Professional Liability Defense QUARTERLY

I Don't Have to Produce These, Do I? "At Issue" Waiver of Privileged Communications

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The attorney-client privilege is foundational to the practice of law. It is for this reason that we have written on this issue so frequently in our column addressing legal malpractice issues. See *"Tripartite Relationship Minefield: Lack of Cooperation Disclosure," PLDF Quarterly*, Volume 10, Issue 2, *"Privilege Update: Attorneys' Bills/Internet Transmission,"* PLDF Quarterly, No. 9, Issue 2, and *"Tribe's Trump Tweet: A-C Privilege and Confidentiality," PLDF Quarterly*, Vol. 8, Issue 4. To protect both the client and attorney, it is essential to ensure those communications will be shielded from discovery.

The unique relationship among insurers, insureds, and counsel complicates the determination of when attorney-client privilege should apply. The analysis differs depending on whether the communications arise 1) in the defense of the insured or 2) in the defense of the insurer in a coverage action, whether initiated by the insured or the insurer. This column will discuss attorney-client privilege in the context of coverage actions between an insurer and an insured.

In *In re: Mt. Hawley Insurance Company*, 829 S.E.2d 707, 709 (2019), the Supreme Court of South Carolina answered the following certified question from the United States Court of Appeals for the Fourth Circuit:

> Does South Carolina law support application of the "at issue" exception to attorney-client privilege such that a party may waive the privilege by denying liability in its answer?

The Court held that "a denial of bad faith and/or the assertion of good faith in the answer does not, standing alone, place a privileged communication 'at issue' in a case such that the attorney-client privilege is waived." *Id*. at 718. We will review the facts of the case, the reasoning of the court, and the implications for counsel and insurers.

The Coverage Dispute

The *Mt. Hawley* case involved a bad faith claim by an insured against an insurer. Mt. Hawley issued an excess commercial general liability policy to Contravest Construction Company ("Contravest"). *Id*. at 709. Contravest constructed a development and then was sued by the homeowners' association for allegedly defective construction. *Id*. at 709-710. Mt. Hawley refused to defend the lawsuit against Contravest, which Contravest contended Mt. Hawley should have defended. *Id*. Contravest ultimately settled with the plaintiff in the underlying case. *Id*.

Contravest and the underlying plaintiff then sued Mt. Hawley for bad faith, breach of contract, and unjust enrichment. *Id*. Mt. Hawley removed the case to federal court based upon diversity jurisdiction. *Id*. Contravest issued discovery to Mt. Hawley seeking claims files which contained communications with counsel. *Id*. Mt. Hawley objected, asserted

attorney-client privilege, and provided a privilege log. *Id*. The district court overruled the objections finding that the communications were put "at issue" by Mt. Hawley's denial of liability in the bad faith action and there was an "implied" waiver. *Id*.

Mt. Hawley filed a writ of mandamus to the Fourth Circuit and the certified question was issued to assist it in resolving the issue because the scope and application of attorney-client privilege in a diversity case is a question of South Carolina state law. *Id*.

The South Carolina Supreme Court's Reasoning

As an initial matter, it is important to note that the South Carolina Supreme Court recognized the rather typical, but competing, principles that nearly every court has adopted: the need for liberal discovery and the importance of the attorney-client privilege. *Id*. at 712. With respect to waiver of the privilege, which can only be done by the client who holds the privilege, the Court stated "[s]uch waiver must be 'distinct and unequivocal.' As a result, when a party asserts an implied waiver of privilege, 'caution must be exercised, for waiver will not be implied from doubtful acts.'" *Id*.

To resolve the tension between these competing policies in the context of a coverage dispute, the Court considered three approaches to "at issue" waiver of otherwise protected attorney-client communications. *Id*. at 711 citing *Bertelsen v. Allstate Ins. Co.,* 796 N.W.2d 685, 702 n.6 (S.D. 2011) and *Restatement (Third) of the Law Governing Lawyers § 80*. The first approach holds that whenever a party seeks judicial relief, the party impliedly waives the privilege. *Independent Productions Corp. v. Loew's, Inc.*, 22 F.R.D. 266, 277 (S.D.N.Y. 1958). As bad faith is a tort under South Carolina law, the application of this approach would result in the extension of the crime-fraud exception to alleged violations of tort law. *Id*. at 713-714 citing *Nichols v. State Farm Mut. Auto. Ins. Co*., 306 S.E.2d 616, 619 (S.C. 1983); *Cedell v. Farmers Ins. Co. of Wash*., 295 P.3d 239, 245-46 (Wash. 2013). The court rejected this approach. *Id.*

