

Potential Secondary Effects of Regulatory Examinations: Evidentiary Issues and Preclusion in Parallel Litigation

October 13, 2016

Increasingly aggressive and adversarial examinations by state regulators can expose insurers to troubling evidentiary issues in subsequent individual and class action litigation. Plaintiffs' counsel may seek to admit into evidence documents or communications exchanged with regulators, or the conclusions contained in an examination report. And where an examination leads to administrative hearings, plaintiffs' counsel may argue that findings made in the administrative hearing should be binding in subsequent civil litigation. When the subject matter of a regulatory examination has the potential to overlap with pending or anticipated class action litigation, insurers should involve litigation counsel early in the process to help prepare responses, present the company's conduct in the best possible light, develop legal arguments, and make tactical decisions that can reduce the risk of adverse consequences in pending or subsequent civil litigation. **Evidence Generated During Regulatory Examinations** The most obvious example of a regulatory document that opposing counsel may seek to use as "evidence" in subsequent litigation is a final examination report. Although an examination report's factual findings and conclusions offered for the truth of the underlying assertions are classic hearsay, plaintiffs' counsel may seek to admit them pursuant to the "public records" hearsay exception set forth in Fed. R. Evid. 803(8). Rule 803(8) provides that a record of a public office may be admitted into evidence as an exception to the rule against hearsay if "(A) it sets out ... (iii) in a civil case ... factual findings from a legally authorized investigation; and (B) the opponent does not show that the source of information or other circumstances indicate a lack of trustworthiness." (Note that the public records exception will not typically apply to preliminary reports and correspondence setting forth allegations or preliminary findings and conclusions that have not been formally adopted by the agency.) Courts do not always construe "factual findings" within the meaning of Rule 803(8) narrowly, and some may admit *conclusions* reached by regulators that are *based on* factual findings if deemed trustworthy.¹ Contrary to what some counsel may

believe, the fact of a settlement with regulators will not itself prevent admission of a final examination report in subsequent litigation. Documents generated or produced by the company during the examination process can also find their way into a private civil lawsuit. For example, if a plaintiff's counsel is successful in obtaining copies of the company's written communications or statements made to regulators in response to allegations, findings, or requests for information, the plaintiff's counsel may attempt to use such communications in litigation. While materials submitted to state insurance departments are typically subject to a confidentiality statute in that state's insurance code, several courts have held that these statutes do not create an evidentiary privilege for the insurer in private civil litigation.² Plaintiffs may argue that statements made by the company in communications with regulators are "party admissions," which are not hearsay and are admissible under Fed. R. Evid. 801(d)(2). Plaintiffs also may attempt to obtain copies of productions of records made by the company to insurance departments. These records may be discoverable if plaintiffs can reasonably tailor their requests to their claims.³ In addition, plaintiffs often argue that regulatory findings or conclusions can be used for a variety of purported non-hearsay purposes, such as the effect on the recipient or intent. For example, a claimant might argue that a finding that a particular practice or document is misleading is relevant to show intent if the company continued the practice after the finding. Plaintiffs also often argue that regulatory findings and conclusions can be used for impeachment of the insurer's experts testifying about the practice at issue. **Potential Preclusive Effect of Administrative Litigation** Insurers that challenge the findings of an examination report in administrative litigation face another risk— that the hearing will result in decisions that may be binding under principles of collateral estoppel (issue preclusion) in subsequent civil litigation. Although individual state laws vary, a state agency proceeding is usually given the same preclusive effect as a court proceeding if the agency acts in a judicial capacity—affording the parties the minimum protections of due process, including a full and fair opportunity to be heard, the right to representation by counsel, cross-examination of witnesses, the existence of hearing transcripts, a neutral fact finder, and the availability of judicial review. A more complicated issue concerns the extent to which a plaintiff who was not a party (or privy thereof) to the administrative hearing may preclude a defendant from re-litigating a specific issue that was already decided against the defendant in another proceeding. Issue preclusion laws vary among jurisdictions on the use of such "offensive non-mutual" collateral estoppel. Many states allow at least limited offensive use of non-mutual collateral estoppel; some states do not; and federal courts have "broad discretion" in applying federal common law to determine when such use should be permitted.⁴ Courts in jurisdictions that allow offensive use of non-mutual collateral estoppel typically are guided by principles of efficiency and fairness and are sensitive to the heightened potential for unfairness to the defendant.

Takeaways

- Carriers should ensure that employees handling regulatory examinations update in-house litigation counsel (and if retained, outside counsel) on the scope of the examinations to identify the potential for overlap with pending or subsequent litigation.

