

# The Elastic Contours of Attorney-Client Privilege and Waiver in the Context of Insurance Company Bad Faith: There's a Chill in the Air

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## I. INTRODUCTION

Tensions between insurance companies and their policyholders have significantly increased within the last fifteen years.<sup>1</sup> When the disputes resulting from these increasingly adversarial relationships have been brought into the courts, juries have awarded policyholders large verdicts.<sup>2</sup> Today, an insurer that denies coverage does so at its own financial risk. Even if an insurance company denies payment because an apparently sound basis for a defense or a settlement exists, a bad-faith judgment may nevertheless result if it is later determined that the insurer's denial was "wrongful." If the insurer is found to have acted in bad faith, it might pay a judgment in excess of its policy limits to a third party, or pay to its insured the underlying amount covered by the policy, including any emotional distress damages suffered and, potentially, punitive damages.

Two decades ago, courts relied exclusively on substantive contract law to resolve insurance policy disputes.<sup>3</sup> Historically, there was no differentiation between breaches of insurance contracts and breaches of ordinary commercial contracts.<sup>4</sup> Where a wrongful denial of policy benefits was established, the successful policyholder was awarded the amount due under the policy, plus interest.<sup>5</sup> Damages for emotional distress or economic loss were not available

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<sup>1</sup> Douglas R. Richmond, *An Overview of Insurance Bad Faith Law and Litigation*, 25 SETON HALL L. REV. 74, 75 (1994).

<sup>2</sup> *Id.*

<sup>3</sup> See Randy Papetti, Note, *The Insurer's Duty of Good Faith in the Context of Litigation*, 60 GEO. WASH. L. REV. 1931 (1992).

<sup>4</sup> *Id.* Traditionally, breach of insurance contracts were treated the same as breaches of ordinary commercial contracts. Policy holders who established a wrongful denial of policy benefits would receive only the amount due on the policy, plus interest. Phyllis Savage, Note, *The Availability of Excess Damages for Wrongful Refusal to Honor First Party Insurance Claims*, 45 FORDHAM L. REV. 164, 164-66 (1976). However, in *Braesch v. Union Insurance Co.*, 464 N.W.2d 769 (Neb. 1991), the court explained the difference in the nature of the relationship that exists between the insurance carrier and its insured from other consensual commercial relationships. The court set forth three reasons for this difference: (1) the public status of insurance contracts; (2) the non-commercial aspects of insurance contracts; and (3) the inequality of bargaining power in the relationship between the insured and the insurance company. *Id.* at 774-75. One commentator has described the primary difference on "public interest" grounds, noting that insurance plays a pivotal role in modern capitalistic society which demands public regulation and oversight. See Roger C. Henderson, *The Tort of Bad Faith in First-Party Insurance Transactions: Refining the Standard of Culpability and Reformulating the Remedies by Statute*, 26 U. MICH. J.L. REFORM 1, 7-11 (1992).

<sup>5</sup> Papetti, *supra* note 3, at 1931; see also Savage, *supra* note 4, at 164-66.

under general contract law.<sup>6</sup> Punitive damages were not available as a deterrent.<sup>7</sup>

Unlike standard contractual relationships which are entered into at arm's length, a special relationship exists regarding the purchase of insurance due to the parties' perceived unequal bargaining power and the nature of insurance policies. This relationship can, potentially, allow unscrupulous insurance companies to exploit their insureds' misfortune by refusing to resolve or settle claims.<sup>8</sup> In fact, insurance policies are routinely characterized as contracts of adhesion.<sup>9</sup> The Ninth Circuit Court of Appeals made the following observation:

When coverage and liability are established . . . a game of the strong against the weak can begin. A claim known to be valid and legitimate can be settled for far less than its actual value if the need for funds by the victim is great enough and the insurance company is obstinate enough to use its knowledge of that fact to

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<sup>6</sup> See, e.g., *Dawkins v. Nat'l Liberty Life Ins. Co.*, 252 F. Supp. 800, 802-03 (D.S.C. 1966); *Fletcher v. W. Nat'l Life Ins. Co.*, 89 Cal. Rptr. 78, 92 (Ct. App. 1970); *Savage*, *supra* note 4, at 167. Strident common-law principles of foreseeability limited recovery to policy benefits. Terry B. Light, Note, *Damages Assessed Against Insurers for Wrongful Failure to Pay*, 10 WM. & MARY L. REV. 466, 466-68 (1968). However, commentators argued for a broader damages standard since the early 1970s. See David Tartaglio, Note, *The Expectation of Peace of Mind: A Basis for Recovery of Damages for Mental Suffering Resulting from the Breach of First Party Insurance Contracts*, 56 S. CAL. L. REV. 1345, 1348 (1983) (arguing that "disruption of peace of mind" damages should be awarded); see also Eric M. Holmes, *Is There Life After Gilmore's Death of Contract? – Inductions from a Study of Commercial Good Faith in First-Party Insurance Contracts*, 65 CORNELL L. REV. 330, 339 (1980) (contending that insurance companies are aware of the emotional protection policyholders contemplate).

<sup>7</sup> Light, *supra* note 6, at 467; *Savage*, *supra* note 4, at 167-68. Allowing punitive damages against insurance companies for bad conduct breaches of contract is an exception to the general bar on extra-compensatory damages in contract law. See Susan G. Gresham, Note, *"Bad Faith Breach": A New and Growing Concern for Financial Institutions*, 42 VAND. L. REV. 891, 892 n.5 (1989) (analyzing decisions from jurisdictions that follow California courts in allowing tort recovery for bad-faith breaches of insurance contracts). For a representative description of the cases where damages were awarded for a denial of coverage based on specious pretexts, see Roger C. Henderson, *The Tort of Bad Faith in First-Party Insurance Transactions After Two Decades*, 37 ARIZ. L. REV. 1153 (1995), discussing punitive damage liability triggered by outright refusals to pay, delays, misinterpretation of records or policies for the purpose of defeating coverage, using threats to force unfair settlements, and falsely accusing the insured of wrongdoing. See also Richmond, *supra* note 1, at 74-76 (examining first-party and third-party bad-faith law).

<sup>8</sup> See, e.g., *Arnold v. Nat'l County Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987).

<sup>9</sup> See, e.g., *Clemco Indus. v. Commercial Union Ins. Co.*, 665 F. Supp. 816, 818 (N.D. Cal. 1987), *aff'd*, 848 F.2d 1242 (9th Cir. 1988); *Intermountain Gas Co. v. Indus. Indem. Co.*, 868 P.2d 510, 513 (Idaho Ct. App. 1994).

force acceptance of a lesser sum.<sup>10</sup>

Because insurance policies are not purchased for commercial advantage, but rather for protection against calamity,<sup>11</sup> they are unique contracts. When a covered loss occurs, the insured expects to have the purchased protection. If the insurance company refuses or fails to pay a valid claim without sufficient justification, the insured may be put in a vulnerable economic position. In this situation, contract damages may fail to provide adequate compensation for the breach of security purchased through the insurance contract. Moreover, limiting the insured only to contract damages may create an incentive for insurance companies to deny claims before performing an adequate evaluation of the claim. In *Rawlings v. Apodaca*,<sup>12</sup> the Arizona Supreme Court addressed the need for deterring this type of conduct in the insurance context. According to the *Rawlings* court, contract damages

offer no motivation whatsoever for the insurer *not* to breach. If the only damages an insurer will have to pay upon a judgment of breach are amounts that it would have owed under the policy plus interest, it has every interest in retaining the money, earning the higher rates of interest on the outside market, and hoping eventually to force the insured into a settlement for less than the policy amount.<sup>13</sup>

Against this backdrop, courts created tort liability for an

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<sup>10</sup> *Holmgren v. State Farm Mut. Auto. Ins. Co.*, 976 F.2d 573, 578 (9th Cir. 1992) (emphasis omitted). In *State Farm Fire & Casualty Co. v. Simmons*, 857 S.W.2d 126, 136 (Tex. App. 1993), the court observed that the void created by the parties' disparity of bargaining power coupled with the insurance company's exclusive control over claims processing can be filled by imposition of the tort duty of good faith and fair dealing.

<sup>11</sup> Unlike traditional contractual relations, insureds purchase insurance policies for peace of mind and security, rather than financial gain. *Love v. Fire Ins. Exch.*, 271 Cal. Rptr. 246, 252 (Ct. App. 1990) ("An insured does not enter an insurance contract seeking profit, but instead seeks security and peace of mind through protection against calamity."); *Ainsworth v. Combined Ins. Co. of Am.*, 763 P.2d 673, 676 (Nev. 1988) ("A consumer buys insurance for security, protection, and peace of mind."), *reh'g denied*, 774 P.2d 1003 (Nev.), *cert. denied*, 493 U.S. 958 (1989).

<sup>12</sup> 726 P.2d 565 (Ariz. 1986).

<sup>13</sup> *Id.* at 575 (quoting *Wallis v. Superior Court*, 207 Cal. Rptr. 123, 128 (Ct. App. 1984)); see *Oki Am., Inc. v. Microtech Int'l, Inc.*, 872 F.2d 312, 315 (9th Cir. 1989) (Kozinski, J., concurring) ("[The] tortification of contract law . . . gives rise to a new form of entrepreneurship: investment in tort causes of action."); *White v. W. Title Ins. Co.*, 710 P.2d 309, 312 n.2 (Cal. 1985) (Kaus, J., concurring and dissenting) ("It seems to me that attorneys who handle policy claims against insurance companies are no longer interested in collecting on those claims, but spend their wits and energies trying to maneuver the insurers into committing acts which the insureds can later trot out as evidence of bad faith.").

insurance company's unreasonable denial of coverage.<sup>14</sup> Although limiting recovery to contract damages may create a motivation for improper claim handling on the part of the insurance company, the creation of tort liability for bad faith produces an equally dangerous motivation.

Part II of this Article provides an overview of insurance bad-faith principles. A foundational understanding of these principles will assist the reader in evaluating the role of attorney-client communications.

In Part III, the attorney-client privilege is discussed generally, as well as specifically, in the context of insurer bad faith. In Part III.A., a general overview of the attorney-client privilege is presented. In Part III.B., commonly recognized exceptions to the attorney-client privilege are discussed, as well as how those exceptions relate to bad-faith insurance cases. In Part III.C., express and implied waivers of the attorney-client privilege are discussed. The courts have disagreed on the general contours of the test to be applied in determining whether an implied waiver of the attorney-client privilege has occurred, and what should be the precise formulation for that determination. The courts have also disagreed as to when a client may be deemed to have injected privileged attorney-client communications into a case, causing an implied waiver. There are three general approaches to determine whether a litigant has impliedly waived the attorney-client privilege. Each of these approaches is discussed. In Part III.D., the Article discusses how the direct assertion of the advice-of-counsel defense results in waiver of

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<sup>14</sup> Only a few remaining jurisdictions do not recognize first-party bad faith. As an example, Michigan does not recognize an independent bad-faith tort against an insurance company for an alleged breach of contract due to the implied covenant of good faith and fair dealing. *See Kewin v. Mass. Mut. Life Ins. Co.*, 295 N.W.2d 50 (Mich. 1980); *see also Roberts v. Auto-Owners Ins. Co.*, 374 N.W.2d 905, 909 (Mich. 1985); *Ulrich v. Fed. Land Bank of St. Paul*, 408 N.W.2d 910, 911 (Mich. Ct. App. 1991). Damages recoverable for breach of contract are those that arise naturally from the breach or those that were in the contemplation of the parties at the time the contract was made. *Kewin*, 295 N.W.2d at 53. However, an insurance company does have an obligation to act in "good faith" in its resolution of claims. *See Commercial Union Ins. Co. v. Liberty Mut. Ins. Co.*, 393 N.W.2d 161 (Mich. 1986) (establishing 12 factors to be considered in determining liability for third-party bad-faith claims). Similarly, the courts of Minnesota do not recognize first-party bad faith. *See Morris v. Am. Mut. Ins. Co.*, 386 N.W.2d 233 (Minn. 1986); *Haagenson v. Nat'l Farmers Union Prop. & Cas. Co.*, 277 N.W.2d 648, 652 (Minn. 1979) ("Minnesota . . . follows the traditional rule that bad faith breach of contract does not convert the breach of contract into a tort."). However, Minnesota does recognize third-party bad faith. *See, e.g., Short v. Dairyland Ins. Co.*, 334 N.W.2d 384 (Minn. 1993).

the attorney-client privilege. The nature and scope of the advice-of-counsel defense is explored.

In Part III.E., the changing boundaries of waiver by implication are examined in light of three leading cases. The courts in Delaware, Arizona, and Ohio have expanded the waiver-by-implication rule substantially in recent years. As a result of this expansion, uncertainty exists as to when a waiver by implication will occur in the context of insurance company bad faith. This uncertainty may have a chilling effect upon the advice that insurance companies seek from counsel. The courts throughout the country have consistently held that an insurance company's mere denial of a bad-faith allegation is not sufficient to waive attorney-client privilege. Recent cases suggest, however, that an insurance company can lose the protection of the attorney-client privilege simply because the opposing party raises an issue to which advice of counsel may be relevant, including allegations of bad faith.

## II. AN OVERVIEW OF INSURANCE BAD-FAITH PRINCIPLES

As a concept, bad faith, like negligence, must be considered in a specific context because it has no definite independent meaning.<sup>15</sup> The court in *Wallbrook Insurance Co. v. Liberty Mutual Insurance Co.*<sup>16</sup> made the following insightful observation:

Insurers are required to act with good faith in dealings with their insureds. The courts of this state recognize that the concept of good faith possesses "an intangible and abstract quality with no technical meaning." One commentator sees the idea of good faith as having "no definite meaning of its own," but is commonly illustrated in a negative fashion, "by explaining what it is not." Coming to the same conclusion, another observer notes that good faith "is a phrase which has no general meaning or meanings of its own, but which serves to exclude many heterogeneous forms of

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<sup>15</sup> See James C. Nielsen, *Advice of Counsel in Insurance Bad Faith Litigation: A Substantive Framework for Pleading, Discovery and Proof*, 25 TORT & INS. L.J. 533, 534-35 (1990). Commentators have offered varying reviews of how many standards of bad faith exist. For an analysis of how commentators have offered various opinions on the standard to determine bad faith, see Lane Christine Boyarski, *The Best Place, Inc. v. Pan America Insurance Co.: Hawai'i Bad Faith Cause of Action for Insurer Misconduct*, 19 U. HAW. L. REV. 845, 853-54 (1997). For a description of the creation of the tort of insurance company bad faith, see Henderson, *supra* note 4, at 22-26. See also Thomas A. Diamond & Howard Foss, *Proposed Standards for Evaluating When the Covenant of Good Faith and Fair Dealing Has Been Violated: A Framework for Resolving the Mystery*, 47 HASTINGS L.J. 585, 585-86 (1996) (describing the difficulty in determining when the implied covenant of good faith had been violated).

<sup>16</sup> 7 Cal. Rptr. 2d 513 (Ct. App. 1992).

bad faith. . . . In a particular context the phrase takes on specific meaning, but usually this is only by way of contrast with the specific form of bad faith actually or hypothetically ruled out.” Looking to define bad faith is hardly less frustrating, for it too is recognized as an “amorphous concept” which “necessarily varies with the context” and thus has “no generally accepted ‘correct’ definition.”

As may be gathered, the issue of whether good faith was exercised covers a broad range of territory. . . . [D]ecisions of the Courts of Appeal have established that the litmus of good faith/bad faith is to be tested against the background of the totality of the circumstances in which the insurer’s disputed actions occurred.<sup>17</sup>

The tort of bad faith has been described as a hybrid cause of action, sharing elements of both a negligence action and an intentional tort.<sup>18</sup> The tort is composed of two essential elements. The first element—whether the insurance company acted reasonably toward its insured—is based upon a simple, objective negligence standard.<sup>19</sup> The second element—whether the insurance company acted knowingly<sup>20</sup>—is a subjective determination. The introduction

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<sup>17</sup> *Id.* at 518.

<sup>18</sup> *Trus Joist Corp. v. Safeco Ins. Co. of Am.*, 735 P.2d 125, 134 (Ariz. Ct. App. 1986).

<sup>19</sup> The concept of bad faith requires more than negligence to support judgment by the insurance company. *Centennial Ins. Co. v. Liberty Mut. Ins. Co.*, 404 N.E.2d 759 (Ohio 1980). “It imports a dishonest purpose, more obliquity, conscious wrongdoing, breach of a known duty through some ulterior motive or ill-will partaking of the nature of fraud.” *Id.* at 762. The requirement of more than mere negligence is supported by the holdings in many published decisions. *See, e.g.*, *Gen. Star Nat’l Ins. Co. v. Liberty Mut. Ins. Co.*, 960 F.2d 377, 380 (3rd Cir. 1992) (interpreting New York law); *White v. Cont’l Gen. Ins. Co.*, 831 F. Supp. 1545, 1555 (D. Wyo. 1993); *Turner Constr. Co. v. First Indem. of Am. Ins. Co.*, 829 F. Supp. 752, 762-64 (E.D. Pa. 1993); *Matt v. Liberty Mut. Ins. Co.*, 798 F. Supp. 429, 434 (W.D. Ky. 1991), *aff’d*, 968 F.2d 1215 (6th Cir. 1992) (interpreting Kentucky law); *Ins. Co. of N. Am. v. Citizens Bank of Thomasville*, 491 So. 2d 880, 882 (Ala. 1986); *First Marine Ins. Co. v. Booth*, 876 S.W.2d 255, 257 (Ark. 1994); *Dolan v. AID Ins. Co.*, 431 N.W.2d 790, 794 (Iowa 1988); *Wittmer v. Jones*, 864 S.W.2d 885, 890-92 (Ky. 1993); *Universal Life Ins. Co. v. Veasley*, 610 So. 2d 290, 295 (Miss. 1992); *Ganaway v. Shelter Mut. Ins. Co.*, 795 S.W.2d 554, 556 (Mo. Ct. App. 1990); *see also* *Mission Ins. Co. v. Aetna Life & Cas. Co.*, 687 F. Supp. 249, 253 (E.D. La. 1988) (requiring “something more than mere error of judgment” to show insurer bad faith). However, a minority of states apply a negligence standard. *See, e.g.*, *Mock v. Mich. Millers Mut. Ins. Co.*, 5 Cal. Rptr. 2d 594, 607 (Ct. App. 1992); *Ind. Ins. Co. v. Plummer Power Mower & Tool Rental, Inc.*, 590 N.E.2d 1085, 1093 (Ind. Ct. App. 1992); *Hartford Cas. Ins. Co. v. N.H. Ins. Co.*, 628 N.E.2d 14, 17 (Mass. 1994); *Gelinas v. Metro. Prop. & Liab. Ins. Co.*, 551 A.2d 962, 966 (N.H. 1988); *Shamblin v. Nationwide Mut. Ins. Co.*, 396 S.E.2d 766, 776 (W. Va. 1990).

<sup>20</sup> It is the unreasonableness of the insurance company’s conduct that is the

of this second element of knowledge is what elevates the cause of action to a quasi-intentional tort.

The first, negligence-based element of the tort acts as a threshold test for bad-faith actions.<sup>21</sup> It is well established that “[w]here an insurer acts reasonably, there can be no bad faith.”<sup>22</sup> The court in *Trus Joist Corp. v. Safeco Insurance Co. of America* gave an excellent exposition of this concept:

[D]id the insurance company act in a manner consistent with the way a reasonable insurer would be expected to act under the circumstances[?] This is the threshold test for all bad faith actions, whether first or third-party. Where an insurer acts reasonably, there can be no bad faith. However, the converse of this proposition is not necessarily true: merely because an insurer acts unreasonably does not mean that it is guilty of bad faith. Negligent conduct which results solely from honest mistake, oversight, or carelessness does not necessarily create bad faith liability even though it may be objectively unreasonable. Some form of consciously unreasonable conduct is required.<sup>23</sup>

Where an insurance company intentionally denies, fails to process, or refuses to pay a claim without a reasonable basis for such action, the tort of bad faith may arise.<sup>24</sup> Insurance companies are

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essence of the tort. See *Tomaselli v. Transamerica Ins. Co.*, 31 Cal. Rptr. 2d 433 (Ct. App. 1994); *Chester v. State Farm Ins. Co.*, 789 P.2d 534, 537 (Idaho Ct. App. 1990); *Alsbrook v. Nat'l Travelers Life Ins. Co.*, 852 P.2d 768, 770 (Okla. Ct. App. 1992). The focus is upon the actual knowledge of the insurance company that its conduct was unreasonable or whether the company should have known that it was acting unreasonably. See, e.g., *Galusha v. Farmers Ins. Exch.*, 844 F. Supp. 1401, 1404 (D. Colo. 1994); *Turner v. State Farm Fire & Cas. Co.*, 614 So. 2d 1029, 1032 (Ala. 1993); *Ness v. W. Sec. Life Ins. Co.*, 851 P.2d 122, 125 (Ariz. Ct. App. 1992); *Brown v. Liberty Mut. Ins. Co.*, 513 N.W.2d 762, 763 (Iowa 1994); *Weatherly v. Blue Cross Blue Shield Ins. Co.*, 513 N.W.2d 347, 354 (Neb. Ct. App. 1994); *Transp. Ins. Co. v. Moriel*, 879 S.W.2d 10, 18 (Tex. 1994).