The second approach rejects the implied waiver altogether and looks at whether the client asserting the privilege has interjected the issue into the litigation and whether the claim of privilege, if upheld, would deny the inquiring party access to proof needed to fairly resist the client's own evidence on that very issue. *Id*. at 714; *Rhone-Poulenc Rorer, Inc. v. Home Indem. Co.*, 32 F.3d 851 (3rd Cir. 1994); see generally C. Mueller & L. Kirkpatrick, Modern Evidence § 5.30 (1995); C. Wolfram, Modern Legal Ethics § 6.4.7 (1986). *Hearn v. Rhay*, 68 F.R.D. 574, 581 (E.D.Wash. 1975). The court also rejected this approach. *Id*.

The third approachseeks to balance the need for disclosure against the need for protecting the confidentiality of the client's communications on the facts of the individual case. *Id*. at 715; *Pitney-Bowes, Inc. v. Mestre*, 86 F.R.D. 444, 447 (S.D.Fla.1980); *Black Panther Party v. Smith*, 661 F.2d 1243, 1271-72 (D.C.Cir.1981); *Elia v. Pifer*, 977 P.2d 796 (Ariz.Ct.App.1998). The *Mt. Hawley* Court adopted this case-by-case approach, as articulated by the Arizona Supreme Court in *State Farm Mutual Automobile Insurance Co. v. Lee*, 13 P.3d 1169 (Ariz. 2000).

In *Lee*, the insurer was sued by a class of individuals who claimed their uninsured and underinsured motorist claims had been denied. *Id.* at 715. The insurer contended that it relied on the advice of counsel in making the coverage determinations, but was not arguing that the reliance on counsel was evidence of good faith. *Id*. In overruling the objections and ordering production of the communications, the Court held that "*The advice of counsel defense is impliedly one of the bases for the defense [the insurer] maintain[s] in this action*. [The insurer has], therefore, impliedly waived the attorney-client privilege." *Id*. (emphasis in original). The *Lee* court concluded that "in [cases in] which the litigant claiming the privilege relies on and advances as a claim or defense a subjective and allegedly reasonable evaluation of

the law—but an evaluation that necessarily incorporates what the litigant learned from its lawyer—the communication is discoverable and admissible." *Id*. at 715.

The Court concluded its opinion by emphasizing that an insurer does not waive privilege by simply defending a bad faith lawsuit. *Id*. at 717. Rather, the Court adopted the *Lee* approach that an insurer waives the privilege over claims materials if it based its claim denial on (1) a good-faith belief that the law supported the denial and (2) its subjective belief following a legal evaluation. *Id*. The Court then added the additional requirement that the party seeking waiver of the attorney-client privilege make a *prima facie* showing of bad faith. *Id*. Whether the plaintiff presented *prima facie* evidence in this case was beyond the question presented to the Court.

Lessons for Counsel

Both coverage counsel providing advice to an insurer on coverage issues and counsel defending an insurer on bad faith claims could be affected by this decision. The simple solution for coverage counsel is to be correct on the initial coverage evaluation, but sometimes there is a close question or counsel is incorrect. What steps should counsel take to protect communications with an insurance client?

The answer to that question will often rest on the legal position taken in the bad faith action. Under the rule adopted by the South Carolina Supreme Court, waiver occurs only when, in addition to *prima facie* evidence of bad faith, the insurer asserts that its claim denial was the result of a reasonable belief that the law permitted the decision and a subjective belief based on a legal evaluation. In states that employ this rule, coverage counsel may decide, and it is possible that insurers will ask, that coverage evaluations be committed to writing with less frequency so that they cannot be discovered later.

Though this decision is limited to South Carolina and to the context of a tort action for bad faith, it portends broader lessons for counsel representing all manner clients and in all types of actions. Assiduously guarding communications with the client is fundamental to an attorney's role in representation of a client. Given the variety of rules adopted across the country on this issue, counsel should try to ascertain the standard for waiver that applies in the jurisdictions in which they practice and potentially take steps to protect communications from being disclosed should litigation ensue. In most contexts, attorneys assume that their communications are confidential and will remain so. However, courts across the country seem increasingly prepared to erode the protections of the attorney-client privilege.

The *Mt. Hawley* Court adopted the "middle of the road" approach between implied waiver which requires almost automatic production on the one hand and whether the party has injected the issue into the case which typically shields communications on the other. How the rule in *Mt. Hawley* will be applied and whether it will be more broadly adopted remains to be seen. Until then, counsel and carriers should proceed with caution in communicating, and when communications are in writing it should be assumed that they will be produced in any subsequent bad faith litigation.

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