- Personnel handling responses to examinations covering areas that overlap with pending or foreseeable litigation should coordinate closely with litigation counsel in dealings with the examiners and with other parties related to the examination. Depending on the importance of the issues, it may be wise to start this coordination early during the state's data-gathering process. And in some circumstances, responses should be handled as if the requests were from a litigation adversary. For example, the failure to correct a regulator on the facts or point out legal arguments regarding why the company believes it has not violated a particular disclosure regulation could lead to adverse preliminary findings. Examiners may be less flexible about accepting information and arguments later in the process after they have reached preliminary conclusions.
- If the company believes an insurance department is determined to make adverse findings, regardless of the facts, it should consider strategies to avoid the admissibility of those findings in related litigation. Official agency reports are not admissible under Federal Rule of Evidence 803(8) (C) if the opponent of the evidence shows they are untrustworthy. The Advisory Committee note accompanying the Rule lays out four, nonexclusive factors for determining trustworthiness: (1) the timeliness of the investigation; (2) the special skill and experience of the official; (3) whether a hearing was held and the level at which it was conducted; and (4) possible motivation problems. Bias of the examiner or department is one obvious basis for questioning a report's trustworthiness.
- We have seen regulatory investigations and examinations of insurance companies follow closely on the heels of lobbying efforts by lawyers and companies interested in pursuing litigation. And we frequently observe regulators hiring as consultants individuals who make a living testifying against the insurance industry in private civil litigation. Techniques for obtaining evidence of bias include open records requests and discovery requests seeking communications between self-interested third parties and regulators (or higher level government officials) who may have influenced a department's process. While such techniques can be potentially detrimental to the relationship with a department, given the stakes and unfair prejudice that can accompany admission of inappropriate regulatory findings, they may be worth the fight.
- Settlements alone will not impact the admissibility of a final report. However, the circumstances of the settlement, such as a written acknowledgement that a particular finding should be modified, could provide a basis for arguing that the report is untrustworthy or that it should be excluded under Federal Rule of Evidence 403, which allows the court to exclude relevant evidence if "its probative value is substantially outweighed by a danger of ... unfair prejudice, confusing the issues, misleading the jury, undue delay, wasting time, or needlessly presenting cumulative evidence." And settlement will eliminate the possibility of a final judgment in an administrative proceeding and the related risk of collateral estoppel.

- If a department has made adverse findings that overlap areas of pending or anticipated litigation, the company should consider whether to challenge those findings in an administrative hearing. The considerations behind that decision are complex and varied, but one factor should be the potential for a decision with binding effect on the company. The basic requirements of collateral estoppel are often difficult to satisfy: the issue in question in the second proceeding must be identical to that litigated in the first proceeding; there must be a final judgment on the merits; the issue must have been actually decided and necessary to the final judgment; and there must have been a full and fair opportunity to litigate the issue in the first forum.
- Differences in substantive laws, burdens of proof, and standards of review applicable in administrative proceedings can also undermine the identity of issues required for collateral estoppel. Particularly relevant to the application of offensive non-mutual collateral estoppel, the procedures of the administrative forum may not be sufficiently adjudicative in nature such that resulting decisions should be given binding effect. For example, administrative hearings in many states may be presided over by employees of the commissioner, making the impartiality of the decision maker inherently suspect.

Conclusion A regulatory examination can have a significant impact on the discovery, evidence, and legal rulings in an overlapping litigation matter and create substantial risks for insurance carriers. An overlapping strategy can help carriers manage these risks. (Endnotes) ¹ See *Beech Aircraft Corp. v. Rainey*, 488 U.S. 153, 170 (1988) (holding that conclusions or opinions in an investigatory report can be admissible under Rule 803(8) if they are "based on a factual investigation and satisf[y] the Rule's trustworthiness requirement"). ² Compare *AmTrust N. America v. Safebuilt Ins. Servs.*, No. MC-169 (CM) (JLC), 2016 WL 2858898 (S.D.N.Y. May 16, 2016) (holding that Montana insurance code provision did not create evidentiary privilege) with *Rowe v. Bankers Life & Cas.*, No. 09 C491, 2011 WL 1897181 (C.D. Cal.) (holding that insurer could invoke California Insurance Code provision to withhold market examination report). ³ *Marion v. State Farm Fire & Cas. Co.*, Civ. No. 1:06CV969, 2008 WL 7908019 (S.D. Miss. Feb. 13, 2008) (denying motion to compel insurer to produce "documents regarding meetings with the Department of Insurance, unless such meetings relate specifically to the [plaintiff's] claim."). ⁴ *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 331 (1979) (affirming district court's decision in stockholder class action to prevent corporate and individual defendants from re-litigating adverse decision in declaratory judgment action brought by the SEC).

Authored By



Michael N. Wolgin

Related Practices

Life, Annuity, and Retirement Litigation
Securities Litigation and Enforcement

Related Industries

Life, Annuity, and Retirement Solutions

©2024 Carlton Fields, P.A. Carlton Fields practices law in California through Carlton Fields, LLP. Carlton Fields publications should not be construed as legal advice on any specific facts or circumstances. The contents are intended for general information and educational purposes only, and should not be relied on as if it were advice about a particular fact situation. The distribution of this publication is not intended to create, and receipt of it does not constitute, an attorney-client relationship with Carlton Fields. This publication may not be quoted or referred to in any other publication or proceeding without the prior written consent of the firm, to be given or withheld at our discretion. To request reprint permission for any of our publications, please use our Contact Us form via the link below. The views set forth herein are the personal views of the author and do not necessarily reflect those of the firm. This site may contain hypertext links to information created and maintained by other entities. Carlton Fields does not control or guarantee the accuracy or completeness of this outside information, nor is the inclusion of a link to be intended as an endorsement of those outside sites.