precluded by Model Rule 1.7 ("Conflict of Interest: Current Clients") or Model Rule 1.9 ("Duties to Former Clients"). In the fidelity bond claim context, it is difficult to envision a situation in which the testimony of the outside investigating attorney would create a conflict of interest with the insurer within the scope of these two rules, unless the attorney’s testimony conflicts with testimony of insurer personnel, which might implicate Rule 1.7. The likelihood of such a scenario occurring, however, appears remote.

Accordingly, in the fidelity bond claim context, even if the outside counsel who investigated the claim for the insurer is found to be a “necessary witness,” other members of the counsel’s firm likely will be able to act as trial counsel in coverage litigation, barring any conflict of interest created by the lawyer witness’s testimony.

VI. CONCLUSION

Increasingly, fidelity claims are presented and investigated by in-house and outside counsel for insureds. Similarly, the adjusters handling these claims also are lawyers, and historically outside counsel was retained early in fidelity claim investigations to assist in the analysis of those claims. Given the participation of so many lawyers in the claim process, it seems prudent for counsel for both insureds and insurers to understand their ethical obligations under the rules of professional conduct.

This article has attempted to analyze some of the ethical issues that can arise when counsel is involved in a fidelity claim investigation. Unfortunately, there is at present a dearth of reported case law examining and applying the ethical rules discussed above to the behavior of attorneys in the context of presenting, analyzing, and adjusting claims. Regardless, it makes sense for lawyers to review the professional conduct rules and the unfair claim practice statues/regulations adopted in the jurisdiction(s) in which the insured is located and/or where the claim could; Brown, 180 F.R.D. at 301 (in light of “drastic nature of disqualification,” Rule 3.7(b) does not require that entire firm be disqualified even though partner will be necessary witness).
is being investigated. These rules should be reviewed to appreciate the importance of determining whether the insured is represented by counsel, the duty of the insured and the insurer to preserve documents and records, and ethical issues arising from contacts and communications between the insured and the insurer during the claim investigation. In addition, it is important for counsel to understand what claim investigation materials are protected by the attorney-client privilege and work product doctrine, and to understand the potential impact of the “lawyer as a witness” prohibition in any coverage litigation that may occur if the claim is denied.