<sup>21</sup> *Trus Joist*, 735 P.2d at 134.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.* (citation omitted). Thus, mere negligence or inadvertence is insufficient to establish the cause of action. *Rawlings v. Apodaca*, 726 P.2d 565, 576 (Ariz. 1986). The court in *Rawlings* observed:

Insurance companies, like other enterprises and all human beings, are far from perfect. Papers get lost, telephone messages misplaced and claims ignored because paper-work was misfiled or improperly processed. Such isolated mischances may result in a claim being unpaid or delayed. None of these mistakes will ordinarily constitute a breach of the implied covenant of good faith and fair dealing, even though the company may render itself liable for at least nominal damages for breach of contract in failing to pay the claim.

*Id.* at 573.

<sup>24</sup> *Noble v. Nat'l Am. Life Ins. Co.*, 624 P.2d 866, 867 (Ariz. 1981); *Anderson v. Cont'l Ins. Co.*, 271 N.W.2d 368 (Wis. 1978).



permitted, however, to challenge claims that are “fairly debatable.”<sup>25</sup> An examination of the circumstances surrounding the claim presentation should be made.<sup>26</sup> A claim is typically “fairly debatable” where there remain unanswered material questions involving law or fact that provide an explanation for the insurance company’s delay or refusal to pay a claim.<sup>27</sup> The presence of a legitimate coverage defense to a claim submission may preclude bad faith.<sup>28</sup> Claims may be denied on the basis of a “fairly debatable” policy interpretation,

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<sup>25</sup> *Jordan v. Union Ins. Co.*, 771 F. Supp. 1031, 1033 (D.S.D. 1991) (stating that insurer is entitled to challenge fairly debatable claims); *Dirks v. Farm Bureau Mut. Ins. Co.*, 465 N.W.2d 857, 861 (Iowa 1991) (same); *see also* *Ward v. Fireman’s Fund Ins. Cos.*, 731 P.2d 106 (Ariz. Ct. App. 1986). Numerous courts have articulated a “fairly debatable” standard in insurance bad-faith cases. *See, e.g.*, *Davis v. Cotton States Mut. Ins. Co.*, 604 So. 2d 354, 358 (Ala. 1982); *Deese v. State Farm Mut. Auto. Ins. Co.*, 838 P.2d 1265, 1268 (Ariz. 1992); *Garnett v. Transamerica Ins. Servs.*, 800 P.2d 656, 666 (Idaho 1990); *Nassen v. Nat’l State Ins. Co.*, 494 N.W.2d 231, 236 (Iowa 1992), *cert. denied*, 507 U.S. 1031 (1993); *Pickett v. Lloyds of London*, 621 A.2d 445, 453 (N.J. 1993); *Tokles & Son, Inc. v. Midwestern Indem. Co.*, 605 N.E.2d 936, 943 (Ohio 1992); *Bartlett v. John Hancock Mut. Life Ins. Co.*, 538 A.2d 997, 1000 (R.I. 1988); *In re Certification of a Question of Law from the U.S. Dist. Court of S.D., W. Div. (Champion v. U.S. Fid. & Guar. Co.)*, 399 N.W.2d 320, 324 (S.D. 1987); *Newhouse v. Citizens Sec. Mut. Ins. Co.*, 501 N.W.2d 1, 5-6 (Wis. 1993); *First Wyo. Bank, N.A. v. Cont’l Ins. Co.*, 860 P.2d 1094, 1101 (Wyo. 1993).

Courts have differed in defining and interpreting “fair debatability.” As an example, the Alabama Supreme Court in *National Savings Life Insurance Co. v. Dutton*, 419 So. 2d 1357 (Ala. 1982), found that where there is a genuine issue of law with respect to the insurance company’s denial of a claim, which precluded a directed verdict for the insured, the insurance company was entitled to a directed verdict on the issue of bad faith. However, the *Dutton* rule, which gave rise to the so-called directed verdict test of bad faith, has been rejected by other courts. *See, e.g.*, *Bilden v. United Equitable Ins. Co.*, 921 F.2d 822, 829 (8th Cir. 1990) (interpreting North Dakota Law); *Linthicum v. Nationwide Life Ins. Co.*, 723 P.2d 703, 711-12 (Ariz. Ct. App. 1985), *aff’d in part and rev’d in part*, 723 P.2d 675 (Ariz. 1986).

<sup>26</sup> *Forcucci v. U.S. Fid. & Guar. Co.*, 11 F.3d 1, 2 (1st Cir. 1993).

Courts have differed regarding the point in time that becomes relevant for purposes of assessing whether the insurance company had reasonable grounds for denying the claim. A significant number of courts have stated that they will only consider evidence available to the insurance company at the time of the denial. *See, e.g.*, *Aetna Life Ins. Co. v. Lavoie*, 505 So. 2d 1050, 1053 (Ala. 1987). However, some courts inquire as to whether the insurance company had a fairly debatable reason for denying the claim based on the facts presented at trial. *See, e.g.*, *Mass. Bay Ins. Co. v. Hall*, 395 S.E.2d 851, 857 (Ga. Ct. App. 1990). One commentator has opined that insurance companies should not be permitted to meet the standards by putting forth grounds recognized after the denial of a claim. *See* Chris M. Kallianos, Survey, *Bad Faith Refusal to Pay First-Party Insurance Claims: A Growing Recognition of Extra-Contract Damages*, 64 N.C. L. REV. 1421, 1435 (1986).

<sup>27</sup> *See* *Larson v. Allstate Ins. Co.*, 857 P.2d 263, 266 (Utah Ct. App.) (stating that questions of law and fact can make a claim fairly debatable), *cert. denied*, 862 P.2d 1356 (Utah 1993).

<sup>28</sup> *First Dakota Nat’l Bank v. St. Paul Fire & Marine Ins. Co.*, 2 F.3d 801, 811-12 (8th Cir. 1993).

even though that interpretation ultimately may be rejected by the courts.<sup>29</sup> Insurance companies may litigate issues of first impression<sup>30</sup> by filing a declaratory judgment action without being exposed to bad faith.<sup>31</sup> If the insurer learns that the legal authority previously relied upon does not continue to support its coverage position, however, it may be required to change its position promptly and resolve the claim.<sup>32</sup>

Insurance companies cannot employ deceptive practices or make deliberate misrepresentations to avoid paying claims.<sup>33</sup> They cannot deliberately misinterpret records or policy language to avoid coverage.<sup>34</sup> Instead, insurance companies must perform an adequate investigation in determining the claim, or else risk bad-faith liability arising from an improper claim denial.<sup>35</sup> They must avoid unreasonable delay in resolving a claim.<sup>36</sup> Insurance companies must litigate the claim if litigation is required to resolve a coverage dispute.<sup>37</sup>

The linchpin of the tort of bad faith is the “covenant of good

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<sup>29</sup> See *Mills v. Regent Ins. Co.*, 449 N.W.2d 294, 297 (Wis. Ct. App. 1989), *review denied*, 451 N.W.2d 297 (Wis. 1990). Where open legal questions remain, an insurance company may be insulated from bad faith. See *Aceves v. Allstate Ins. Co.*, 827 F. Supp. 1473, 1484 (S.D. Cal. 1993); *Frost v. Liberty Mut. Ins. Co.*, 828 S.W.2d 915, 920 (Mo. Ct. App. 1992); *J.H. France Refractories Co. v. Allstate Ins. Co.*, 626 A.2d 502, 510 (Pa. 1993).

<sup>30</sup> See, e.g., *First Fin. Ins. Co. v. Rainey*, 401 S.E.2d 490, 491-92 (Ga. 1991); *Armacost v. State Farm Mut. Auto. Ins. Co.*, 644 P.2d 403, 405-06 (Kan. 1982); *Pressman v. Aetna Cas. & Sur. Co.*, 574 A.2d 757, 758-60 (R.I. 1990); *Cuna Mut. Ins. Soc’y v. Norman*, 375 S.E.2d 724, 725-27 (Va. 1989).

<sup>31</sup> *Wierck v. Grinnel Mut. Reins. Co.*, 456 N.W.2d 191, 194 (Iowa 1990); *Ballinger v. Sec. Conn. Life Ins. Co.*, 862 P.2d 68, 70 (Okla. 1993). An insurance company is not in bad faith for litigating an issue of first impression.

<sup>32</sup> See, e.g., *Harrington v. Guar. Nat’l Ins. Co.*, 628 So. 2d 323, 326-27 (Ala. 1993).

<sup>33</sup> See, e.g., *Indep. Life & Accident Ins. Co. v. Peavy*, 528 So. 2d 1112, 1114 (Miss. 1988); *Banker’s Life & Cas. Co. v. Crenshaw*, 483 So. 2d 254, 270-73 (Miss. 1985), *aff’d*, 486 U.S. 71 (1988); *Timmons v. Royal Globe Ins. Co.*, 653 P.2d 907, 910-11 (Okla. 1982); *State Farm Fire & Cas. Co. v. Gros*, 818 S.W.2d 908, 912-13 (Tex. App. 1991); *Hampton v. State Farm Mut. Auto. Ins. Co.*, 778 S.W.2d 476, 479 (Tex. App. 1989).

<sup>34</sup> See, e.g., *Hall v. Svea Mut. Ins. Co.*, 493 N.E.2d 1102, 1104-05 (Ill. App. Ct. 1986).

<sup>35</sup> See, e.g., *Standard Plan, Inc. v. Tucker*, 582 So. 2d 1024, 1030-32 (Ala. 1991); *Morgan v. Golden Rule Ins. Co.*, 568 So. 2d 184, 188-89 (La. Ct. App. 1990); *Indus. Indem. Co. of the Northwest, Inc. v. Kallevig*, 792 P.2d 520, 526-28 (Wash. 1990).

<sup>36</sup> See, e.g., *Filaski v. Preferred Risk Mut. Ins. Co.*, 734 P.2d 76, 83 (Ariz. 1987) (noting that there were months of delay which included “such dilatory tactics as not returning insured’s phone calls, ignoring her pleas for personal assistance in completing forms, repeating requests which the insured had already complied with, and rejecting her claims but providing no reason for doing so”).

<sup>37</sup> See *White v. W. Title Ins. Co.*, 710 P.2d 309, 316-17 (Cal. 1985).

faith and fair dealing,” which is implied by law and imputed into all insurance policies.<sup>38</sup> The implied covenant of good faith and fair dealing is often expressed as a promise implied in all contracts “that neither party will do anything which will injure the right of the other to receive the benefits of the agreement.”<sup>39</sup> A primary benefit flowing from the insurance company’s express agreement to protect its insured from covered calamities “is the insured’s expectation that his insurance company will not wrongfully deprive him of the very security for which he bargained or expose him to the catastrophe from which he sought protection.”<sup>40</sup>

A breach of the covenant of good faith and fair dealing can occur notwithstanding the insurance company’s payment of full policy benefits due on a particular claim.<sup>41</sup> The focus of the inquiry is

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<sup>38</sup> See *Kan. Bankers Sur. Co. v. Lynass*, 920 F.2d 546, 548 (8th Cir. 1990); *State Farm Mut. Auto. Ins. Co. v. Weiford*, 831 P.2d 1264, 1266 (Alaska 1992); *Walter v. Simmons*, 818 P.2d 214, 223 (Ariz. Ct. App. 1991); *Pemberton v. Farmers Ins. Exch.*, 858 P.2d 380, 382 (Nev. 1993); *Pavia v. State Farm Mut. Auto. Ins. Co.*, 626 N.E.2d 24, 27 (N.Y. 1993); *Austin Co. v. Royal Ins. Co.*, 842 S.W.2d 608, 610 (Tenn. Ct. App. 1992). The implied covenant of good faith and fair dealing can be traced back as far as the late nineteenth century. See *Germania Ins. Co. v. Redwig*, 80 Ky. 223, 235 (1882); see also *Brassil v. Md. Cas. Co.*, 104 N.E. 622, 624 (N.Y. 1914); Neal A. Goldberg et al., *Can the Puzzle Be Solved: Are Punitive Damages Awardable in New York for First Party Bad Faith?*, 44 SYRACUSE L. REV. 723, 727 (1993). The implied covenant of good faith and fair dealing is an outgrowth of society’s promotion of reliance on contracts, and fairness and reasonableness in contractual relationships, which has formed the public policy of a particular state. See *Koehrer v. Superior Court*, 226 Cal. Rptr. 820, 828 (Ct. App. 1986).

<sup>39</sup> *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 200 (Cal. 1958); see also *Wagonseller v. Scottsdale Mem’l Hosp.*, 710 P.2d 1025, 1038 (Ariz. 1985).

A few courts have described the duties that an insurance company owes its insured as those of a fiduciary. See, e.g., *Frommoethelydo v. Fire Ins. Exch.*, 721 P.2d 41, 44 (Cal. 1986) (stating that because insurance companies hold themselves out as such, they are fiduciaries); *Bonke v. Mukwonago-Vernon Mut. Ins. Co.*, 329 N.W.2d 243, 248 (Wis. Ct. App. 1982) (declaring that insurance companies have “a fiduciary duty to act on behalf of” their insureds as if their own interests were at stake). Other courts, however, have characterized the relationship as confidential and have imposed quasi-fiduciary duties on the insurance company. Typically, courts have prescribed an obligation which describes the duty as “fiduciary in nature.” See *Hassard, Bonnington, Roger & Huber v. Home Ins. Co.*, 740 F. Supp. 789, 792 (S.D. Cal. 1990) (“[T]he relationship between an insurer and an insured has many of the elements of a fiduciary relationship, but is not an actual fiduciary relationship.”); *Love v. Fire Ins. Exch.*, 271 Cal. Rptr. 246, 251-52 (Ct. App. 1990) (stating that an insurance company’s obligation is “akin to fiduciary-type responsibilities”); *Tynes v. Bankers Life Co.*, 730 P.2d 1115, 1125-26 (Mont. 1986). But see *William T. Baker et al., Is an Insurer a Fiduciary to Its Insureds?*, 25 TORT & INS. L.J. 1, 1-2 (1989) (arguing that insurance companies are not fiduciaries).

<sup>40</sup> *Rawlings*, 726 P.2d at 571.

<sup>41</sup> The Arizona Supreme Court has observed:

Failure to perform the express covenant to pay the claim is not the *sine*

not whether a specific express provision of the insurance policy has been breached by the insurer, but instead, whether the company's conduct damaged "the very protection or security which the insured sought to gain by buying insurance."<sup>42</sup> When conduct is found to be designed to deprive the policyholder of the benefits of the contract, bad faith may exist, notwithstanding mere technical compliance with the literal terms of the contract, because the remedies available may be insufficient, undermining public policy.<sup>43</sup> Courts differ on whether a breach of the covenant can be sustained in the absence of specific coverage.<sup>44</sup>

Insurance bad-faith actions are generally classified as either first- or third-party claims. This classification is based upon the type of insurance coverage provided by the policy in question. Where the insurance company contracts to pay benefits directly to the insured, a first-party coverage situation arises. Examples of first-party coverage include health and accident, life, disability, homeowner's, fire, title, and property damage insurance. In contrast, when the insurance

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*qua non* for an action for breach of the implied covenant of good faith and fair dealing. To characterize the cases otherwise, would, in effect, construe them to hold that any breach of the express covenant would give rise to the tort action for bad faith. We hold explicitly that such a result is not permitted. Not every breach of an express covenant in an insurance contract is a breach of the covenant of good faith and fair dealing.

*Id.* at 573.

<sup>42</sup> *Id.* Compare Paul E.B. Glad et al., *Bad Faith Liability in the Absence of Coverage?*, 7 BAD FAITH L. REP. 1 (1991) (arguing that no bad-faith liability can exist absent coverage except in extraordinary cases), with Stephan S. Ashley, *Bad Faith Liability in the Absence of Coverage: A Response*, 7 BAD FAITH L. REP. 6 (1991) (explaining that "the law does not preclude bad faith in the absence of coverage").

<sup>43</sup> See, e.g., *St. Benedict's Dev. Co. v. St. Benedict's Hosp.*, 811 P.2d 194, 198-200 (Utah 1991). One court has observed that tort liability in this context requires more than the intent to breach the contract or the intent to deprive the policyholder of benefits. See, e.g., *Metro. Life Ins. Co. v. Noble Lowndes Int'l, Inc.*, 600 N.Y.S.2d 212, 214-15 (App. Div. 1993). Several jurisdictions have rejected tort-based remedies for breach of the implied covenant of good faith and fair dealing. These jurisdictions have allowed recovery of consequential economic damages for breach of contract by the insurance company. See, e.g., *Marquis v. Farm Family Mut. Ins. Co.*, 628 A.2d 644, 650-52 (Me. 1993); *Lawton v. Great Southwest Fire Ins. Co.*, 392 A.2d 576, 579-81 (N.H. 1978); see also *Olson v. Rugloski*, 277 N.W.2d 385, 387-88 (Minn. 1979). Other jurisdictions have substantially blurred the tort-contract distinction in the area of consequential damages. See, e.g., *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951, 957 (7th Cir.), *cert denied*, 459 U.S. 1017 (1982).

<sup>44</sup> Compare *Harbor Ins. Co. v. Urban Constr. Co.*, 990 F.2d 195, 202 (5th Cir. 1993) (holding that absence of coverage, alone, did not preclude recovery for breach of the implied covenant), with *McMillan Scripts N. P'ship v. Royal Ins. Co. of Am.*, 23 Cal. Rptr. 2d 243, 247 (Ct. App. 1993) (holding that where no loss covered by policy occurred, there was no breach of the implied covenant).

company contracts to indemnify the insured against liability to third parties, a third-party coverage situation exists. The type of claim is not determined by the identity of the party bringing the bad-faith action against the insurance company. For example, a third-party action might be brought by the insured in the event that he or she is subjected to excess liability by reason of the insurance company's bad-faith refusal to settle. In that event, the standards applicable to third-party claims would govern the action, although it was brought by the insured, rather than a third-party assignee.

Both first- and third-party bad-faith claims derive from the same duty—the duty of good faith and fair dealing. The two actions, however, involve different factual circumstances and distinct considerations for the insurance company. Ordinarily, a first-party claim involves a coverage dispute between the insurance company and its insured. In this situation the insurance company must not act in bad faith to thwart the insured's reasonable expectations for coverage under the policy. First-party claims do not involve the insurance company in defending a legal action brought by a third party that could result in financial ruin of the insured.

A third-party claim, by comparison, includes the additional risk of subjecting the insured to liability in excess of the policy limits because of the insurance company's bad-faith refusal to settle within those limits. Typically, the insurance company has exclusive authority to accept or reject settlement offers and takes on the additional responsibility of defending the claim.<sup>45</sup> The duty to accept reasonable settlements in third-party situations and the duty not to withhold payment of first-party claims “are merely two different aspects of the same duty.”<sup>46</sup>

Because the risk to the insured and the responsibilities of the

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<sup>45</sup> Kallianos, *supra* note 26, at 1429. The differences between first-party and third-party coverage are significant enough that some jurisdictions refuse to recognize first-party actions while allowing third-party actions. *See, e.g.*, *Spencer v. Aetna Life & Cas. Ins. Co.*, 611 P.2d 149, 155-58 (Kan. 1980); *Lawton*, 392 A.2d at 580-81. The Supreme Court of New Hampshire noted:

The dilemma presented by the absolute control of trial and settlement vested in the insurer by the insurance contract and the conflicting interests of the insurer and insured in the third-party claim requires that the insurer recognize the conflict and give due regard to the interest of the insured. This dilemma is lacking in the first-party claim. The insurer is not in a position to expose the insured to a judgment in excess of the policy limits through its unreasonable refusal to settle a case, nor is it in a position to otherwise injure the insured by virtue of its exclusive control over the defense of the case.

*Id.* at 581 (internal quotation marks and citation omitted).

<sup>46</sup> *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032, 1037 (Cal. 1973).

insurance company are distinguishable in first- and third-party claims, the applicable standard of conduct is necessarily different. In the first-party situation, the insurance company breaches the implied duty of good faith and fair dealing if it (1) acts unreasonably towards its insured, and (2) acts knowingly or with reckless disregard as to the reasonableness of its actions. Under this standard, an insurance company can challenge a claim that is “fairly debatable.” In third-party cases, determining whether the insurance company has acted in bad faith by refusing to settle a claim brought by a third party requires an equal consideration of the comparative hazards. This standard of reasonableness requires that the insurance company consider various factors,<sup>47</sup> one of which is the relative strength of the claim by the third party against the insured. Although the debatability of the claim may be an issue as to liability and damages, it is not determinative. The insurance company must also weigh other considerations, such as the financial risk to the insured in the event of a judgment in excess of the policy limits.<sup>48</sup> The test for determining whether the insurer has appropriately considered the interests of the insured is “whether a prudent insurer without policy limits would have accepted the settlement offer.”<sup>49</sup> In third-party situations, the insured bears a disproportionate share of the risk if the insurance company, in exercising its exclusive control over settlement, fails to accept a reasonable settlement offer within policy limits. The insured faces personal liability for an award exceeding the policy limits, while the insurance company’s potential liability remains constant—it cannot exceed the policy limits.<sup>50</sup>

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<sup>47</sup> The Arizona Supreme Court, in *General Accident Fire & Life Assurance Corp. v. Little*, 443 P.2d 690 (Ariz. 1968), delineated several factors to be considered by the court in assessing whether the insurance company has treated the insured’s interest with an equality of consideration:

[1] the strength of the injured claimant’s case on the issues of liability and damages; [2] attempts by the insurer to induce the insured to contribute to a settlement; [3] failure of the insurer to properly investigate the circumstances so as to ascertain the evidence against the insured; [4] the insurer’s rejection of advice of its own attorney or agent; [5] failure of the insurer to inform the insured of a compromise offer; [6] [t]he amount of financial risk to which each party is exposed in the event of a refusal to settle; [7] the fault of the insured in inducing the insurer’s rejection of the compromise offer by misleading it as to the facts; and [8] any other factors tending to establish or negate bad faith on the part of the insurer.

*Id.* at 694 (internal quotation marks omitted) (quoting *Brown v. Guar. Ins. Co.*, 319 P.2d 69, 75 (Cal. Dist. Ct. App. 1958)).

<sup>48</sup> *Id.*

<sup>49</sup> *Crisci v. Sec. Ins. Co.*, 426 P.2d 173, 176 (Cal. 1967).

<sup>50</sup> The court in *In re Allstate Insurance Co.*, 722 S.W.2d 947 (Mo. 1987), has

## III. ATTORNEY-CLIENT PRIVILEGE AND INSURER BAD FAITH

A. *General Overview of the Privilege*

The attorney-client privilege protects communications between the attorney and the client.<sup>51</sup> The purpose of the attorney-client

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delineated the context in which litigation decisions are made and how these create a vulnerability with regard to the insured:

The insurer has the contract right to direct the litigation. . . . It may evaluate claims and decide whether to settle. . . . It may make economic decisions without the assent of the insured. The insured may want a quick settlement to eliminate further demands on time and energy, but the insurer does not have to settle unless a satisfactory offer is forthcoming. Or the insurer may accept a settlement offer even though the insured wants to go to trial to establish freedom from fault. The insurer may decide what to spend in defense, what discovery is to be had, and what experts to hire. It also has the right to select counsel to defend its interests.

*Id.* at 952. The vulnerability of the insured which arises through the insurance company's control of the defense is exemplified by several cases. *See, e.g.*, *Betts v. Allstate Ins. Co.*, 201 Cal. Rptr. 528, 546 (Ct. App. 1984) (noting that insurance company's appointed defense attorney took advantage of the insured by "actively working to protect [the insurance company] and persisting in manipulating [the insured] against her own best interests"); *Rosenzweig v. Blimshteyn*, 544 N.Y.S.2d 865, 867 (App. Div. 1989) (defense counsel appointed by the insurance carrier adopted a defense to avoid the payment of any monies by the insurance company, regardless of the consequences to the insureds who were his "ostensible clients").

<sup>51</sup> *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981). The traditional elements of the attorney-client privilege that identify communications that may be protected from disclosure and discovery are:

- (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 or a court, or his or her subordinate, and (b) in connection with this 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 of law or (ii) legal services or (iii) assistance in some legal proceeding, and (d) not for the purpose of committing a crime or tort; and
- (4) the privilege has been (a) claimed and (b) not waived by the client.

*In re Grand Jury Investigation*, 599 F.2d 1224, 1233 (3d Cir. 1979) (citing *United States v. United Shoe Mach. Corp.*, 89 F. Supp. 357, 358-59 (D. Mass. 1950)). The attorney-client privilege has been extended to third-party agents of a client or its counsel under certain circumstances. *See, e.g.*, *United States v. Kovel*, 296 F.2d 918, 922 (2d Cir. 1961). Under *Kovel*, "voluntarily disclosing the information contained in the [privileged] documents to nonparties waives the attorney-client privilege, unless such disclosure was 'necessary, or at least highly useful, for the effective consultation between the client and the lawyer which the privilege is designed to permit.'" *Strougo v. BEA Assocs.*, 199 F.R.D. 515, 522 (S.D.N.Y. 2001) (quoting *Kovel*, 296 F.2d at 922). Based on these principles, courts following *Kovel* have applied a two-step analysis in evaluating whether the attorney-client privilege should be extended to third-party agents. This analysis focuses upon: (1) whether the inclusion

privilege is to promote “full and frank communication between attorneys and their clients.”<sup>52</sup> There are two broad justifications that underlie the privilege. The first justification is that the privilege promotes disclosure of all relevant information by the client to enable the attorney to effectively represent the client or to give adequate legal advice.<sup>53</sup> Without the privilege it is presumed that many clients would not communicate all relevant information to the attorney if adverse parties could use it against them in subsequent litigation. The second justification is that an attorney must be able to openly communicate legal advice and strategies to the client in order to adequately represent him or her, and that the attorney would not engage in such communications if adverse litigants could discover them in subsequent litigation.<sup>54</sup> Because “sound legal advice or advocacy serves public ends,”<sup>55</sup> the privilege is necessary to promote

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of the third-party agent in the otherwise privileged communications occurs under circumstances reflecting the parties’ reasonable expectation that the confidentiality of the communications will be maintained, and (2) whether disclosure of the otherwise privileged communications to the third-party agent is necessary in order for the client to obtain appropriately informed legal advice. *See generally* United States v. Ackert, 169 F.3d 136, 139-40 (2d Cir. 1999); Constr. Indus. Servs. Corp. v. Hanover Ins. Co., 206 F.R.D. 43, 47-48 (S.D.N.Y. 2001); *In re Pfohl Bros. Landfill Litig.*, 175 F.R.D. 13, 23-24 (W.D.N.Y. 1997); People v. Osorio, 549 N.E.2d 1183, 1185-86 (N.Y. 1989); Doe v. Poe, 664 N.Y.S.2d 120, 122 (N.Y. 1989). In extending the scope of the privilege, implicitly or explicitly, the courts have found the disclosure of the otherwise privileged communications to the third-party agent to be “necessary” to the client’s ability to seek and receive effective legal advice from counsel, and have found that the third-party agent was essentially fulfilling a role functionally equivalent to that of an integral employee of the client. *See, e.g.*, Fed. Trade Comm’n v. GlaxoSmithKline, 294 F.3d 141, 147-48 (D.C. Cir. 2002); *In re Bieter Co.*, 16 F.3d 929, 938 (8th Cir. 1997); *In re Copper Mkt. Antitrust Litig.*, 200 F.R.D. 213, 215, 219 (S.D.N.Y. 2001).

<sup>52</sup> *Upjohn*, 499 U.S. at 389.

<sup>53</sup> *Id.* (citing Trammel v. United States, 445 U.S. 40, 51 (1980)).

<sup>54</sup> *Id.*

<sup>55</sup> *Id.* Despite the beneficial nature of the attorney-client privilege, some courts have adopted a strict interpretation to limit its scope. *See, e.g.*, Cameron v. Gen. Motors Corp., 158 F.R.D. 581, 586 (D.S.C. 1994), *vacated in part on other grounds sub nom. In re Gen. Motors Corp.*, Case No. 94-2435, 1995 WL 940063 (4th Cir. Feb. 17, 1995). In *Cameron*, a non-insurance case, the district court recognized the limited nature of the attorney-client privilege and the strict construction and limitations governing its application: “Because the attorney-client privilege is an exception from the otherwise liberal construction of discovery rules, its use is not favored by federal courts. Therefore, assertions of attorney-client privilege are to be strictly confined within the narrowest possible limits consistent with the logic of its principal.” *Cameron*, 158 F.R.D. at 586 (internal quotation marks and citations omitted); *see also* Grand Jury Proceedings Under Seal v. United States, 947 F.2d 1188, 1190 (4th Cir. 1991) (“[T]he [attorney-client] privilege must be narrowly construed.”); United States v. Tedder, 801 F.2d 1437, 1441 (4th Cir. 1986), *cert. denied*, 480 U.S. 938 (1987); *In re Grand Jury Investigation*, 599 F.2d at 1235; NLRB v. Harvey, 349 F.2d 900,



full and unrestricted communication within the attorney-client relationship.

Courts must work to apply the privilege in ways that are predictable and certain in order to serve the interests of justice by encouraging consultation with counsel free from the apprehension of disclosure. “An uncertain privilege—or one which purports to be certain, but results in widely varying applications by the courts—is little better than no privilege.”<sup>56</sup> Thus, uncertainty regarding the scope of the attorney-client privilege may have an adverse impact. If uncertainty remains, attorneys and their clients will be forced to assume that private communications will be subject to discovery, essentially eliminating the privilege.<sup>57</sup>

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906 (4th Cir. 1965).

Evidentiary privileges are an exception to the general rule that relevant evidence is admissible. Privileges forbid the admission of otherwise relevant evidence when certain interests the privileges are thought to protect are regarded as more important than the interests served by the resolution of litigation based on full disclosure of all relevant facts. However, the privilege forbidding the discovery of admission of evidence relating to communications between attorney and client is intended to insure that a client remains free from apprehension that consultations with a legal advisor will be disclosed. *See* *Hunt v. Blackburn*, 128 U.S. 464, 470 (1888). The attorney-client privilege encourages the client to reveal to the lawyer confidences necessary for the lawyer to provide advice and representation. *See* MCCORMICK ON EVIDENCE § 87, at 205 (Edward W. Cleary ed., 3d ed. 1984) (stating that lawyers “can act effectively only if they are fully advised of the facts by the parties whom they represent”). Because the privilege serves the interests of justice, courts have observed that it is worthy of maximum protection. *Haines v. Liggett Group, Inc.*, 975 F.2d 81, 90 (3d Cir. 1992). Courts and commentators have supported the privilege:

As long as our society recognizes that advice as to matters relating to the law should be given by persons trained in the law – that is, by lawyers – anything that materially interferes with that relationship must be restricted or eliminated, and anything that fosters the success of that relationship must be retained and strengthened. The relationship and the continued existence of the giving of legal advice by persons accurately and effectively trained in the law is of greater societal value, it is submitted, than the admissibility of a given piece of evidence in a particular lawsuit. Contrary to the implied assertions of the evidence authorities, the heavens will not fall if all relevant and competent evidence cannot be admitted.

*State ex rel. Great Am. Ins. Co. v. Smith*, 574 S.W.2d 379, 383 (Mo. 1978) (quoting Robert Allen Sedler & Joseph J. Simeone, *Privileges in the Law of Evidence: The Realities of Attorney-Client Confidences*, 24 OHIO ST. L.J. 1, 3 (1963)).

<sup>56</sup> *In re Von Bulow*, 828 F.2d 94, 100 (2d Cir. 1987).

<sup>57</sup> *State Farm Mut. Auto. Ins. Co. v. Lee*, 13 P.3d 1169, 1187 (Ariz. 2000) (McGregor, J., dissenting).

B. *Commonly Recognized Exceptions to the Privilege and Their Application to Bad-Faith Cases*

There are three principal exceptions to the attorney-client privilege. The first exception pertains to crimes and fraud.<sup>58</sup> Here, the attorney-client privilege is vitiated when the client seeks the services of the lawyer to commit a crime or fraud.<sup>59</sup> Courts have generally found that mere allegations of insurance company bad faith do not give rise to the crimes or fraud exception.<sup>60</sup> As an example, in

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<sup>58</sup> This exception addresses the perpetuation of crimes or other evil enterprises that are pursued by a client in concert with his attorney. *See, e.g.*, *United Servs. Auto. Ass'n v. Werley*, 526 P.2d 28, 31 (Alaska 1974). Upon a *prima facie* showing of fraud, the attorney-client privilege is defeated. *Id.* at 32. "Although the fraud or crime must have been contemplated by the client at the time of the communication, it is irrelevant whether the attorney was aware of the client's purpose." *Munn v. Bristol Day Hous. Auth.*, 777 P.2d 188, 195 (Alaska 1989) (citations omitted); *see also In re Grand Jury Proceedings*, 183 F.3d 71, 75-76 (1st Cir. 1999) (explaining that attorney-client privilege is vitiated when the client seeks the services of the lawyer and uses the lawyer to commit a crime or a fraud). The attorney need not be aware of the client's fraud for the exception to apply. *Caldwell v. Dist. Court*, 644 P.2d 26, 33-34 (Colo. 1982).

Some jurisdictions have codified the crime or fraud exception. *See, e.g.*, OR. EVID. CODE § 503(4)(a) (2003) (providing that attorney-client privilege does not apply "[i]f the services of the lawyer were sought or obtained to enable or aid anyone to commit or plan to commit what the client knew or reasonably should have known to be a crime or fraud"). Kansas, like Oregon, has also codified the exception. *See* KAN. STAT. ANN. § 60-426(d)(1) (2003). In Kansas the exception applies where communications for legal services are sought in order to enable or aid in the commission or planning of the commission of a crime or tort. *See Fairport Int'l Exploration, Inc. v. Shipwrecked Vessel*, 177 F.3d 491, 501 (D. Kan. 1997); *see also United States v. Anderson*, 85 F. Supp. 2d 1047 (D. Kan. 1999).

<sup>59</sup> *In re Grand Jury Proceedings*, 183 F.3d at 75-76.

<sup>60</sup> *Cf. Freedom Trust v. Chubb Group of Ins. Cos.*, 38 F. Supp. 2d 1170, 1174 (C.D. Cal. 1999) (applying California law) (stating that exception was not triggered merely upon a *prima facie* showing of bad faith); *Gagne v. Ralph Pill Elec. Supply Co.*, 114 F.R.D. 22, 25 (D. Me. 1987) (holding that a person seeking discovery in bad-faith case must present *prima facie* evidence of fraud before materials sought will become discoverable pursuant to the crime or fraud exception); *Riggs v. Schroering*, 822 S.W.2d 414, 415 (Ky. 1991) (finding attorney-client privilege not breached by mere allegation of bad faith); *Levin v. C.O.M.B. Co.*, 469 N.W.2d 512, 515 (Minn. Ct. App. 1991) (while recognizing the crime or fraud exception, noting that "[m]ere allegations of wrongdoing are insufficient to warrant application of the exception").

A significant number of courts in bad-faith actions have found that once a *prima facie* case or bad-faith refusal to pay has been established, the attorney-client privilege between an insurance company and its attorneys is abrogated. *See Silva v. Fire Ins. Exch.*, 112 F.R.D. 699, 700 (D. Mont. 1996); *In re Bergeson*, 112 F.R.D. 692, 697-98 (D. Mont. 1986); *Escalante v. Sentry Ins. Co.*, 743 P.2d 832, 842-43 (Wash. Ct. App. 1987). The court in *Werley*, 526 P.2d 28, held that where the attorney is involved in a bad-faith attempt to defeat or reduce coverage, the invocation of the attorney-client privilege in such bad-faith dealings would be inappropriate. *Id.* at 33. Such conduct constitutes "civil fraud." *Id.* *See generally* BARRY R. OSTRAGER & THOMAS R. NEWMAN,

*Guaranty National Insurance Co. v. George*,<sup>61</sup> the insured sought the production of an opinion letter written by counsel for the insurance company. The Kentucky Court of Appeals concluded that the opinion letter was protected by the attorney-client privilege and was, therefore, not discoverable “in the absence of any evidence indicating the contemplation of a tortious act on behalf of [the insurance company].”<sup>62</sup> The court stated, “To develop an exception in bad faith cases against insurers would impede the free flow of information and honest evaluation of claims. In the absence of fraud or criminal activity, an insurer is entitled to the attorney-client privilege to the same extent as other litigants.”<sup>63</sup>

The Washington Court of Appeals, in *Escalante v. Sentry Insurance Co.*,<sup>64</sup> provided some further guidance in this area. In cases of alleged insurer bad faith, the court held that the attorney-client privilege does not apply when the documents sought to be protected “pertain to ongoing or future fraudulent conduct by the insurer.”<sup>65</sup> In extending the civil fraud exception to the attorney-client privilege to cases implicating insurance company misconduct, the court in *Escalante* established a two-part test to determine whether fraudulent conduct by the insurance company occurred, and whether that conduct was sufficient to overcome the privilege.<sup>66</sup> First, the trial court must determine whether there was “a factual showing adequate to support a good faith belief by a reasonable person that wrongful conduct sufficient to invoke the . . . fraud exception . . . has occurred.”<sup>67</sup> Second, if the trial court finds the requisite factual showing has been made, the requested documents are subjected to an *in camera* inspection, at the trial court’s discretion, to determine whether there is a “foundation in fact” to overcome the privilege

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HANDBOOK ON INSURANCE COVERAGE DISPUTES § 10.11 (4th ed. 1991).

<sup>61</sup> 953 S.W.2d 946 (Ky. 1997).

<sup>62</sup> *Id.* at 948.

<sup>63</sup> *Id.* (quoting the Kentucky Court of Appeals); *see also* State *ex rel.* United States Fid. & Guar. Co. v. Mont. Secondary Judicial Court, 783 P.2d 911, 916 (Mont. 1989) (“An insurance company must have an honest and candid evaluation of the case, possibly including a ‘worse case scenario.’ A concern by the attorney that communications would be discoverable in a [third-party] bad faith suit would certainly chill open and honest communication . . . . It could also impede settlements.”).

<sup>64</sup> 743 P.2d 832 (Wash. Ct. App. 1987), *review denied*, 109 Wash. 2d 1025 (1988).

<sup>65</sup> *Id.* at 842.

<sup>66</sup> *Id.* at 843.

<sup>67</sup> *Id.* at 842-43 (internal quotation marks omitted) (quoting *Caldwell*, 644 P.2d at 33).

based upon civil fraud.<sup>68</sup>

The second exception to the attorney-client privilege encompasses the legal capacity doctrine: the nature of the work

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<sup>68</sup> *Escalante*, 743 P.2d at 842. The *Escalante* civil fraud exception test was applied by the court in *Barry v. USAA*, 989 P.2d 1172, 1176 (Wash. Ct. App. 1999). After the tortfeasor's automobile liability insurance company paid its policy limits, the insured sought underinsured motorist benefits under her own policy. The insured hired her own attorney to pursue the claim. Following several months of delay in the processing of the claim, the insured filed an action against the insurer alleging bad faith and consumer protection violations. The insured sought discovery of reports from the claims adjuster and correspondence from the insurance company's attorney who handled the underinsured motorist claim. *Id.* at 1174. The court applied the two-part test set out in *Escalante*. First, the trial court in *Barry* reviewed the case file and found that the insured had failed to establish sufficient wrongful conduct to invoke the civil fraud exception. The trial court therefore refused to exercise its discretionary right to inspect the privileged documents *in camera*. On appeal the trial court's decision was affirmed. The appellate court could not conclude that the trial court's exercise of discretion was "manifestly unreasonable or based on untenable grounds." *Id.* at 1177.

The *Escalante* test was recently questioned by an unpublished decision of the Washington Court of Appeals. In *In re Azula*, No. 46314-4-I, 2001 Wash. App. LEXIS 219 (Wash. Ct. App. Feb. 5, 2001), the court held that an *in camera* review of relevant documents is mandatory where disclosure of evidence is opposed on the basis of a privilege, insisting that such review "is the only way a court can determine whether a document is exempt from disclosure or sufficiently relevant to even merit disclosure." *Id.* at \*3. The *Azula* court noted that *Barry* and *Escalante*, which allowed discretionary review in such situations, are "inconsistent with Washington Supreme Court holdings, resulting from their mistaken reliance on Colorado law." *Id.* at \*3 n.1.

The Washington court in *Escalante* relied heavily upon the analysis of the Colorado Supreme Court in *Caldwell*, 644 P.2d 26. The *Caldwell* decision is significant for its recognition of a fraud exception to the attorney-client doctrine as an issue that could be raised in a bad-faith claim. In *Caldwell*, the plaintiffs were the losing parties in a prior automobile personal injury case. Plaintiffs presented a theory that the defendants had conspired to commit fraud in the underlying action, resulting in the wrongful entry of summary judgment against plaintiffs. 644 P.2d at 28. Plaintiffs sought discovery of information, which would otherwise be privileged, to show that the defendants had knowingly concealed or misrepresented material information in the underlying case. *Id.* at 29-30. The *Caldwell* court noted its previous recognition of the "future crimes" exception to the attorney-client privilege, and agreed that it should extend that exception to cases involving communications between attorneys and clients and when the privilege is used by the clients to commit current or future fraud. *Id.* at 31-32. The party attempting to show that the exception to the privilege applies must show a "foundation of fact for the charge." *Id.* at 33. However, the *Caldwell* court noted that the trial court may review the requested documents *in camera* without having yet made that determination, thus relying on the evidence in the review documents themselves to determine whether the exception applies. *Id.* The *Caldwell* court also determined that the attorney need not be aware of the client's fraud for the exception to apply, but the client must show that the advice is sought for a wrongful purpose. *Id.* Finally, the *Caldwell* court determined that the work product doctrine is also subject to the crime or fraud exception. *Id.* at 34.

performed should be related to the qualifications of an attorney before the privilege will attach.<sup>69</sup> Thus, merely hiring an attorney does not necessitate the attachment of the attorney-client privilege. For example, in *Merrin Jewelry Co. v. St. Paul Fire & Marine Insurance Co.*,<sup>70</sup> the insured sought discovery of investigative reports created by the insurance company's attorney. The court held that to the extent the investigation and reports did not necessarily have to be conducted by an attorney, using an attorney to conduct such work did not "cloak with privilege matters that would otherwise be discoverable."<sup>71</sup>

The tripartite relationship between the insurance company, its appointed defense counsel, and the insured may trigger the so-called "joint client exception" to the attorney-client privilege.<sup>72</sup> Under this

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<sup>69</sup> See *Taylor v. Travelers Ins. Co.*, 183 F.R.D. 67 (N.D.N.Y. 1998); *Evans v. United Servs. Auto. Ass'n*, 541 S.E.2d 782, 791 (N.C. Ct. App.) (holding that insurance company may not avail itself of privilege if attorney was not acting as a legal advisor when communication was made), *cert. denied*, 547 S.E.2d 810 (N.C. 2001); *West Hampton Adult Home, Inc. v. Nat'l Union Fire Ins. Co.*, 481 N.Y.S.2d 358, 360 (App. Div. 1984) (finding that hiring counsel to conduct policy "examinations under oath" and to supervise investigation were activities normally performed in the ordinary course of the insurance company's business and were not unique to the qualifications of an attorney).

<sup>70</sup> 49 F.R.D. 54 (S.D.N.Y. 1970).

<sup>71</sup> *Id.* at 57; *cf.* *Zullig v. Kan. City Power & Light Co.*, No. Civ. A. 87-2342, 1989 WL 7901, at \*2 (D. Kan. Jan. 17, 1989) (explaining that "[attorney-client] privilege is triggered by the fact that the client is communicating with counsel for the purpose of seeking legal advice"). However, there is consensus among courts and commentators that the definition of the "practice of law" is broad. See, e.g., *Fla. Bar v. Brumbaugh*, 355 So. 2d 1186, 1191-92 (Fla. 1978); Alan Morrison, *Defining the Unauthorized Practice of Law: Some New Ways of Looking at an Old Question*, 4 *Nova L.J.* 363, 364-69 (1980); Debra L. Rhode, *Policing the Professional Monopoly: A Constitutional and Empirical Analysis of Unauthorized Practice Prohibitions*, 34 *STAN. L. REV.* 1 (1981). Potentially, the attorney-client privilege may exist where the advice does not involve licensed attorneys. See generally Larry Alexander, *What We Do and Why We Do It*, 45 *STAN. L. REV.* 1885, 1898-1900 (1993) (arguing that a juris doctorate is helpful but not essential for professors producing "legal scholarship").

<sup>72</sup> See, e.g., *Henke v. Iowa Home Mut. Cas. Co.*, 87 N.W.2d 920, 923 (Iowa 1958) (holding that communications between insurance company and attorney employed by it to defend insured were not privileged because the defense attorney represented the insured and the insurance company). The Iowa Supreme Court limited *Henke* in *Squeller Feeds v. Pickering*, 530 N.W.2d 678 (Iowa 1995). In that case, the court ruled that *Henke* only applies to situations when the attorney is acting as attorney for both the insured and the insurance company. *Id.* at 684; see also *Hodges v. S. Farm Bureau Cas. Ins. Co.*, 433 So. 2d 125, 132 (La. 1983) ("[The attorney's] legal opinions or theories concerning [the original suit] benefited not only [the insurance company] who seeks to prevent their disclosure but also [the insured], who strives to discover them."). In *Broussard v. State Farm Mutual Auto. Insurance Co.*, 519 So. 2d 136 (La. 1988), the Supreme Court of Louisiana stated that "blanket production of the attorney's and insurer's files is not permitted." *Id.*

third exception, an insurance company may not invoke the attorney-client privilege against its insured concerning communications with the attorney hired to represent the insured.<sup>73</sup> Courts have determined that the duty of loyalty runs to the insured, not the insurance company. Thus, the insurance company cannot invoke the privilege and prevent disclosure of confidential communications.<sup>74</sup>

### C. Waiver of Attorney-Client Privilege

Express waivers of the attorney-client privilege are easy to identify and are therefore not discussed herein. Whether an implied waiver has occurred, however, is a vexing issue. Courts disagree about the general contours of the test to be applied to determine whether an implied waiver of the attorney-client privilege has occurred. Courts also dispute at what point a client may be deemed to have injected privileged communications with his or her attorney into the case, thus causing an implied waiver. There are three general approaches courts have used to determine whether the attorney-client privilege has been impliedly waived by a litigant.<sup>75</sup>

The first of these general approaches is the “automatic waiver” rule, which provides that a litigant automatically waives the privilege upon assertion of a claim, counterclaim, or affirmative defense that raises as an issue a matter to which otherwise privileged material is relevant. The second set of generalized approaches provides that the privilege is waived only when the

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The California courts have held that the “joint client exception” does not apply to the appointment of *Cumis* (independent) counsel. *See, e.g.,* Rockford Int’l Corp. v. Superior Court, 26 Cal. App. 4th 1255, 1267 (1994). California courts have refused to extend the “joint client exception” where the insurance company has hired counsel to advise it on disputed coverage issues even though the insured argues the issues of coverage are “a matter of common interest.” *See, e.g.,* Aetna Cas. & Sur. Co. v. Superior Court, 153 Cal. App. 3d 467, 472 (1984); Houston Gen. Ins. Co. v. Superior Court, 108 Cal. App. 3d 958, 961 (1980).

<sup>73</sup> *Henke*, 87 N.W.2d at 923; *Koster v. Junes Trucking, Inc.*, 625 N.W.2d 82, 84 (Mich. Ct. App. 2000) (explaining that attorney-client privilege is not recognized between liability insurer and its insured because attorney hired to defend the insured owed sole loyalty and duty to insured client, not the insurance company); *Longo v. Am. Policy Holders Ins. Co.*, 436 A.2d 577, 579-80 (N.J. Super. Ct. Law Div. 1981) (holding that insurance company was precluded from invoking attorney-client privilege against its insured to prevent disclosure of confidential communications between shared counsel); *see also* John K. Morris, *Conflicts of Interest in Defending Under Liability Insurance Policies: A Proposed Solution*, 1981 UTAH L. REV. 457, 462 (observing that “[a] minority of courts reject the dual representation principle,” while other courts are split on who the true client is – the insurance company or the insured).

<sup>74</sup> *Koster*, 625 N.W.2d at 84.

<sup>75</sup> *Frontier Ref., Inc. v. Gorman-Rupp Co.*, 136 F.3d 695, 699-700 (10th Cir. 1998); *Zenith Radio Corp. v. United States*, 764 F.2d 1577, 1579 (Fed. Cir. 1985).

material to be discovered is both relevant to the issues raised in the case and either vital or necessary to the opposing party's defense of the case. Finally, several courts have recently concluded that a litigant waives the attorney-client privilege if, and only if, the litigant directly puts the attorney's advice at issue in the litigation.<sup>76</sup>

### 1. Automatic Waiver Rule

Under the automatic waiver rule, the attorney-client privilege is waived upon an assertion of a civil claim or an affirmative defense "that raises as an issue a matter to which otherwise privileged material is relevant."<sup>77</sup> The automatic waiver rule works well when directed at a plaintiff who initiates civil litigation. As one court has observed, the civil plaintiff is a voluntary litigant who "has created the situation which requires him to choose between his silence and his lawsuit."<sup>78</sup> Where the plaintiff has initiated the action and forced a defendant into court, the plaintiff cannot use privilege as both a sword and a shield. In *Lyons v. Johnson* the court observed:

The scales of justice would hardly remain equal in these respects, if a party can assert a claim against another and then be able to block all discovery attempts against him by asserting [the attorney-client] privilege to any interrogation whatsoever upon his claim. If any prejudice is to come from such a situation, it must, as a matter of basic fairness in the purposes and concepts on which the right of litigation rests, be to the party asserting the claim and not to the one who has been subjected to its assertion. It is the former who has made the election to create an imbalance in the pans of the scales.<sup>79</sup>

Defendants ought not be denied a possible defense because plaintiffs seek to invoke an alleged privilege. While this same

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<sup>76</sup> *Frontier Ref.*, 136 F.3d at 699-700 (citations omitted).

<sup>77</sup> *Id.* at 699; see *Indep. Prods. Corp. v. Loew's, Inc.*, 22 F.R.D. 266, 276-77 (S.D.N.Y. 1958) (originating "automatic waiver" rule); see also *Lyons v. Johnson*, 415 F.2d 540, 542 (9th Cir. 1969), *cert denied*, 397 U.S. 1027 (1970) (discussing *Independent Products* and automatic waiver rule); *FDIC v. Wise*, 139 F.R.D. 168, 170-71 (D. Colo. 1991) (same).

<sup>78</sup> *Wehling v. Columbia Broad. Sys.*, 608 F.2d 1084, 1089 n.10 (5th Cir. 1979). Typically, a civil plaintiff "voluntarily" brings litigation only because there is no other effective means of protecting legal rights. See Marjorie S. White, Note, *Plaintiff as Deponent: Invoking the Fifth Amendment*, 48 U. CHI. L. REV. 158, 162 (1981) (challenging the voluntary-involuntary distinction); Note, *Toward a Rational Treatment of Plaintiffs Who Invoke the Privilege Against Self-Incrimination During Discovery*, 66 IOWA L. REV. 575, 594-601 (1981).

<sup>79</sup> *Lyons*, 415 F.2d at 542 (discussing specifically the Fifth Amendment privilege against self-incrimination).

consideration exists where a civil defendant raises an affirmative defense that is enmeshed in important evidence that will be unavailable to plaintiff if privilege prevails, it is inescapable that the defendant was not the principal initiator. The “automatic waiver” rule has been criticized because it minimizes the importance of the attorney-client privilege to the adversarial system.<sup>80</sup>

## 2. Intermediate Test Approach

The intermediate approach balances the need for discovery with the importance of maintaining the attorney-client privilege.<sup>81</sup> In *Hearn v. Rhay*,<sup>82</sup> the court applied this approach. The court in *Hearn* analyzed various exceptions to the rules of privilege.<sup>83</sup> Principally, the court reviewed the physician-patient privilege, which is waived by a plaintiff-patient who files a lawsuit placing in controversy the patient’s physical condition,<sup>84</sup> and the attorney-client privilege, which is impliedly waived in litigation between the attorney and client arising out of their relationship.<sup>85</sup> The court also noted that in patent infringement lawsuits, a privilege waiver may occur when the plaintiff places the patent’s validity at issue.<sup>86</sup> In *Hearn*, the court found persuasive an analogy to cases which have found an implied waiver of the attorney-client privilege when a habeas corpus petitioner has contested the constitutionality of his conviction in state court.<sup>87</sup> In the latter situation, other courts have permitted inquiry into the attorney-client relationship to determine whether a “deliberate bypass” of the right alleged to have been violated occurred.<sup>88</sup> A

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<sup>80</sup> See *Greater Newbury Port Clam Shell Alliance v. Pub. Serv. Co.*, 838 F.2d 13, 19 (1st Cir. 1988) (criticizing “automatic waiver” rule); *Afro-Lecan, Inc. v. United States*, 820 F.2d 1198, 1205 (Fed. Cir. 1987) (same).

<sup>81</sup> See *Black Panther Party v. Smith*, 661 F.2d 1243, 1266-69 (D.C. Cir. 1981) (balancing need for discovery with importance of privilege), *vacated without opinion*, *Moore v. Black Panther Party*, 458 U.S. 1118 (1982).

<sup>82</sup> 68 F.R.D. 574, 581-82 (E.D. Wash. 1975).

<sup>83</sup> *Id.* at 580-82.

<sup>84</sup> *Id.* at 580.

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*; see *Honeywell, Inc. v. Piper Aircraft Corp.*, 50 F.R.D. 117, 120 (M.D. Pa. 1970).

<sup>87</sup> *Hearn*, 68 F.R.D. at 581.

<sup>88</sup> See, e.g., *Laughner v. United States*, 373 F.2d 326, 327 (5th Cir. 1967); *Henderson v. Heinz*, 349 F.2d 67, 70-71 (9th Cir. 1965).

A defendant may also waive the privilege by asserting advice of counsel as an affirmative defense. See, e.g., *Hunt v. Blackburn*, 128 U.S. 464, 470 (1888) (holding that allegation that party was misled by counsel resulted in waiver); *Chevron Corp. v. Pennzoil Co.*, 974 F.2d 1156, 1162 (9th Cir. 1992) (holding that privilege was waived when party claimed that its tax position was reasonable because it was based



common denominator in these situations was that “the party asserting the privilege placed information protected by [the attorney-client privilege] in issue through some affirmative act for his own benefit, and to allow the privilege to protect against disclosure of such information would have been manifestly unfair to the opposing party.”<sup>89</sup> The *Hearn* court distilled the factors common to recognized implied waiver situations:

- (1) assertion of the privilege was a result of some affirmative act, such as filing suit, by the asserting party; (2) through this affirmative act, the asserting party put the protected information at issue by making it relevant to the case; and (3) application of the privilege would have denied the opposing party access to information vital to his defense.<sup>90</sup>

The *Hearn* court further instructed that when these three conditions are present, “a court should find that the party asserting a privilege has impliedly waived it through his own affirmative conduct.”<sup>91</sup> Significantly, the third prong of the *Hearn* test places the burden on the party seeking discovery to show that the information is relevant and material to the claim or defense.<sup>92</sup> One court has held that disclosure of information vital to a party’s case should be compelled “only after the litigant has shown that he has exhausted every reasonable alternative source of information.”<sup>93</sup> Furthermore, the party “must describe the information they hope to obtain and its importance to their case with a reasonable degree of specificity.”<sup>94</sup>

A court should begin this analysis with a presumption in favor of

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on advice of counsel).

<sup>89</sup> *Hearn*, 68 F.R.D. at 581.

<sup>90</sup> *Id.*; see also *Home Indem. Co. v. Lane Powell Moss & Miller*, 43 F.3d 1322, 1326 (9th Cir. 1995) (interpreting Alaska law).

<sup>91</sup> *Hearn*, 68 F.R.D. at 581.

<sup>92</sup> *Id.* at 582. The burden is proportionate to the danger posed by the discovery to the type of privilege being asserted. Where a constitutional privilege is involved, for example, the First Amendment associational privilege, a heavy burden for disclosure exists primarily because of the “preferred position of First Amendment rights” in civil cases. *Black Panther Party*, 661 F.2d at 1268; see also *Zenith Radio Corp. v. United States*, 764 F.2d 1577 (Fed. Cir. 1985) (rejecting the automatic waiver rule to protect non-constitutional privileges). The Sixth Amendment provides a shield for the attorney-client privilege only in criminal proceedings. Upon the termination of these proceedings and initiation of a civil action putting the privilege at issue, that constitutional protection ends. The liberal federal policy favoring discovery is of substantially greater relative weight where the party invokes the privilege in a civil rather than a criminal case. *Indep. Prods. Corp. v. Loew’s, Inc.*, 22 F.R.D. 266, 278-79 (S.D.N.Y. 1958).

<sup>93</sup> *Black Panther Party*, 661 F.2d at 1268.

<sup>94</sup> *Id.*

preserving the privilege. However, under the *Hearn* test, in civil actions, fairness may require that the privilege holder surrender the privilege in so far as it will weaken, in a meaningful way, the opposing party's ability to defend. The privilege will give way where a party seeking to pierce the privilege can establish that the claim, and probable defenses thereto, are enmeshed in important, vital evidence that will be otherwise unavailable if the privilege prevails.

The *Hearn* test is followed by the majority of jurisdictions,<sup>95</sup> but the test is not without its critics. A significant minority of courts criticize the *Hearn* analysis because it focuses excessively on the asserted relevancy of the privileged communications while ignoring the reason why the privilege is recognized in the first place.<sup>96</sup> An example of this criticism is found in *Rhone-Poulenc Rorer, Inc. v. Home Indemnity Co.*<sup>97</sup> The court in *Rhone-Poulenc* observed that while the *Hearn* court "dress[ed] up [its] analysis with a checklist of factors, [it] appear[s] to rest on a conclusion that the information sought is relevant and should in fairness be disclosed."<sup>98</sup> Focusing on the important justifications behind the attorney-client privilege, the *Rhone-Poulenc* court expressed the criticism that the relationship between a client and his or her attorney will suffer because of the uncertainty regarding whether communications will remain confidential.

Clients will face the greatest risk of disclosure for what may be the most important matters. Furthermore, because the definition of what may be relevant and discoverable from those consultations

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<sup>95</sup> See, e.g., *Frontier Ref.*, 136 F.3d at 699-700, 701; *Lane Powell Moss & Miller*, 43 F.3d at 1326; see also *Pyramid Controls, Inc. v. Siemens Indus. Automations, Inc.*, 176 F.R.D. 269, 272 (N.D. Ill. 1997) (describing *Hearn* as "the seminal case on 'at issue' waiver"); Timothy P. Glynn, *Federalizing Privilege*, 52 AM. U. L. REV. 59, 118-19 & n.260 (2002) (noting that a majority of jurisdictions follow a *Hearn*-like approach).

<sup>96</sup> See *Harter v. Univ. of Indianapolis*, 5 F. Supp. 2d 657, 664-65 & n.2 (S.D. Ind. 1998) (stating that "better-reasoned cases" hold that the act of filing a lawsuit where state of mind may be relevant does not waive privilege unless client specifically relies on advice of counsel; contrary rule "effectively discourages a client from seeking legal advice by removing the assurance of confidentiality"); *Transamerica Title Ins. Co. v. Superior Court*, 233 Cal. Rptr. 825, 828-29 (Ct. App. 1987) (stating that "[p]rivileged communications do not become discoverable simply because they are related to issues in the litigation" and upholding privilege even though insurer's general state of mind was at issue in bad-faith claim where insurer stipulated that it would not rely on advice-of-counsel defense). Other courts are more protective of the privilege and will not find waiver unless the client directly relies on advice of counsel. See, e.g., *Aranson v. Schroder*, 671 A.2d 1023, 1030 (N.H. 1995) (holding that there is no waiver unless "the privilege holder injects the privileged material itself into the case").

<sup>97</sup> 32 F.3d 851, 863 (3d Cir. 1994) (criticizing *Hearn* as of dubious validity).

<sup>98</sup> *Id.* at 864.

may depend on the facts and circumstances of as yet unfilled litigation, the client will have no sense of whether the communication may be relevant to some future issue, and will have no sense of certainty or assurance that the communication will remain confidential.<sup>99</sup>

The court in *Rhone-Poulenc* found that the advice of counsel was not placed in issue merely because it was relevant and that the advice given did not necessarily become an issue merely because the attorney's advice might affect the client's state of mind in a relevant matter.<sup>100</sup> The advice of counsel is placed in issue where the client asserts a claim or defense, and attempts to prove that claim or defense by disclosing or describing an attorney-client communication.<sup>101</sup>

### 3. Restrictive Test

Under this approach, a litigant waives the attorney-client privilege if, and only if, the litigant directly puts the attorney's advice at issue in the litigation.<sup>102</sup> For example, when a client files a malpractice action against his attorney, he or she may waive the privilege as to particular communications.<sup>103</sup> By placing the attorney's advice at issue, the client is waiving the privilege by requiring an examination of the facts and issues relating to that advice.<sup>104</sup>

#### D. Waiver Through Direct Assertion of the Advice-of-Counsel Defense

An insurance company may defend itself against allegations of bad faith and malicious claim handling by providing evidence that it relied upon the advice of competent counsel.<sup>105</sup> The so-called advice-

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<sup>99</sup> *Id.*

<sup>100</sup> *Id.* at 863.

<sup>101</sup> *Id.*; see also *Pittston Co. v. Allianz Ins. Co.*, 143 F.R.D. 66, 71 (D.N.J. 1992); *N. River Ins. Co. v. Phila. Reins. Corp.*, 797 F. Supp. 363, 370 (D.N.J. 1992).

<sup>102</sup> *Rhone-Poulenc*, 32 F.3d at 863-64 (adopting restrictive test and criticizing more liberal views of waiver; purpose of privilege still applies when "state of mind" is at issue and single-minded focus on relevance "completely undermines the interest to be served"; no waiver where plaintiffs had not "injected the advice of counsel as an essential element of a claim"); see also *Public Serv. Co. of N.M. v. Lyons*, 10 P.3d 166, 173 (N.M. Ct. App. 2000) (rejecting the *Hearn* approach and adopting the *Rhone-Poulenc* test that there must be "an offensive or direct use of privileged information" before the attorney-client privilege will be deemed to have been waived).

<sup>103</sup> *Rhone-Poulenc*, 32 F.3d at 863.

<sup>104</sup> *Id.* at 865.

<sup>105</sup> *State Farm Mut. Auto. Ins. Co. v. Superior Court*, 279 Cal. Rptr. 116, 117-18 (Ct. App. 1991). Reliance on advice of counsel has also allowed insurers to avoid punitive damages for bad-faith conduct. See, e.g., *Gorman v. Southeastern Fid. Ins. Co.*, 775 F.2d 655, 659-60 (5th Cir. 1985) (interpreting Mississippi law); see also

of-counsel<sup>106</sup> defense<sup>107</sup> provides that when an insurer's actions are in conformity with advice given by its counsel, the insurer's actions are made in good faith. Thus, state of mind, an essential element that an aggrieved policyholder must demonstrate in establishing insurer bad faith, is nullified.<sup>108</sup> Conversely, the rejection of counsel's advice<sup>109</sup> or the failure to seek legal advice when prudent claim handling dictates

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Melrich Builders, Inc. v. Superior Court, 207 Cal. Rptr. 47, 50 (Ct. App. 1984) (holding that good faith reliance on advice of counsel is a "complete defense" to a punitive damage claim).

<sup>106</sup> For competing views on the scope of advice of counsel and its appropriateness, compare James M. Fischer, *Should Advice of Counsel Constitute a Defense for Insurer Bad Faith?*, 72 TEX. L. REV. 1447 (1994), with Michael Sean Quinn, *The Advice-of-Counsel Defense: A Response to Fischer*, 72 TEX. L. REV. 1487 (1994). See generally Nielsen, *supra* note 15, at 542-44.

<sup>107</sup> The term "defense" is a misnomer. The advice of counsel is typically accepted as only some evidence that, if believed, may tend to negate the claim that an insurance company engaged in bad faith. Advice of counsel is less frequently accepted as an absolute defense to a claim of bad faith. See Annotation, *Reliance on, or Rejection of, Advice of Counsel as Factor Affecting Liability in Action Against Liability Insurer for Wrongful Refusal to Settle Claim*, 63 A.L.R.3d 725, 730 (1975); cf. Crowe v. Lucas, 595 F.2d 985, 992 (5th Cir. 1979) ("Reliance on advice of counsel does not serve as an absolute defense to a civil rights action. Rather, it is among the calculus of facts that a jury is to consider on the issue of good faith.").

<sup>108</sup> Guy O. Kornblum, *The Current State of Bad Faith and Punitive Damages in the United States*, 23 TORT & INS. L.J. 812, 838-39 (1988). Many courts have articulated a "fairly debatable" standard for insurer bad faith. See, e.g., Davis v. Cotton States Mut. Ins. Co., 604 So. 2d 354, 358 (Ala. 1992); Deese v. State Farm Mut. Auto. Ins. Co., 838 P.2d 1265, 1268 (Ariz. 1992); Garnett v. Transamerica Ins. Servs., 800 P.2d 656, 666 (Idaho 1990); Nassen v. Nat'l States Ins. Co., 494 N.W.2d 231, 236 (Iowa 1992), *cert. denied*, 503 U.S. 1031 (1993); Pickett v. Lloyds of London, 621 A.2d 445, 453 (N.J. 1993); Tokles & Sons, Inc. v. Midwestern Indem. Co., 605 N.E.2d 936, 943 (Ohio 1992); Bartlett v. John Hancock Mut. Life Ins. Co., 538 A.2d 997, 1000 (R.I. 1988); *In re Certification of a Question of Law from the U.S. Dist. Court of S.D., W. Div. (Champion v. U.S. Fid. & Guar. Co.)*, 399 N.W.2d 320, 324 (S.D. 1987); Newhouse v. Citizens Sec. Mut. Ins. Co., 501 N.W.2d 1, 5-6 (Wis. 1993); First Wyo. Bank, N.A. v. Cont'l Ins. Co., 860 P.2d 1094, 1101 (Wyo. 1993). For a different permutation of the "fairly debatable" standard, see *Hans Construction Co. v. Phoenix Assurance Co.*, 995 F.2d 53 (5th Cir. 1993), where the court, applying Mississippi law, held that the retention and use of an independent expert gave the insurance company "arguable reasons" for denying a claim. Conflicting opinions of the insurer's counsel and the policyholder's counsel, after each has reviewed the facts and law, may legitimize the presence of a fairly debatable dispute.

<sup>109</sup> See, e.g., *Md. Cas. Co. v. Elmira Coal Co.*, 69 F.2d 616, 620 (8th Cir. 1934); *Am. Mut. Liab. Ins. Co. v. Cooper*, 61 F.2d 446, 448 (5th Cir. 1932), *cert. denied*, 289 U.S. 736 (1933); *Kinder v. W. Pioneer Ins. Co.*, 42 Cal. Rptr. 394, 398-99 (Ct. App. 1965); *Thompson v. Commercial Union Ins. Co. of N.Y.*, 250 So. 2d 259, 260 (Fla. 1971); *Cotton States Mut. Ins. Co. v. Trevehan*, 390 So. 2d 724, 728 (Fla. Dist. Ct. App.), *appeal denied*, 392 So. 2d 1373 (Fla. 1980).

For a cynical discussion of insurer's reliance on advice of counsel, see *Lozier v. Auto Owner's Insurance Co.*, 951 F.2d 251, 255-56 (9th Cir. 1991) (interpreting Arizona law).

doing so may be evidence of bad faith.<sup>110</sup>

Jurisdictions are split over the acceptance of the advice-of-counsel defense.<sup>111</sup> Whether the advice-of-counsel defense is available may depend upon a particular jurisdiction's legal standard regarding the tort of bad faith. A definitive standard of bad faith is difficult to formulate because the elements of the test change as the context changes.<sup>112</sup> Where the insurer's state of mind is the focus of the bad-faith claim of unreasonableness, the advice-of-counsel defense may be applicable.<sup>113</sup> In those jurisdictions where the tort requires proof of

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<sup>110</sup> See H. Walter Croskey, *Bad Faith in California: Its History, Development and Current Status*, 26 TORT & INS. L.J. 561, 579 (1991) (opining that insurers may be under duty to consult with counsel at least in matters involving the reasonableness of settlement demands). An interesting case is *Allen v. Allstate Insurance Co.*, 656 F.2d 487, 489-90 (9th Cir. 1981), holding that, under California law, a jury could find that the insurance company acted in bad faith when it relied on the litigation estimate provided by counsel rather than on the litigation estimate prepared by the district manager. The court characterized the attorney's opinion as "wishful." *Id.* at 489.

<sup>111</sup> STEPHAN S. ASHLEY, BAD FAITH ACTIONS § 7:13 (1984 & Supp. 1993) (reporting an almost even split between those jurisdictions that recognize the defense and those that reject it).

<sup>112</sup> See Nielsen, *supra* note 15. Commentators have offered varying views of how many standards of bad faith exist. For an analysis of how commentators have offered various opinions on the standard to determine bad faith, see Boyarski, *supra* note 15.

<sup>113</sup> The link between the advice-of-counsel defense and the insurance company's state of mind can be seen in non-insurance cases. As an example, in *Ortho Pharmaceutical Corp. v. Smith*, 959 F.2d 936 (Fed. Cir. 1992), the advice of counsel was advanced in a patent infringement case to negate the element of willfulness. The court noted that "counsel's opinion must be thorough enough . . . to instill a belief in the infringer that the court might reasonably hold the patent is invalid, not infringed, or unenforceable." *Id.* at 944. In *Read Corp. v. Portec, Inc.*, 970 F.2d 816 (Fed. Cir. 1992), the court noted that the advice-of-counsel defense does not lie when the legal advice is not sufficient to instill in the client a basis for reasonable belief in the accuracy and soundness of the advice. The court explained:

This . . . does not mean a client must itself be able to evaluate the legal competency of its attorney's advice to avoid a finding of willfulness. The client would not need the attorney's advice at all in that event. That an opinion is "incompetent" must be shown by objective evidence. For example, an attorney may not have looked into the necessary facts, and, thus, there would be no foundation for his opinion. A written opinion may be incompetent on its face by reason of its containing merely conclusory statements without discussion of facts or obviously presenting only a superficial or off-the-cuff analysis.

*Id.* at 829. The court also noted:

An opinion of counsel, of course, need not unequivocally state that the client will not be held liable for infringement. An honest opinion is more likely to speak of probabilities than certainties. A good test that the advice given is genuine and not merely self-serving is whether the asserted defenses are backed up with viable proof during trial which raises substantial questions.

*Id.* n.9.

the insurance company's actual intent to harm, the advice-of-counsel defense may undermine and diminish the required mental state necessary to establish bad faith. It must be established that the company knew or should have known that its conduct created an unreasonable risk of harm to the insured.<sup>114</sup> Where the alleged bad faith is based on the insurance company's conduct, the advice of counsel may become irrelevant because the insurance company's conduct should be evaluated against industry standards for claims handling and claims processing.<sup>115</sup>

Commentators have different views regarding the necessary elements that give rise to the advice-of-counsel defense. One commentator<sup>116</sup> has delineated four necessary elements of the defense: "(1) the insurer sought counsel's advice in good faith; (2) the insurer disclosed all pertinent information to its attorney; (3) the insurer acted on the advice in good faith; and (4) the attorney was competent in the particular area of law and disinterested in the matter."<sup>117</sup>

Although these proposed elements may be jointly sufficient to establish the absence of bad faith, other commentators postulate that fewer elements are necessary:

For example, it is not necessary that the insurer seek counsel's advice in good faith. The insurer might seek counsel's advice in bad faith and come into a state of good faith by having been jolted by counsel's vivid, perceptive, and well-reasoned opinion letter. It also is not necessary that the insurer disclose all pertinent information to its attorney. The insurer may not have all of the pertinent information, and might commission the lawyer to complete the investigation. Moreover, if the opinion letter came to the correct conclusion, even though missing pertinent information, if the insurer acted on the letter appropriately, and if the failure to disclose all of the pertinent information was nothing more than negligent, the opinion letter

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<sup>114</sup> See, e.g., *Webb v. Int'l Indem. Co.*, 599 So. 2d 1144, 1146 (Ala. 1992); see also *Walbrook Ins. Co. v. Liberty Mut. Ins. Co.*, 7 Cal. Rptr. 2d 513, 517-18 (Ct. App. 1992) (explaining that establishing good faith involves an inquiry into motive, intent, and state of mind).

<sup>115</sup> See *Travelers Ins. Co. v. Savio*, 706 P.2d 1258, 1275 (Colo. 1985) ("Whether an insurer has acted reasonably in denying or delaying approval of a claim will be determined on an objective basis, requiring proof of the standards of conduct in the industry."). But see *Silberg v. Cal. Life Ins. Co.*, 521 P.2d 1103, 1109 (Cal. 1974) ("The scope of the duty of an insurer to deal fairly with its insured is prescribed by law and cannot be delineated entirely by customs of the insurance industry.").

<sup>116</sup> Nielsen, *supra* note 15.

<sup>117</sup> *Id.* at 543 (emphasis omitted).

should still immunize the insurer from bad faith.<sup>118</sup>

Professor Quinn has identified criteria associated with the hiring of counsel to analyze coverage questions:<sup>119</sup> (1) reasonable judgment must be exercised by the insurer in selecting experienced and competent coverage counsel; (2) sufficient facts and information must be provided for coverage counsel to render an appropriate opinion; (3) coverage counsel reasonably appears to have researched, investigated, and analyzed the issues; (4) coverage counsel communicates the opinion in a reasonable way; that is, coverage counsel's analysis shows that objective consideration has been given to the facts and issues, any alternatives, the law, how to present arguments, and so forth; (5) the insurer thoughtfully considered the coverage opinion; and (6) the insurer largely follows the advice of counsel.<sup>120</sup> Furthermore, reliance on the advice of counsel must be

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<sup>118</sup> Michael Sean Quinn & Kimberly Steele, *Insurance Coverage Opinions*, 36 S. TEX. L. REV. 479, 494-95 (1995). However, courts may take a contrary view. In *Bertero v. National General Corp.*, 529 P.2d 608 (Cal. 1974), the court observed:

[I]f the initiator acts in bad faith or withholds from counsel facts he knew or should have known would defeat a cause of action otherwise appearing from the information supplied, that [reliance on legal advice] defense fails. Similarly, counsel's advice must be sought in good faith and ". . . not as a mere cloak to protect one against a suit for malicious prosecution."

*Id.* at 616 (citations omitted) (quoting *Walker v. Jensen*, 212 P.2d 569, 572 (Cal. Ct. App. 1949)); see *Read Corp.*, 970 F.2d at 829 & n.9.

<sup>119</sup> Quinn, *supra* note 106.

<sup>120</sup> *Id.* at 1489. The method by which the advice of coverage counsel is communicated to the insurance company is through a so-called coverage opinion letter. The components of this type of correspondence were discussed by Professors Quinn and Steele:

Generally, insurance coverage opinions recite the issues; recount and analyze the facts, if they are undisputed; make factual assumptions, if the insurance company wants to know the law applicable to one or more stipulated sets of facts; explore factual conflicts, if the facts are disputed; set forth the applicable provisions of the insurance contract verbatim; if necessary, interpret the language of the insurance contract in light of the law; analyze the facts, or assumed or conflicting factual scenarios, in the light of the contract as interpreted; provide reasoned answers to the issues posed; and report any important deadlines. . . . [T]here are two interconnected and overriding issues: Does the insured have a right to be paid or to be provided with some service? And, if so, how much or of what kind of service? . . . The format of opinions is fairly uniform. After reciting the opening pleasantries, they set forth undisputed, assumed, or disputed version of the facts, as appropriate; the applicable language of the contract; the law governing the analysis of the contract; the analysis of the contract; the law governing the domain of relevant facts; the legal rules governing how to apply the contract to the facts; answers to the various issues; and vindications of those answers. If there are qualifications or caveats,

reasonable.<sup>121</sup> This requires, in part, that the insurance company provide counsel with sufficient factual and other available, relevant information necessary to offer an accurate opinion or advice.<sup>122</sup> Where an insurance company knows or has reason to know that the advice of its counsel is incorrect, it will not be able to avoid bad-faith liability exposure by claiming reliance.<sup>123</sup> Finally, the advice must be

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these are frequently stated, or repeated, at the end of the letter. . . . Often, if the insurer needs to send some sort of letter to the insured, a proposed draft will accompany the opinion letter. This might be an unqualified affirmation of coverage, sometimes called an unqualified acceptance of the claim; it might be a reservation of rights letter, by which the insurer agrees to provide money or services, or to perform additional investigations, without committing itself further; or it might be a letter declining coverage, or as it is called in some property insurance circles, a letter rejecting the claim.

Quinn & Steele, *supra* note 118, at 480-82 (paragraph structure omitted). Coverage opinions “are epistolary, single-spaced, and long.” *Id.* at 484.

<sup>121</sup> See, e.g., *Burns v. Okla. Farm Bureau Mut. Ins. Co.*, 11 P.3d 162 (Okla. 2000) (acknowledging that reliance on advice of counsel can be a defense provided that reliance was reasonable, and, because advice of counsel was against existing case law and statutes, holding that reliance was unreasonable).

<sup>122</sup> See, e.g., *Ins. Co. of N. Am. v. Smith*, 375 S.E.2d 866, 868-70 (Ga. Ct. App. 1988) (holding that where insurance company does not provide its counsel with all facts or information necessary to offer an accurate opinion or advice, it cannot invoke the defense); see also *Bertero*, 529 P.2d at 616-17.

<sup>123</sup> See *Allan v. Allstate Ins. Co.*, 656 F.2d 487, 489-90 (9th Cir. 1981) (holding that insurer’s reliance on obviously poor strategic advice of defense counsel did not shield it from bad-faith claim). The case law has not addressed the probabilistic relationship regarding the advice provided by counsel and a particular justification for denying coverage. One commentator has discussed this dilemma:

[I]t is not likely that there will ever be helpful law on this point. It is fairly obvious, in this context, that if a lawyer advises an insurance company that a given argument on behalf of no coverage should succeed before a court in a perfectly rational world, and if there is a sixty percent chance that it will succeed in our world, then this should constitute enough probability to defeat any suggestion of bad faith. But there are complications. How the law treats assessments of probability may depend upon whether the uncertainty derives from fact, or whether it derives from law. Obviously, in an unsettled area of the law, low probabilities as to the legal aspects of the opinion do not necessarily mean that there is no reasonable basis for the carrier’s action. Further, the factual aspects of the opinion may be complicated. An insurance carrier is expected to know what happened with a high degree of certainty in the absence of conflicting factual scenarios. Obviously, if there are materially conflicting factual scenarios, probability assessments are extremely difficult. Material and credible factual disputes may, in and of themselves, constitute a reasonable basis for denying the claim. The upshot of this discussion is that there is no obvious connection between the probability that an opinion is right, and whether the insurance carrier has a reasonable basis for denying a claim. There is some relationship, to be sure, but the relationship is complex.



timely. An insurance company cannot bootstrap an incorrect coverage decision by later consulting with counsel.<sup>124</sup>

The nature of the communication must be examined. Where the attorney is hired to perform claims adjusting or to act in a capacity other than as a lawyer, the communications may not be privileged.<sup>125</sup> Some courts look to the “dominant purpose” of the communication to determine whether the attorney-client privilege exists for communications between the insurance company and the attorney.<sup>126</sup> The dominant purpose of the transaction must be to transmit information in the course of the attorney’s professional employment.<sup>127</sup> “The relevant question is not whether [the attorney] was retained to conduct an investigation, but rather, whether this investigation was related to the rendition of legal services.”<sup>128</sup> Therefore, the parties must intend the communication to be confidential.<sup>129</sup>

The scope of the waiver that occurs when the advice-of-counsel

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Quinn & Steele, *supra* note 118, at 497-98; *see also* Clemco Indus. v. Commercial Union Ins. Co., 665 F. Supp. 816, 827-28 (N.D. Cal. 1987) (holding that the insurance carrier had not acted in bad faith when it incorrectly relied upon the definition of “occurrence” which was used to form a manifestation trigger theory in the 1970s and 1980s but was currently outdated); Hartford Accident & Indem. Co. v. Aetna Cas. & Sur. Co., 792 P.2d 749 (Ariz. 1990) (reversing prior precedent and finding that insurance company should have anticipated a change in the law).

<sup>124</sup> *See, e.g.*, Employers Mut. Cas. Co. v. Thompkins, 490 So. 2d 897, 900-05 (Miss. 1986); *see also* Beacon Nat’l Ins. Co. v. Reynolds, 799 S.W.2d 390 (Tex. App. 1990). In *Beacon*, the insurance company wrongfully denied a claim which resulted in a state board of insurance complaint. Months after denying the claim, and only in response to the board’s demand, did the insurance company seek counsel. *Id.* at 397. The insurance company attempted to introduce its counsel’s letter at trial as proof of its reasonable claim denial. *Id.* The trial court refused to permit the letter’s introduction. The court in *Beacon* concluded that the insurance company could not have relied on its counsel’s advice in good faith given the timing of the letter. *Id.*

<sup>125</sup> Mission Nat’l Ins. Co. v. Lilly, 112 F.R.D. 160, 163 (D. Minn. 1986) (holding that the ordinary business of a party is outside the scope of attorney-client privilege); Hercules, Inc. v. Exxon Corp., 434 F. Supp. 136, 147 (D. Del. 1977) (stating that advice of counsel rendered on non-legal matters is not within scope of attorney-client privilege); Aetna Cas. & Sur. Co. v. Superior Court, 200 Cal. Rptr. 471, 476 (Ct. App. 1984).

<sup>126</sup> *See, e.g.*, Travelers Ins. Co. v. Superior Court, 191 Cal. Rptr. 871 (Ct. App. 1983).

<sup>127</sup> *Id.* at 879. In *Lanasa v. State*, 71 A. 1058, 1064 (Md. 1909), the test utilized for “legal advice” was whether the communications relate to professional advice and to the subject matter about which such advice is sought.

<sup>128</sup> *In re Allen*, 106 F.3d 582, 603 (4th Cir. 1997) (internal quotation marks omitted) (holding that a determination of whether the investigation is privileged will focus on whether the issues are routine or whether they are complex issues of law, which intrinsically require sophisticated legal appraisals).

<sup>129</sup> *See In re Underwriters at Lloyds*, 666 F.2d 55, 57 (4th Cir. 1981).

defense is raised is unclear.<sup>130</sup> Once the insurance company interposes the advice-of-counsel defense regarding a particular claim, the correspondence between the attorney and the insurance company is placed at issue and becomes discoverable.<sup>131</sup> A relevant query at this juncture becomes whether reliance on the advice of counsel acts as an implied waiver of other coverage opinions prepared for the same insurance company by the same attorney (or the same law firm).<sup>132</sup> Waiver of the attorney-client privilege for one communication may in some instances permanently waive the privilege for all related communications.<sup>133</sup>

*E. Recent Expansion of Implied Waiver*

Recently, the supreme courts of Delaware, Arizona, and Ohio

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<sup>130</sup> See *Conkling v. Turner*, 883 F.2d 431, 434-35 (5th Cir. 1989); *Bowne of N.Y.C., Inc. v. Am. Base Corp.*, 150 F.R.D. 465, 487-89 (S.D.N.Y. 1993); *SEC v. Forma*, 117 F.R.D. 516, 523 (S.D.N.Y. 1987); *Bd. of Trs. v. Coulter Corp.*, 118 F.R.D. 532, 533 (S.D. Fla. 1987); *Russell v. Curtin Matheson Scientific, Inc.*, 493 F. Supp. 456, 458 (S.D. Tex. 1980); *Pitney-Bowes v. Mestre*, 86 F.R.D. 444, 446-47 (S.D. Fla. 1980); *Handgards, Inc. v. Johnson & Johnson*, 413 F. Supp. 926, 929 (N.D. Cal. 1976); *Garfinkle v. Arcata Nat'l Corp.*, 64 F.R.D. 688, 689-90 (S.D.N.Y. 1974); *Republic Ins. Co. v. Davis*, 856 S.W.2d 158, 163 (Tex. 1993).

<sup>131</sup> See, e.g., *Ellison v. Gray*, 702 P.2d 360, 363 (Okla. 1985).

<sup>132</sup> One commentator has discussed this slippery slope:

Insurers frequently limit the number of firms they engage to provide coverage opinions for good reasons. One of them is economic. Another is that insurance coverage is a niche practice, where reservoirs of learning and practical experience are extremely valuable. In legal situations where there are recurrent themes and problems, forms are used. Many coverage attorneys who have a large number of duty-to-defend coverage opinions to deliver, develop a standardized discourse upon the [state] law of the duty-to-defend. This befits a form, and routinely appears in formal opinion letters.

If the waiver of the attorney-client privilege for a coverage opinion might lead to the implied waiver of that privilege for other letters, this matter must be carefully considered. The route from the letter produced, to the letters not produced is quite simple. The policyholder might take the deposition of the lawyer who wrote the coverage opinion and ask him which sections of the letter were canned. If the lawyer identifies several, and is then induced to go on and say that he frequently relies upon forms, the policyholder might have the right to discover redacted versions of other letters on somewhat the same topic.

Quinn & Steele, *supra* note 118, at 496.

<sup>133</sup> See, e.g., *Duplin Corp. v. Deering Milliken, Inc.*, 397 F. Supp. 1146, 1161-62 (D.S.C. 1974). But see *Commonwealth v. Goldman*, 480 N.E.2d 1023, 1027 (Mass. 1985) (holding that waiver will only apply to communications relating to same object); *Transamerica Title Ins. Co. v. Superior Court*, 233 Cal. Rptr. 825, 828 (Ct. App. 1987) (holding that disclosure of limited number of attorney-client privilege materials will not entitle opposing party to the materials relating to advice given).

have rendered significant decisions regarding implied waiver in the insurance bad-faith context. Although each of these courts utilizes previously recognized analytic approaches to the implied waiver question, the courts set a minimal threshold for waiver that is the functional equivalent of a *per se* waiver rule. When an implied waiver question arises, courts must objectively determine when the privileged party's conduct reaches a certain point of disclosure, such that fairness requires that the privilege be waived irrespective of whether the privileged person intended such waiver. In Delaware, the threshold for waiver involved the insurance company's statement that it had engaged in "routine [claim] handling." The Delaware court examined *in camera* the insurance company's claim file, and, on its own initiative, found sufficient facts to conclude that waiver was required. In Arizona, the "certain point" is reached when the insurance company "claims its conduct was proper and permitted by law and based in whole or in part on its evaluation of the state of the law." This situation exists in almost all insurance bad-faith cases. In Ohio, as in Delaware, the court examined *in camera* the insurance company's claim file. If the court finds in its review any attorney-client privileged communications that show a lack of good faith, those communications are "wholly unworthy of the protections afforded by any claimed privilege." In Ohio, the mere filing of a bad-faith case entitles a court to an *in camera* review of the insurance company's attorney-client privileged communications. Collectively, the Delaware, Arizona, and Ohio precedents may represent a trend in the law regarding implied waiver that will have a chilling effect upon attorney-client communications in the insurance context. The Delaware, Arizona, and Ohio precedents are discussed below.

1. *Tackett v. State Farm Fire & Casualty Insurance Co.*  
(Delaware)

In *Tackett v. State Farm*,<sup>134</sup> an insured sued State Farm for bad faith, claiming that the insurance company had wrongfully attempted to underpay, and then delayed payment of, an underinsured motorist claim following a company "get tough" policy.<sup>135</sup> The "get tough" policy was established to limit an expected increase in bodily injury claims.<sup>136</sup> State Farm took the position that it had "reasonable justification" for underpayment and delay.<sup>137</sup> When pressed for an

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<sup>134</sup> *Tackett v. State Farm Fire & Cas. Ins. Co.*, 653 A.2d 254 (Del. 1995).

<sup>135</sup> *Id.* at 256-57.

<sup>136</sup> *Id.*

<sup>137</sup> *Id.* at 258.

explanation of this “reasonable justification,” State Farm responded by stating in an answer to an interrogatory, that the claims-handling process “show[ed] a reasonable and orderly pattern of claims handling which ultimately and in due course led to the payment of the policy coverage.”<sup>138</sup> The insured then sought discovery of the basis of State Farm’s position.<sup>139</sup> State Farm withheld certain documents, claiming that both attorney-client privilege and the work product doctrine applied.<sup>140</sup> After an *in camera* examination of the pertinent documents, the trial court ordered their disclosure.<sup>141</sup> The Delaware Supreme Court affirmed. In doing so, the supreme court noted that “waiver of the attorney client privilege may be implicit, even if contrary to the party’s actual intent.”<sup>142</sup> The court explained that considerations of fairness and consistency are perforce included in determining waiver:

A privileged person would seldom be found to waive, if his intention not to abandon could alone control the situation. There is always also the objective consideration that when his conduct touches a certain point of disclosure, fairness requires that his immunity shall cease whether he intended the result or not.<sup>143</sup>

After acknowledging that in the context of the attorney-client privilege, waiver rests on the rationale of fairness (that is, disclosure of otherwise privileged information by the client under circumstances where “it would be unfair to deny the other party an opportunity to discover other relevant facts with respect to that subject matter”<sup>144</sup>), the court noted that a party cannot compel an insurance company to surrender the protections of the attorney-client privilege simply by bringing a bad-faith lawsuit.<sup>145</sup> “Where, however, an insurer makes factual assertions in defense of a claim which incorporate, expressly *or implicitly, the advice and judgment of its counsel*, it cannot deny an opposing party ‘an opportunity to uncover the foundation for those

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<sup>138</sup> *Id.* (emphasis omitted).

<sup>139</sup> *Id.* at 257.

<sup>140</sup> *Tackett*, 653 A.2d at 257.

<sup>141</sup> *Id.*

<sup>142</sup> *Id.* at 259.

<sup>143</sup> *Id.* (quoting 8 JOHN H. WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2327 (J. McNaughton rev. ed. 1961)).

<sup>144</sup> *Id.* (quoting *Hercules, Inc. v. Exxon Corp.*, 343 F. Supp. 136, 156 (D. Del. 1977)).

<sup>145</sup> *Id.* (citing generally *Hoescht Celanese Corp. v. Nat’l Union Fire Ins. Co. of Pittsburgh*, 623 A.2d 1118, 1125 (Del. Super. Ct. 1992)).

assertions in order to contradict them.”<sup>146</sup>

The court in *Tackett* concluded that the insured had met the exacting standards for a finding of implied waiver of the attorney-client privilege.<sup>147</sup> In its answer, State Farm contended that it did not unreasonably deny the insured’s claim, and raised the affirmative defense of failure of the insured to provide information necessary for the insurer to process the claim.<sup>148</sup> Although this defense did not directly relate to any protected communications, the court observed that it did “suggest that there was nothing in the routine handling of the claim that contributed to the delay.”<sup>149</sup> When State Farm was required to set forth the reasons to support its claim of reasonable justification for non-payment, it relied upon the affidavit of one of its claims superintendents who was responsible for handling the Tackett claim.<sup>150</sup> The affidavit cited in relevant part the following:

Based on my experience of ten years, this claim was handled routinely, without any undue delay, with no bad faith on the part of State Farm Mutual Automobile Insurance Company or its employees. Furthermore, no reason existed to handle this claim unlike any other claim that comes through this office, and based on my experience, State Farm handled this claim as expediently as any other claims office in this local [sic] would have handled a similar claim.<sup>151</sup>

Reviewing these facts the court in *Tackett* observed:

Once State Farm alleged particularized facts that implicitly relied upon communications with counsel contained in the Tacketts’ file, the first prong of the waiver analysis was satisfied—disclosure of otherwise protected facts relevant to a particular subject matter relied upon as a defense.

. . . Here, once State Farm alleged a routine handling of the Tacketts’ claim and suggested that any delay was attributable to inaction on the part of the insured, the Tacketts could challenge those allegations only with a full showing of the facts contained in the claim file. To rule otherwise would permit State Farm to gain the inference that, not only was the claim handled routinely, but the routine analysis of the claim supported the delay in payment. Fairness requires that assertions of fact be tested by disclosure.

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<sup>146</sup> *Tackett*, 653 A.2d at 259 (quoting *Friction Div. Prods., Inc. v. E.I. Du Pont De Nemours & Co.*, 117 F.R.D. 535, 538 (D. Del. 1987)).

<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *Id.* at 260.

<sup>151</sup> *Id.* at 258.

Without access to the complete file, the Tacketts would be unable to challenge State Farm's assertions and would be forced to accept as true its claim of routine handling.<sup>152</sup>

The *Tackett* court, therefore, recognized that "[a] party cannot force an insurer to waive the protections of the attorney-client privilege merely by bringing a bad faith claim."<sup>153</sup> The court also emphasized that the standard for waiver is "exacting,"<sup>154</sup> and warned that its holding "does not create a rule of *per se* waiver of the attorney-client privilege in insurance bad faith cases."<sup>155</sup>

The court expressly rejected the notion that it was creating a rule of *per se* waiver of the attorney-client privilege in insurance bad-faith cases.<sup>156</sup> The court observed, however, that where an insurance company "makes factual representations which implicitly rely upon legal advice as justification for non-payment of claims, the insurer cannot shield itself from disclosure of the complete advice of counsel relevant to the handling of the claim."<sup>157</sup> At issue in *Tackett* was the advice State Farm received from its outside counsel, which was contained within the State Farm claim file. In its internal evaluation report, a State Farm claims representative had evaluated the Tacketts' settlement demand and supporting documentation, and concluded that the claim was valued at between \$45,000 and \$50,000.<sup>158</sup> State Farm established a \$50,000 reserve on the claim but ordered an independent medical examination (IME) because it was possible that a previous accident had contributed to the insured's condition.<sup>159</sup>

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<sup>152</sup> *Tackett*, 653 A.2d at 260.

<sup>153</sup> *Id.* at 259.

<sup>154</sup> *Id.*

<sup>155</sup> *Id.* at 260.

<sup>156</sup> *Id.* Tellingly, several subsequent Delaware cases applying *Tackett* have held that insurers have not waived the privilege by denying bad faith. See *Clausen v. Nat'l Grange Mut. Ins. Co.*, 730 A.2d 133, 143 (Del. Super. Ct. 1997) (holding no waiver where insurer merely "denied having no reasonable justification for its actions"); *Ruger v. Commonwealth Land Title Ins. Co.*, No. 93C-04-210, 1996 WL 769793, at \*6 (Del. Super. Ct. Nov. 27, 1996) (no waiver where insurer did not assert affirmative defenses and merely asserted in a letter that its policy interpretation was proper without any partial disclosure of facts); *Kemper Ins. v. Soligo*, No. 95 C-08-266-WTQ, 1996 WL 944919, at \*1-\*2 (Del. Super. Ct. May 9, 1996) (holding no waiver, even though privileged communications conceivably could have been implicated, where insurer asserted medical expert opinion as reasonable justification for claims handling). But see *Wolhar v. Gen. Motors Corp.*, 712 A.2d 457 (Del. 1997) ("The Court cannot permit [a litigant] to make bare, factual allegations that are central to the dispute between the parties and then permit [it] to assert the attorney-client privilege as a barrier to the better understanding of the factual situation.").

<sup>157</sup> *Tackett*, 653 A.2d at 260.

<sup>158</sup> *Id.*

<sup>159</sup> *Id.* at 257.

State Farm's outside counsel, however, reported that "the possible benefit of an independent medical examination is questionable."<sup>160</sup> Outside counsel also advised the State Farm claims representative that "the arbitrator would probably find the [Tacketts'] claim had a value of \$50,000 or more even though it has some obvious disabilities."<sup>161</sup> The doctor performing the IME notified State Farm that "Mrs. Tackett does not have any impressive neurological signs," but that the accident in question did trigger a prior back condition.<sup>162</sup> As a result of the IME findings, State Farm authorized a payment of \$30,000 and made an initial offer of \$20,000.<sup>163</sup> The settlement offer was rejected, and counsel for the insured repeated a prior demand for the policy limits.<sup>164</sup> Shortly thereafter, the file was transferred to a new claims superintendent.<sup>165</sup> The new claims superintendent concluded, after a full review of the claims file, that State Farm had undervalued the claim. Therefore, a written offer of policy limits was sent to the Tacketts' attorney.<sup>166</sup> Although the court determined that State Farm had waived the attorney-client privilege, the finding of waiver did not automatically relinquish the protection provided by the work product doctrine.<sup>167</sup> Recognizing the landscape of this debate,<sup>168</sup> the court rejected the contention that Federal Rule of Civil Procedure 26(b)(3) grants absolute immunity to opinion work

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<sup>160</sup> *Id.* (internal quotation marks omitted).

<sup>161</sup> *Id.* (internal quotation marks omitted).

<sup>162</sup> *Id.* (internal quotation marks omitted).

<sup>163</sup> *Tackett*, 653 A.2d at 257.

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*

<sup>166</sup> *Id.*

<sup>167</sup> *Id.* at 260.

<sup>168</sup> The court in *Tackett* observed:

On the one hand, courts continually seek to provide an atmosphere in which clients may have unfettered communications with counsel, and in which attorneys may freely develop a client's case without undue interference from opposing counsel. On the other hand, a bad faith claim against an insurer cannot be proven without sufficient access to the claim file which frequently contains opinion work product.

*Id.* at 261 (citations omitted). This dilemma has "generated significant commentary and a conflict among courts when deciding whether to allow a party to discover opinion work product." *Id.*; see, e.g., Andrea L. Borgford, Comment, *The Protected Status of Opinion Work Product: A Misconduct Exception*, 68 WASH. L. REV. 881 (1993); Papetti, *supra* note 3; Donna Goodin Payne, Note, *Insurer Bad Faith: The Need for an Exception to the Attorney-Client Privilege*, 11 REV. LITIG. 111 (1991); Jayne E. Powell & Ellen L. Lyons, *Alaska Supreme Court Year in Review 1990*, 8 ALASKA L. REV. 70 (1990); see also Diego C. Asencio, F.S. 624.155 Actions: *The Expanding Field of Claimants, Claims and Complexities*, 9 TRIAL ADVOC. Q. 31, 37 (1990); Nielsen, *supra* note 15; Thomas E. Workman, *Plaintiff's Right to the Claim File, Other Claim Files and Related Information: The Ticket to the Gold Mine*, 25 TORT & INS. L.J. 137 (1988).

product. Thus, the court declined to read the mandatory language of the rule as establishing an impenetrable barrier to discovery of opinion work product.<sup>169</sup>

2. *State Farm Mutual Automobile Insurance Co. v. Lee*  
(Arizona)

In *State Farm Mutual Auto. Insurance Co. v. Lee*,<sup>170</sup> the Arizona Supreme Court explored the contours of the “at issue” implied waiver doctrine as it related to the attorney-client privilege.<sup>171</sup>

In *Lee*, a class representing approximately one thousand State Farm insureds brought suit against State Farm contesting the systematic denial of uninsured and underinsured motorist coverage stacking claims.<sup>172</sup> Between 1988 and 1995, State Farm rejected stacking<sup>173</sup> claims in single loss situations. It was State Farm’s practice

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<sup>169</sup> *Tackett*, 635 A.2d at 262.

<sup>170</sup> 13 P.3d 1169 (Ariz. 2000).

<sup>171</sup> Arizona law provides that information contained in communications between attorney and client in the context of the attorney-client relationship is confidential if maintained in confidence. ARIZ. REV. STAT. § 12-2234 (2003). Generally, the Arizona courts “construe privilege statutes narrowly because they exclude relevant evidence and impede the fact-finder’s search for the truth.” *Blazek v. Superior Court*, 869 P.2d 509, 511 (Ariz. Ct. App. 1994); *see also Church of Jesus Christ of Latter-Day Saints v. Superior Court*, 764 P.2d 759, 764 (Ariz. Ct. App. 1988). This is consistent with the law of other jurisdictions. *See, e.g., United States v. Mierzwicki*, 500 F. Supp. 1331, 1334 (D. Md. 1980) (“Any examination of the attorney-client privilege should begin with the observation that privileges are not favored in the law and are seen as a hinderance to litigation.”); *League v. Vanice*, 374 N.W.2d 849, 856 (Neb. 1985); *Cohen v. Jenkintown Cab Co.*, 257 A.2d 689, 693-94 (Pa. Super. Ct. 1976); MCCORMICK ON EVIDENCE § 77, at 156 (Edward W. Cleary ed., 2d ed. 1972) (noting that privilege serves only to “shut out the light”).

Under Arizona law, the attorney-client privilege belongs to the client and serves “to encourage free exchange of information between the attorney and the client to promote the administration of justice.” *State v. Holsinger*, 601 P.2d 1054, 1058 (Ariz. 1979). The privilege encourages clients to tell their lawyers the truth. “Unless the lawyer knows the truth, he or she cannot be of much assistance to the client.” *Samaritan Found. v. Goodfarb*, 862 P.2d 870, 874 (Ariz. 1993). Thus, the privilege under Arizona law is “central to the delivery of legal services.” *Id.* The privilege, however, may be waived either expressly or implicitly if the person that holds the privilege voluntarily discloses information within its purview. *Danielson v. Superior Court*, 754 P.2d 1145, 1148-49 (Ariz. Ct. App. 1987).

<sup>172</sup> *Lee*, 13 P.3d at 1171.

<sup>173</sup> There are two types of stacking in the automobile insurance context. Intra-policy stacking can occur when the stated per person policy limits are multiplied by the number of vehicles covered by the policy. Courts in other jurisdictions have permitted this type of stacking. *See, e.g., Allstate Ins. Co. v. Randall*, 753 F.2d 441 (5th Cir. 1985) (applying Mississippi law); *Am. Ins. Co. v. Takahashi*, 575 P.2d 881 (Haw. 1978); *Chaffee v. United States Fid. & Guar. Co.*, 591 P.2d 1102 (Mont. 1979); *Allstate Ins. Co. v. Maglish*, 586 P.2d 313 (Nev. 1978); *Am. States Ins. Co. v. Milton*, 573 P.2d 367 (Wash. 1978). Professor Long, in his treatise on liability insurance law,



to issue separate insurance policies covering each vehicle in a multiple vehicle household.<sup>174</sup> When losses occurred for which there were insufficient insurance funds to compensate the insured from the other tortfeasor's insurance policies, the State Farm class members presented underinsured motorist claims to State Farm for additional compensation.<sup>175</sup> State Farm rejected these claims based on the wording of A.R.S. § 20-259.01(H),<sup>176</sup> which permitted insurance companies to use anti-stacking policy clauses to eliminate stacking.<sup>177</sup> In 1995, however, the Arizona Supreme Court, in *State Farm Mutual Insurance Co. v. Lindsey*,<sup>178</sup> determined that the anti-stacking language

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commented on this type of policy limit stacking:

The most common rationale used by courts in permitting intra-policy stacking is that a combination of the limits of liability clause and the payment of separate premiums creates an ambiguity, which must, of course, be construed against the insurer. An argument (in addition to the statute) is that since a premium was paid for the coverage, claimant is entitled to the coverage. Since the coverage is a contract benefit which has been paid for, plaintiff is not seeking a windfall as a result of his injury, but full indemnity based on payment of separate premiums. When separate premiums are paid, and allocated, for each vehicle listed, considerations of equity apply. As stated by Professor Widiss:

A premium has been paid for each of the endorsements and coverage has been issued. It seems both equitable and desirable to permit recovery under more than one endorsement until the claimant is fully indemnified.

3 ROWLAND H. LONG, *THE LAW OF LIABILITY INSURANCE* § 24.27 (1990) (footnotes omitted) (quoting A. WIDISS, *A GUIDE TO UNINSURED MOTORIST COVERAGE* 112 (1969)). However, the Arizona courts do not permit this type of stacking. *See, e.g., Hampton v. Allstate Ins. Co.*, 616 P.2d 78 (Ariz. Ct. App. 1980). The court in *Hampton* rejected the insured's argument that stacking should be permitted because a separate premium was charged for the coverage available on each vehicle. In responding to this argument, the court found that the individual premium charge was justified because of the additional risk associated with covering multiple vehicles. *Id.* at 80-81.

Interpolicy stacking arises in multi-policy situations. "Other insurance" clauses are typically used by the insurance industry to eliminate the stacking of coverages in multiple-policy situations. The typical anti-stacking clause contains two essential provisions. First, the policy requires coverage to be prorated. Second, the policy establishes a total coverage limit available for the loss to which the prorated percentage applies. Unless the policy places a limit on the amount of the loss, stacking can occur. *See, e.g., Barrett v. Farmer's Ins. Group*, 220 Cal. Rptr. 135 (Ct. App. 1985); *Menke v. Country Mut. Ins. Co.*, 386 N.E.2d 1133 (Ill. App. Ct. 1979); *Bishop v. Washington*, 480 A.2d 1088 (Pa. Super. Ct. 1984).

<sup>174</sup> *Lee*, 13 P.3d at 1171.

<sup>175</sup> *Id.*

<sup>176</sup> ARIZ. REV. STAT. § 20-259.01(H) (2003) (formerly ARIZ. REV. STAT. § 20-259.01(F)).

<sup>177</sup> *Id.*

<sup>178</sup> 897 P.2d 631 (Ariz. 1995).

used by State Farm was legally insufficient to prevent stacking.<sup>179</sup>

The class member insureds argued that even before the court's decision in *Lindsey*, State Farm knew the anti-stacking clause was invalid.<sup>180</sup> Therefore, State Farm acted in bad faith when, from 1988 to 1997, State Farm denied its insureds' requests to stack coverage.<sup>181</sup> State Farm maintained that until *Lindsey* was decided, it had acted reasonably in interpreting A.R.S. § 20-259.01(H) in conjunction with its policy language in order to preclude stacking.<sup>182</sup>

During discovery State Farm acknowledged having received the advice of counsel regarding whether to pay or reject class member claims.<sup>183</sup> State Farm asserted the attorney-client privilege regarding the production of counsel's coverage analysis, but declared that it would not advance a good faith defense based on the advice of counsel.<sup>184</sup> The trial court accepted State Farm's position that it would not advance an advice-of-counsel defense directly.<sup>185</sup> Thus,

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<sup>179</sup> In *Lindsey*, the court held that the provisions of ARIZ. REV. STAT. § 20-259.01(F) (now, subsection (H)) are not self-executing because the wording of the statute is merely permissive. 897 P.2d at 633. To be effective, "[a]dditional policy language is needed to incorporate the limitation into a policy." *Id.*

The importance of having appropriate court "anti-stacking" language in the policy was demonstrated in *State Farm Mutual Automobile Insurance Co. v. Herron*, 599 P.2d 768 (Ariz. 1979), where the insurance company argued that stacking was prohibited under Arizona law generally: "[A]ppellee argues that the law of Arizona does not allow 'stacking' of uninsured motorist coverages and that appellant may not collect an additional \$35,000 under the provisions of his own policy because this would constitute 'stacking'." *Id.* at 771. In rejecting this argument, the court stated: "We recognized the elementary principle of contract law that if one wishes to buy more coverage, he may do so and the extent of that coverage will depend on the terms of the contract." *Id.* The "other insurance" clause in *Herron* was an excess type and did not preclude stacking. Indeed, the court in *Herron* acknowledged that the case did not involve a stacking question. *Id.* at 772. The court gave effect to the excess clause. *Id.* at 772-73.

<sup>180</sup> *Lee*, 13 P.3d at 1172.

<sup>181</sup> *Id.*

<sup>182</sup> *Id.* State Farm argued that its position rejecting stacking was not unreasonable because of the unsettled status of Arizona law. State Farm cited *Giannini v. State Farm Mutual Automobile Insurance Co.*, 837 P.2d 1203, 1206 (Ariz. Ct. App. 1992), in which Division One held that the anti-stacking provision in State Farm's policy was sufficient to invoke the statute and precluded stacking. *See also* *State Farm Mut. Auto. Ins. Co. v. Lindsey*, 885 P.2d 144, 150 (Ariz. Ct. App. 1994) (Division One again holding that anti-stacking provision in State Farm's policies "plainly encompass[es] the statute's] limitation on stacking"). *But see* *State Farm Mut. Auto. Ins. Co. v. Berardi*, No. 2 CA-CV 93-0051 (Ariz. Ct. App. 1993) (mem.), *review denied*, (Mar. 16, 1994) (Division Two requiring State Farm to permit stacking of policyholder's uninsured motorist/underinsured motorist claims).

<sup>183</sup> *Lee*, 13 P.3d at 1172.

<sup>184</sup> *Id.* The documents involved communications with 15 different law firms. *Id.*

<sup>185</sup> *Id.* at 1173.

State Farm would not be able to rely upon the objective reasonableness of its decision to deny stacking.<sup>186</sup> State Farm did assert the subjective good faith of its claims managers in deciding to deny stacking, and argued that their beliefs were reasonable in light of their understanding of the law at that time.<sup>187</sup> Because State Farm avowed to the trial court “that it would defend in part on what its decisionmakers knew, thought and did,” the trial court determined that State Farm’s knowledge “included advice of counsel because that was a part of the basis for the defense.”<sup>188</sup> The trial court held, therefore, “that State Farm impliedly waived the privilege when it *put at issue* the subjective *legal* knowledge of its managers after they sought and received legal advice.”<sup>189</sup>

The Arizona Court of Appeals accepted jurisdiction and vacated the trial court’s discovery order.<sup>190</sup> The court of appeals held that State Farm had not impliedly waived the privilege or put its attorney-client communications at issue because it had only refuted plaintiff’s allegations, and had not injected privilege-related issues into the case.<sup>191</sup> As a threshold matter, the court adopted<sup>192</sup> the three-prong test for “at issue” implied waivers set forth in *Hearn v. Rhay*.<sup>193</sup>

The Arizona Supreme Court rejected the view that implied waiver will be found only when the party advances an express claim of reliance on advice of counsel.<sup>194</sup> The court noted that if the client’s intent not to abandon the privilege could alone control the situation, then waiver would seldom be found.<sup>195</sup> Thus, the determination of

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<sup>186</sup> *Id.*

<sup>187</sup> *Id.*

<sup>188</sup> *Id.* (internal quotation marks and citation omitted).

<sup>189</sup> *Lee*, 13 P.3d at 1173.

<sup>190</sup> In discovery matters, Arizona trial judges have broad discretion, and their decisions are reviewed only for abuse. *See Brown v. Superior Court*, 670 P.2d 725, 729 (Ariz. 1983).

<sup>191</sup> *Lee*, 13 P.3d at 1173.

<sup>192</sup> *Id.*

<sup>193</sup> 68 F.R.D. 574, 581 (E.D. Wash. 1975). *Hearn* involved a prisoner plaintiff’s claim that the government had violated his constitutional rights by confining him to a mental health unit without a hearing or review. *Id.* at 577. The government asserted the defense of qualified immunity, alleging that it acted in the good-faith belief that its actions did not violate any clearly established constitutional right. *Id.* The government expressly disavowed reliance on advice of counsel. *Id.* at 581 n.5. Nonetheless, the *Hearn* court found that the assertion of the defense was an affirmative act that made the government’s communication with counsel relevant, and the denial of access to those communications would have been manifestly unfair to the plaintiff. *Id.* at 581-82.

<sup>194</sup> *Lee*, 13 P.3d at 1178.

<sup>195</sup> *Id.* (citing 8 JOHN H. WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2327, at

whether implied waiver has occurred also includes an objective consideration: when one's conduct reaches a "certain point of disclosure," fairness demands that the privilege be waived regardless of the privileged person's intentions.<sup>196</sup> Turning to this inquiry, the court recognized that there was "a great deal of confusion" in this area, and then quoted the *Restatement (Third) of the Law Governing Lawyers* in describing various approaches used in other jurisdictions:

At least three approaches to the waiver [issue exist]: The first approach radically holds that, whenever a party seeks judicial relief, the party impliedly waives the privilege. A second approach would attempt 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. The third approach avoids the extremes of an over-inclusive automatic-waiver rule or an indeterminate, ad hoc balancing approach. Instead, it focuses on 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 fairly to resist the client's own evidence on that very issue.<sup>197</sup>

Privilege is waived under the first two views "whenever a client's mental state was in issue."<sup>198</sup> The court observed that this approach was "dubious absent acceptance of the Benthamite principle that the privilege ought to be overthrown to facilitate the search for truth."<sup>199</sup> The court in *Lee* adopted the third, intermediate approach as being least restrictive of the three approaches outlined above.<sup>200</sup> By adopting this approach, the court "reject[ed] the idea that the mere filing of a bad faith action, the denial of bad faith, or the affirmative claim of good faith may be found to constitute an implied waiver of the privilege."<sup>201</sup> Waiver will occur, however, if the privileged party has asserted a claim or defense—for example, that its evaluation of the law was reasonable—which would include, necessarily, the information received from its counsel.<sup>202</sup> At that point the privileged party has injected "the issue of advice of counsel into the litigation to the extent that recognition of the privilege would deny the opposing

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636 (J. McNaughton rev. ed. 1961)).

<sup>196</sup> *Id.* The court in *Lee* questioned where that "certain point" is reached in which fairness requires waiver. *Id.* at 1178-79.

<sup>197</sup> *Id.* at 1179 (internal citations omitted) (citing RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 80 cmt. b (1998)).

<sup>198</sup> *Id.*

<sup>199</sup> *Id.* (internal quotation marks omitted).

<sup>200</sup> *Lee*, 13 P.3d at 1179.

<sup>201</sup> *Id.*

<sup>202</sup> *Id.*

party access to proof without which it would be impossible for the factfinder to fairly determine the very issue raised by that party.”<sup>203</sup>

The court in *Lee* concluded that the “certain point” at which fairness requires waiver is reached when “the party asserting the privilege claims its conduct was proper and permitted by law and based in whole or in part on its evaluation of the state of the law.”<sup>204</sup> When this occurs, the privileged party’s knowledge about the law becomes central, and the advice of its counsel, highly relevant to the legal implications of the privileged party’s conduct.<sup>205</sup> In this situation, “the truth cannot be found absent exploration of [the] issue.”<sup>206</sup> A contrary finding would result in “unfairness not just to the party opposing assertion of the privilege but to the entire [judicial] system.”<sup>207</sup>

Preemptively, the majority focused on Justice Martone’s dissenting opinion. The court agreed with the dissent that it was the plaintiffs who had raised the issue of subjective bad faith among State Farm’s employees, but noted that the waiver of the privilege was not based on State Farm’s denial of that allegation.<sup>208</sup> Further, State Farm’s affirmative assertion of good faith did not waive the privilege.<sup>209</sup> The court then identified the basis for its decision:

It is, rather, State Farm’s affirmative assertion that its actions were reasonable because of its evaluation of the law, based on its interpretation of the policies, statutes, and case law, and because of what its personnel actually knew and did.

But what its personnel did, presumably among other things, was to consult counsel and obtain counsel’s views of the meaning of the policies, statutes, and case law. Having asserted that its actions were reasonable because of what it knew about the applicable law, State Farm has put in issue the information it obtained from counsel.<sup>210</sup>

Although State Farm did not specifically state that legal “advice was relevant to the legal significance of its conduct,”<sup>211</sup> an assertion that the insurance company relied upon advice of counsel would be

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<sup>203</sup> *Id.*

<sup>204</sup> *Id.* at 1178, 1179.

<sup>205</sup> *Id.* at 1179.

<sup>206</sup> *Lee*, 13 P.3d at 1179.

<sup>207</sup> *Id.*

<sup>208</sup> *Id.* at 1181.

<sup>209</sup> *Id.*

<sup>210</sup> *Id.* at 1180-81.

<sup>211</sup> *Id.* at 1181.

“the functional equivalent of an express advice-of-counsel defense.”<sup>212</sup> The court noted that “[m]ost sophisticated litigants [would] know better than to dig that hole for themselves.”<sup>213</sup> The concept of implied waiver does not “require such a magical admission,” nor does it require the court to “accept as dispositive the client’s assertion that it did not rely on the advice it received.”<sup>214</sup> The majority found that a contrary holding would make “a mockery of the law.”<sup>215</sup> On the one hand, an insurance company could argue “that it acted reasonably because it made a legal evaluation from which it concluded that the law permitted it to act in a certain manner,”<sup>216</sup> while, on the other hand, it would allow that same insurance company “to withhold from its adversary and the factfinder information it received from counsel on that very subject.”<sup>217</sup> In that situation, “[t]he sword and shield metaphor would truly apply.”<sup>218</sup>

The court found that “[b]y asserting the subjective evaluation and understanding of its personnel about the state of the law on stacking, State Farm has affirmatively injected the legal knowledge of its claims managers into the litigation and put the extent, and thus the sources, of this legal knowledge at issue.”<sup>219</sup> Thus, the insurance company will be precluded from testifying “that they investigated the state of the law and concluded [that they] believed they were acting within the law but deny Plaintiffs the ability to explore the basis for this belief and to determine whether [the insurance company] might have known its actions did not conform to the law.”<sup>220</sup>

The court, however, limited the scope of its ruling. As an example, the court noted that its holding did not have the effect of waiving the privilege for communications between the insurer and outside counsel on subjects merely pertaining to the legal question at issue.<sup>221</sup> In essence,

[p]laintiffs are not entitled to a fishing expedition through all of counsel’s communications . . . but only to discovery of those communications pertaining to the permissibility or deniability of the [legal issue] under the policy language, the case law, and the

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<sup>212</sup> *Lee*, 13 P.3d at 1181.

<sup>213</sup> *Id.*

<sup>214</sup> *Id.*

<sup>215</sup> *Id.* at 1182.

<sup>216</sup> *Id.*

<sup>217</sup> *Id.*

<sup>218</sup> *Lee*, 13 P.3d at 1182.

<sup>219</sup> *Id.*

<sup>220</sup> *Id.* (internal quotation marks omitted).

<sup>221</sup> *Id.* n.8.

statutes as they existed at the time the claims were presented.<sup>222</sup>

Ultimately, the court held that the trial judge had not committed legal error or abused his discretion by permitting discovery of attorney-client privileged materials.<sup>223</sup> The court also approved the *Hearn* test,<sup>224</sup> and adopted the test set forth in *Restatement (Third) of the Law Governing Lawyers* § 80(1), which provides, in relevant part, that:

The attorney-client privilege is waived for any relevant communication if the client asserts as to a material issue in a proceeding that:

(a) the client acted upon the advice of a lawyer or that the advice was otherwise relevant to the legal significance of the client's conduct . . . .<sup>225</sup>

The court rejected the notion "that the mere filing of a bad faith action, the denial of bad faith, or the affirmative claim of good faith may be found to constitute an implied waiver of the privilege."<sup>226</sup> The court found that a party does not waive the attorney-client privilege

unless it has asserted some claim or defense, such as the reasonableness of its evaluation of the law, which necessarily includes the information received from counsel. In that situation, the party claiming the privilege has interjected the issue of advice of counsel into the litigation to the extent that recognition of the privilege would deny the opposing party access to proof without which it would be impossible for the factfinder to fairly determine the very issue raised by that party. We believe such a point is reached when, as in the present case, the party asserting the privilege claims its conduct was proper and permitted by law and based in whole or in part on its evaluation of the state of the law. In that situation, the party's knowledge about the law is vital, and the advice of counsel is highly relevant to the legal significance of the client's conduct. Add to that the fact that the truth cannot be found absent exploration of that issue, and the conditions of RESTATEMENT § 80 are met.<sup>227</sup>

The deposition of Gillespie, State Farm's Tucson claims superintendent, demonstrated the unfairness of this aspect of the judicial system. The review of the deposition indicated that Gillespie

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<sup>222</sup> *Id.*

<sup>223</sup> *Id.* at 1184.

<sup>224</sup> *See Lee*, 13 P.3d at 1173.

<sup>225</sup> *Id.* at 1179 (emphasis omitted) (quoting RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 80(1)).

<sup>226</sup> *Id.*

<sup>227</sup> *Id.*

had little or no legal knowledge except that which was supplied to him by State Farm's counsel.<sup>228</sup> When Gillespie was asked to describe the legal training that State Farm had given him to qualify him to make the evaluation in question, Gillespie indicated that he could not recall what training he had.<sup>229</sup> When asked whether there were any sources that opposing counsel could look to in order to determine what legal information would have been available to Gillespie apart from the advice he received from counsel, Gillespie indicated there were no other sources.<sup>230</sup> The court found that by asserting the subjective evaluation and understanding of its personnel about the state of the law on stacking, State Farm had affirmatively injected the legal knowledge of its claims managers into the litigation and put the extent, and thus the sources, of that legal knowledge at issue.<sup>231</sup> The court found that "State Farm's claims managers [could not] testify that they investigated the state of the law and concluded and believed they were acting within the law but deny Plaintiffs the ability to explore the basis for this belief and to determine whether it might have known its actions did not conform to the law."<sup>232</sup>

State Farm argued that it injected the subjective belief of its claims personnel into the litigation because the plaintiffs had alleged State Farm not only misinterpreted the law but did so knowingly.<sup>233</sup> Thus, State Farm argued that the plaintiffs, and not State Farm, had injected the issue of subjective belief into the litigation.<sup>234</sup> After acknowledging that it would be difficult for State Farm to meet plaintiffs' allegation without affirmatively alleging that it had investigated and evaluated the law,<sup>235</sup> the court stated that State Farm could have done so simply by denying that it knew it was acting unlawfully and relying on a defense of objective reasonableness.<sup>236</sup> Plaintiffs would then be forced to prove State Farm knew it was acting unlawfully.<sup>237</sup>

Justice Martone vigorously dissented from the majority's holding. The Justice prefaced his dissent by acknowledging and

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<sup>228</sup> *Id.* n.5.

<sup>229</sup> *Id.*

<sup>230</sup> *Lee*, 13 P.3d at 1179 n.5.

<sup>231</sup> *Id.* at 1183.

<sup>232</sup> *Id.* at 1182 (internal quotation marks omitted).

<sup>233</sup> *Id.*

<sup>234</sup> *Id.*

<sup>235</sup> *Id.* at 1183 (describing State Farm's position as being "between Scylla and Charybdis").

<sup>236</sup> *Lee*, 13 P.3d at 1182.

<sup>237</sup> *Id.*



agreeing with the majority that the Restatement and the *Hearn* tests set forth the appropriate rule when a client impliedly waives the attorney-client privilege by putting assistance or communication in issue.<sup>238</sup> Having made these concessions, the dissent observed that the Restatement and *Hearn* analyses requires the *privilege holder* and not the other party to the litigation to affirmatively inject an issue that implicates privileged communications. The dissent emphasized that the Restatement approach required that either of two conditions be met: “[T]he client acted upon the advice of a lawyer or *that the advice was otherwise relevant to the legal significance of the client’s conduct.*”<sup>239</sup> In that regard, it did not suffice “that the advice was otherwise relevant to the legal significance of the client’s conduct.”<sup>240</sup> Rather, the dissent noted that the Restatement requires the client to “assert that the advice was otherwise relevant to the legal significance of the client’s conduct.”<sup>241</sup>

In Arizona, a bad-faith claim “requires proof of both objective and subjective unreasonableness on the part of the insurer.”<sup>242</sup> The plaintiff, not the privilege holder insurance company, determines whether to put at issue the subjective reasonableness of defendant’s conduct.<sup>243</sup> In fact, “the plaintiff must inject the issue of subjective unreasonableness into the litigation.”<sup>244</sup> This is so because under the *Noble/Zilisch* test for bad faith in Arizona, “[t]he appropriate inquiry is whether there is sufficient evidence from which reasonable jurors could conclude that in the investigation, evaluation, and processing of the claim, the insurer acted unreasonably and *either knew or was conscious of the fact that its conduct was unreasonable.*”<sup>245</sup> The dissent criticized the majority because the majority ruling requires a bad-faith defendant to choose between defending against both prongs of the *Noble/Zilisch* test, and thereby waiving the attorney-client privilege, or defending solely on the objective reasonableness of its decision.<sup>246</sup>

The practical consequence of the majority’s ruling would be that

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<sup>238</sup> *Id.* at 1184 (Martone, J., dissenting).

<sup>239</sup> *Id.* (internal quotation marks omitted) (quoting RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 80(1)(a)).

<sup>240</sup> *Id.* (internal quotation marks omitted).

<sup>241</sup> *Id.*

<sup>242</sup> *Lee*, 13 P.3d at 1185 (Martone, J., dissenting) (citing *Noble v. Nat’l Am. Life Ins. Co.*, 624 P.2d 866, 868 (Ariz. 1981); *Zilisch v. State Farm Mut. Auto. Ins. Co.*, 995 P.2d 276, 280 (Ariz. 2000)).

<sup>243</sup> *Id.*

<sup>244</sup> *Id.*

<sup>245</sup> *Id.* (quoting *Zilisch*, 995 P.2d at 280) (internal quotation marks omitted).

<sup>246</sup> *Id.*

no bad-faith defendant could properly defend the action without waiving the privilege. In that regard, the majority's application of *Hearn* and the Restatement in the context of the bad-faith case before it, completely subverted the critical elements of each test.

The dissent observed that “[u]nder the majority view, a plaintiff may abrogate the defendant’s attorney-client privilege simply by raising a bad faith claim on any matter regarding an interpretation of the law.”<sup>247</sup> The dissent further observed that “it may well be that an insurer would be willing to make a coverage decision without relying on the advice of its lawyers. But the prudent insurer will consult a lawyer and under today’s decision that advice always will be admissible in an action against it claiming bad faith.”<sup>248</sup> Justice

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<sup>247</sup> *Id.*

<sup>248</sup> *Lee*, 13 P.3d at 1185 (Martone, J., dissenting). Justice McGregor’s dissent points to the slippery slope that was created by the majority’s opinion:

But today’s holding, which applies not only to plaintiffs’ bad faith claim, but also to the counts alleging fraud, will sweep even more broadly. If a defendant can waive the privilege simply by relying upon knowledge gained, in part, through advice of counsel to deny a plaintiff’s allegations, any plaintiff advancing a subjective claim will run the risk of waiving the privilege simply by filing an action. A plaintiff who advances a subjective claim seemingly will waive the privilege if, before asserting his claim, he consults with his lawyer and uses the knowledge obtained to reasonably evaluate his claim. Because many, perhaps most, potential litigants do not know the elements of claims they seek to assert before consulting a lawyer, and do not understand whether they possess sufficient basis to assert a claim, a plaintiff’s decision to proceed with an action necessarily relies upon the advice of counsel. For instance, these plaintiffs presumably consulted with their attorneys before bringing this action for bad faith, which involves the subjective element described by the majority. If so, their reliance on their “subjective and alleged reasonable evaluation of the law—but an evaluation that necessarily incorporates what the litigant learned from its lawyer [renders] the communication . . . discoverable and admissible.” Can the defendant now discover otherwise privileged communications to determine whether the plaintiffs in fact had a basis for making their claim? Similarly, a plaintiff in a personal injury action who claims subjective damages for pain and suffering could be found to have waived the attorney-client privilege if the knowledge on which she bases her claim and right to bring it derive, at least in part, from communications with counsel. If bringing the claim does not itself waive the privilege, is an assertion from the defendant that the plaintiff lacked a good faith basis for bringing the claim sufficient to waive the privilege? And if the defendant’s assertion alone does not waive the privilege, surely, in the words of the majority opinion, the plaintiff’s denial of the argument that he lacked a good faith basis for his claims constitutes an attempt “to establish [his] mental state by asserting that [he] acted after investigating the law and reaching a well-founded belief that the law permitted the action [he] took . . . .”

*Id.* at 1186-87 (McGregor, J., dissenting) (internal citations omitted).

McGregor, who dissented but wrote separately, delivered a eulogy for the attorney-client privilege because of the majority's decision:

Today we make the scope of the attorney-client privilege uncertain, at best, and abrogate the privilege in many instances, at worst. . . . To permit plaintiffs to discover communications that they quite probably do not need to establish their claim, we have placed in jeopardy countless attorney-client communications, which litigants rightly anticipated would be confidential. We also have introduced needless uncertainty into the attorney-client relationship, and have discouraged persons from seeking needed legal advice, which they cannot assume will remain confidential.<sup>249</sup>

### 3. *Boone v. Vanliner Insurance Co.* (Ohio)

The attorney-client privilege has long been recognized by the Ohio courts.<sup>250</sup> In a split decision, however, the Ohio Supreme Court in *Boone v. Vanliner Insurance Co.*<sup>251</sup> declared that “in an action alleging bad faith denial of insurance coverage, the insured is entitled to discover claims file materials containing attorney-client communications related to the issue of coverage that were created prior to the denial of coverage.”<sup>252</sup>

The insured, Richard Boone, was an over-the-road truck driver.<sup>253</sup> He purchased a commercial vehicle liability policy from Vanliner Insurance Company<sup>254</sup> and a second policy was issued to Boone's employer.<sup>255</sup> Both policies provided liability coverage,<sup>256</sup> and both policies provided underinsured motorist (UIM) coverage.<sup>257</sup> Boone was involved in a significant trucking accident in which he suffered serious injuries.<sup>258</sup> The tortfeasor's insurance company paid Boone the maximum of its liability policy limits.<sup>259</sup> Because his injuries were serious, Boone then presented UIM claims to Vanliner under both

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<sup>249</sup> *Id.* at 1187 (McGregor, J., dissenting) (paragraph structure omitted).

<sup>250</sup> *See, e.g., In re Klemann*, 5 N.E.2d 492, 493-94 (Ohio 1936) (explaining that the attorney-client privilege is intended to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice).

<sup>251</sup> 744 N.E.2d 154 (Ohio 2001).

<sup>252</sup> *Id.* at 158.

<sup>253</sup> *Id.* at 154.

<sup>254</sup> *Id.*

<sup>255</sup> *Id.*

<sup>256</sup> *Id.*

<sup>257</sup> *Boone*, 744 N.E.2d at 154.

<sup>258</sup> *Id.* at 155.

<sup>259</sup> *Id.*

the employer's and Boone's individual policies.<sup>260</sup> Vanliner denied coverage under the employer's policy, asserting an exclusion which Vanliner believed precluded UIM coverage for the accident.<sup>261</sup>

Boone filed a declaratory judgment action against Vanliner and included a claim for bad faith.<sup>262</sup> Boone alleged that the insurer lacked a reasonable justification for denying UIM coverage.<sup>263</sup> Through discovery, Boone sought access to Vanliner's claims file.<sup>264</sup> Vanliner initially denied that UIM coverage was available under the employer's policy.<sup>265</sup> After Boone sought discovery of Vanliner's claims file, Vanliner changed its position and admitted that the employer's policy provided UIM coverage.<sup>266</sup> Following this admission of coverage, Vanliner moved for a protective order regarding numerous privileged documents in its claims file.<sup>267</sup> The trial court held an *in camera* inspection of the Vanliner claims file,<sup>268</sup> and ordered partial disclosure of the privileged documents identified by Vanliner.<sup>269</sup>

The Ohio Supreme Court began its analysis in *Boone*<sup>270</sup> by reviewing its prior decision in *Moskovitz v. Mt. Sinai Medical Center*.<sup>271</sup> In *Moskovitz*, the plaintiffs in a medical malpractice lawsuit sought prejudgment interest as authorized by *Ohio Revised Code* § 1343.03(C).<sup>272</sup> Under this statutory provision, the prevailing party in the underlying case had the burden of proving that the opposing party "failed to make a good faith effort to settle" the case, before prejudgment interest could be awarded.<sup>273</sup>

The *Moskovitz* court delineated the extent to which a plaintiff may seek to discover the contents of a malpractice insurance company's claim file notwithstanding the insurer's assertion of work

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<sup>260</sup> *Id.*

<sup>261</sup> *Id.*

<sup>262</sup> *Id.* at 155. Ohio recognizes that an insurance company's lack of good faith in processing a claim gives rise to a cause of action in tort against the insurance company. *Hoskins v. Aetna Life Ins. Co.*, 452 N.E.2d 1315 (Ohio 1983).

<sup>263</sup> *Boone*, 744 N.E.2d at 155.

<sup>264</sup> *Id.*

<sup>265</sup> *Id.*

<sup>266</sup> *Id.*

<sup>267</sup> *Id.*

<sup>268</sup> *Id.* at 156.

<sup>269</sup> *Boone*, 744 N.E.2d at 156.

<sup>270</sup> *Id.* at 156-57.

<sup>271</sup> 635 N.E.2d 331 (Ohio 1994).

<sup>272</sup> *Id.* at 340-41 (referring to OHIO REV. CODE § 1343.03(C)).

<sup>273</sup> *Id.* at 348.

product protection and attorney-client privilege.<sup>274</sup> The court in *Moskovitz* found that “[d]ocuments and other things showing the lack of a good faith effort to settle by a party or the attorneys acting on his or her behalf *are wholly unworthy of the protections afforded by any claimed privilege.*”<sup>275</sup>

Having reviewed its prior decision in *Moskovitz*, the court in *Boone* addressed the question of whether claims file materials showing an insurer’s lack of good faith in determining coverage were equally unworthy of protection.<sup>276</sup> In reaching its decision that claims file materials showing lack of good faith in an insurer’s decision to deny coverage are unworthy of protection,<sup>277</sup> the court summarily dismissed Vanliner’s argument that its holding would discourage insurance companies from seeking legal advice. The court rejected this argument “because it assumes that insurers will violate their duty to conduct a thorough investigation by failing, when necessary, to seek legal counsel regarding whether an insured’s claim is covered under the policy of insurance, in order to avoid the insured later having access to such communications, through discovery.”<sup>278</sup>

The court in *Boone* limited its holding to only attorney-client communications and work product documents created prior to the denial of coverage.<sup>279</sup> Although the lack of a good faith effort to settle involves continuing conduct throughout the entire claims process, “a lack of good faith in determining coverage involves conduct that occurs when assessment of coverage is being considered.”<sup>280</sup>

Three Justices of the Ohio Supreme Court dissented in *Boone*. The dissent stated that the “unworthy of protection” rationale espoused by the majority was unsupported in *Moskovitz* and is unsupported now.<sup>281</sup> The dissent began its analysis by stating its allegiance to the public policy considerations underlying the attorney-client privilege, namely, the encouragement of “full and frank communication between attorneys and their clients” to “promote broader public interests in the observance of law and the administration of justice.”<sup>282</sup> The dissent observed that there are

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<sup>274</sup> *Id.* at 348-52.

<sup>275</sup> *Id.* at 349 (emphasis added).

<sup>276</sup> *Boone*, 744 N.E.2d at 157.

<sup>277</sup> *Id.*

<sup>278</sup> *Id.*

<sup>279</sup> *Id.* at 158.

<sup>280</sup> *Id.*

<sup>281</sup> *Id.* at 159 (Cook, J., dissenting).

<sup>282</sup> *Boone*, 744 N.E.2d at 160 (Cook, J., dissenting) (internal quotation marks omitted).

already safeguards in place that prevent abuse of the attorney-client privilege.<sup>283</sup> Particularly, communications in furtherance of a crime or fraud are not deserving of protection.<sup>284</sup> By adopting its “unworthy of protection” rationale, however, the majority likened communications in furtherance of civil fraud with an insurance company’s communications with its attorney before the denial of coverage,<sup>285</sup> without recognizing that a conceptual difference exists between bad faith and civil fraud. As the dissent noted,

[B]ad faith by an insurer is conceptually different from fraud. Bad-faith denial of insurance coverage means merely that the insurer lacked a “reasonable justification” for denying a claim. In contrast, an actionable claim of fraud requires proof of a false statement made with intent to mislead. Proof of an insurer’s bad faith in denying coverage does not require proof of any false or misleading statements; an insurer could, for example, act in bad faith by denying coverage without explanation. Because bad faith is not inherently similar to fraud, there is no reason why an allegation of bad faith should result in an exception to the attorney-client privilege akin to the crime-fraud exception.<sup>286</sup>

The dissent addressed what it perceived was the “startling” practical effect of the majority’s holding:

The majority’s holding is also startling for its practical effect. After today’s decision, an insured need only *allege* the insurer’s bad faith in the complaint in order to discover communications between the insurer and the insurer’s attorney. Not even an allegation of the crime-fraud exception’s applicability carries such an absolute entitlement to discovery of attorney-client communications. In order to overcome the attorney-client privilege based on the crime-fraud exception, a party must demonstrate “a factual basis for a showing of probable cause to believe that a crime or fraud has been committed and that the communications were in furtherance of the crime or fraud.” The rule created today requires no similar *prima facie* showing of bad faith before an insured is entitled to discover attorney-client communications of the insurer. The result of the majority’s decision is a categorical exception to the attorney-client privilege applicable in *any* case alleging a bad-faith denial of insurance

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<sup>283</sup> *Id.*

<sup>284</sup> *Id.* Ohio has a well established “crime-fraud exception, which denies the protection of the privilege when the client communicates with an attorney for the purpose of committing or continuing a crime or fraud.” *State ex rel. Nix v. Cleveland*, 700 N.E.2d 12, 16 (Ohio 1998).

<sup>285</sup> *Boone*, 744 N.E.2d at 160 (Cook, J., dissenting).

<sup>286</sup> *Id.* at 160 (citations omitted).

coverage. This is a sweeping exception that a number of courts have refused to adopt.<sup>287</sup>

Finally, the dissent found that the majority's holding that insurance company communications were unworthy of the attorney-client privilege was inconsistent with the purpose of the privilege.<sup>288</sup>

The dissent stated that

the privilege is designed to encourage open discussion between attorney and client, so as to promote the observance of the law and allow an attorney to adequately advise the client. With today's decision, the majority declares that an insurer's consultation with an attorney prior to a denial of coverage does not fall within this purpose. The rule laid down today *assumes that an insurer will always have some sinister intent to act in bad faith when it discusses a coverage decision with its attorney*. But the majority overlooks the fact that an insurance company may consult with legal counsel to obtain legal advice about a coverage decision. "[A]n insurance company's retention of legal counsel to interpret the policy, investigate the details surrounding the damage, and to determine whether the insurance company is bound for all or some of the damage, is a 'classic example of a client seeking legal advice from an attorney.'" These types of communications further the purpose of the attorney-client privilege and should be protected in the same manner as a communication by any other client seeking legal advice from an attorney.<sup>289</sup>

Insurance companies, the dissent wrote, "should be free to seek legal advice in cases where coverage is unclear without fearing that the communications necessary to obtain that advice will later become

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<sup>287</sup> *Id.* at 160-61 (citation omitted). Courts have routinely refused to adopt a *per se* rule of waiver based on mere allegations of bad faith. *See, e.g.,* *Dion v. Nationwide Mut. Ins. Co.*, 185 F.R.D. 288, 294 (D. Mont. 1998) (applying Montana law); *Ferrara & DiMercurio, Inc. v. St. Paul Mercury Ins. Co.*, 173 F.R.D. 7, 11 (D. Mass. 1997) (applying Massachusetts law); *Dixie Mill Supply Co., Inc. v. Cont'l Cas. Co.*, 168 F.R.D. 554, 558 (E.D. La. 1996) (applying Louisiana law); *Aetna Cas. & Sur. Co. v. S.F. Superior Court*, 200 Cal. Rptr. 471, 477 (Ct. App. 1984) (explaining that when that insurer's "state of mind" is at issue in a bad-faith action, this does not justify an exception to the privilege); *Tackett v. State Farm Fire & Cas. Ins. Co.*, 653 A.2d 254, 259-260 (Del. 1995) (declining to create a "*per se* waiver" of privilege in bad-faith cases); *Hartford Fin. Serv. Group, Inc. v. Lake County Park & Recreation Bd.*, 717 N.E.2d 1232, 1235-36 (Ind. Ct. App. 1999) (relying on *Aetna* to reject exception to privilege in bad-faith cases); *see also* *Md. Am. Gen. Ins. Co. v. Blackmon*, 639 S.W.2d 455, 458 (Tex. 1982) ("[I]f a plaintiff attempting to prove the validity of a claim against an insurer could obtain the insurer's investigative files merely by alleging the insurer acted in bad faith, all insurance claims would contain such allegations.").

<sup>288</sup> *Boone*, 744 N.E.2d at 161 (Cook, J., dissenting).

<sup>289</sup> *Id.* (emphasis added) (citations omitted).

available” to a dissatisfied insured.<sup>290</sup> The majority’s holding would have a chilling effect on an insurance company seeking legal advice.<sup>291</sup> The uninhibited flow of information between the insurance company and its attorney facilitates the accurate assessment of coverage.<sup>292</sup>

#### IV. CONCLUSION

An insurance company should not lose the protection of the attorney-client privilege simply because its litigation opponent raises an issue to which advice of counsel may be relevant. Implied waiver can only occur when the privilege holder affirmatively injects advice of counsel into the litigation. If the privilege holder does not use advice of counsel as a sword, there is no basis for stripping him or her of its shield. For this reason, courts throughout the country have consistently held that an insurer’s mere denial of a bad-faith allegation is not sufficient to waive the attorney-client privilege.<sup>293</sup> Even when a *Hearn*-type “issue” analysis is applied, more than a mere denial has been required to waive the privilege in the context of insurance bad faith. The Seventh Circuit Court of Appeals has determined that “[t]o waive the attorney-client privilege by voluntarily injecting an issue in the case, a defendant must do more than merely deny a plaintiff’s allegations. The holder must inject a new factual or legal issue into the case.”<sup>294</sup> Merely offering “a new form of evidence to counter an issue injected by the plaintiffs,” such as bad faith, does not waive the privilege.<sup>295</sup> The proposition that an insurance company affirmatively argues its good faith ignores the principle that good faith in the insurance context is merely the

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<sup>290</sup> *Id.* (internal quotation marks omitted) (citing *Aetna Cas. & Sur. Co. v. S.F. Superior Court*, 200 Cal. Rptr. 471, 475 (Ct. App. 1984); *State ex rel. U.S. Fid. & Guar. Co. v. Mont. Second Judicial Dist. Court*, 783 P.2d 911, 916 (Mont. 1989)).

<sup>291</sup> *Id.*

<sup>292</sup> *Id.*

<sup>293</sup> *See, e.g., Chi. Meat Processors, Inc. v. Mid-Century Ins. Co.*, No. 95 C 4277, 1996 WL 172148, at \*11-\*12 (N.D. Ill. Apr. 10, 1996) (rejecting argument that insurance company waived attorney-client privilege on grounds that insurance company did “not raise[] as an affirmative defense reliance on counsel in support of its defense to the [bad] faith claim,” but instead “simply denied [insured’s] allegations of bad faith [which] is insufficient to waive the privilege”); *Barr Marine Prods. Co. v. Borg-Warner Corp.*, 84 F.R.D. 631, 635 (E.D. Pa. 1979) (holding that privilege is not waived merely by defending a suit, but by “rais[ing] as a defense that which transpired between client and counsel, or reliance on advice of counsel, or questions counsel’s authority”).

<sup>294</sup> *Lorenz v. Valley Forge Ins. Co.*, 815 F.2d 1095, 1098 (7th Cir. 1987).

<sup>295</sup> *Id.* (reversing lower court’s holding that insurer had waived the privilege by arguing that it acted in good faith during settlement negotiations, where insurer had merely denied and refuted allegation of bad-faith failure to settle).



absence of bad faith. Indeed, as a technical matter, a “bad faith” claim is an allegation that the insurer has breached its implied covenant of good faith and fair dealing. Plaintiffs will typically raise an insurance company’s good faith, or lack thereof, in their complaint, and the insurance company should not waive its privilege by denying those allegations.<sup>296</sup>

Insureds could simply induce an automatic waiver by accusing an insurance company of bad faith. A claim that an insurance company’s “state of mind” is at issue, would lead to a demand to examine privileged materials as a matter of “fairness,” on the theory that advice of counsel must have contributed to the insurer’s state of mind. The California Court of Appeals convincingly demonstrated the flaws of this logic in *Aetna Casualty & Surety Co. v. Superior Court*.<sup>297</sup> In that case, Aetna brought a declaratory judgment action to determine coverage, and its insured counter-claimed, accusing Aetna of bad-faith denial of benefits.<sup>298</sup> Although the trial court ruled that the insured could discover communications between Aetna and outside coverage counsel, the California Court of Appeals issued a preemptory writ of mandamus overturning that ruling.<sup>299</sup> The appellate court found that Aetna did not implicitly waive the privilege by effectively relying upon advice of counsel as a basis for its actions. The court continued:

‘Aetna is not saying that their conduct was reasonable *because their counsel opined so*, but rather that their conduct was reasonable because the *facts* indicated that no valid claim existed.’ . . . Stated differently, Aetna claims it acted as it did not because it was advised to do so, but because the advice was, in its view, correct; and it is prepared to defend itself on the basis of that asserted correctness rather than the mere fact of the advice. Such a defense does not waive the attorney-client privilege.<sup>300</sup>

The *Aetna* court also rejected the insured’s argument that Aetna lost its privilege because the insured’s bad-faith claim had put Aetna’s “state of mind” at issue. The court held that argument to be

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<sup>296</sup> See *Oil, Chem. & Atomic Workers Int’l Union v. Sinclair Oil Corp.*, 748 P.2d 283, 290 (Wyo. 1987) (holding that where plaintiffs in defamation action alleged that defendants acted with malice, defendants did not waive privilege by asserting their lack of knowledge as a defense: “When, as in this case, malice is an element of a libel action, the burden of pleading and proving that element rests on the plaintiff. Consequently, malice became an issue in this case when appellants filed their complaint.”) (citation omitted), *cert. denied*, 488 U.S. 821 (1988).

<sup>297</sup> 200 Cal. Rptr. 471 (Ct. App. 1984).

<sup>298</sup> *Id.* at 472.

<sup>299</sup> *Id.* at 478.

<sup>300</sup> *Id.* at 475.

“palpably untenable” because its adoption would eviscerate the attorney-client privilege “in a myriad of actions where state of mind is an issue or could easily be made one.”<sup>301</sup> As the court observed, Aetna had not put its state of mind at issue by seeking declaratory relief; “[r]ather, it was [the insured] (the party *seeking* discovery) who put Aetna’s state of mind at issue by filing a counter claim for bad faith denial of insurance coverage,” and “[i]f [the insured] could in this manner waive the privilege on behalf of Aetna . . . bad faith claims would surely proliferate as a new device for obtaining discovery.”<sup>302</sup>

In *Tackett*, State Farm’s representation that the claim file showed “routine handling” was questionable. An independent medical examination was ordered notwithstanding the advice of State Farm’s outside counsel that the possible benefit of the independent medical examination was “questionable.”<sup>303</sup> In addition, outside counsel advised State Farm that the claim had a value at policy limits “or more.”<sup>304</sup> State Farm proceeded with the IME and also offered sixty percent of the claim value as assessed by State Farm’s outside counsel. This type of “routine” claims handling was relevant to the bad-faith claim when considered in conjunction with State Farm’s “get tough” policy, and the potential bad-faith pattern and practice it demonstrated. The court’s *in camera* examination revealed State Farm’s questionable conduct. These relevant facts, however, came to light *after* the *in camera* examination. Before the *in camera* examination, the only “particularized fact[]”<sup>305</sup> asserted by State Farm was the assertion that the claim file was “handled routinely.”<sup>306</sup> This was a general conclusory assertion that exists in most insurance bad-faith cases. The “particularized facts” the *Tackett* court found to support waiver were found as a result of the *in camera* claims file review. The court then appears to use those findings of relevant evidence to retroactively support waiver. Although the concept of waiver is not particularly novel, the *Tackett* court’s low threshold for *in camera* review is. By using an *in camera* examination of documents, the court puts itself in the position of using its judicial powers to find

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<sup>301</sup> *Id.* at 476-77.

<sup>302</sup> *Id.* at 477; *see also* *Palmer v. Farmers Ins. Exch.*, 861 P.2d 895, 907 (Mont. 1993) (holding that although insurer’s expert witness testified that advice of counsel influenced the insurer’s decision to deny coverage, such testimony did not waive the privilege where insurer did not rely directly on advice of counsel as a defense to bad-faith allegations).

<sup>303</sup> *Tackett v. State Farm Fire & Cas. Ins. Co.*, 653 A.2d 254, 257 (Del. 1995).

<sup>304</sup> *Id.*

<sup>305</sup> *Id.* at 260.

<sup>306</sup> *Id.* at 258.

relevant information for the plaintiff. Under the *Tackett* approach, therefore, the court assumes the principal role of lead investigator.

The *Tackett* approach results in a judicial hunt for rejection of advice of counsel which potentially makes deviation from advice of counsel *per se* discoverable. Each time the court finds that the insurance company sought the advice of counsel and then rejected that advice, the rejection would be *per se* relevant and therefore discoverable. The court does not give any guidance as to what degree of deviation from counsel's advice falls within *per se* discoverability. This approach will have a chilling effect if an insurance company is compelled to follow the advice of counsel merely in order to preserve the attorney-client privilege, and this approach ignores the fact that "advice" is not synonymous with "rigid command."

A similar role was assumed by the court in *Vanliner*. There, the court utilized a procedure in which plaintiff was entitled to an *in camera* review of the insurance company's claim file. If, during the *in camera* inspection, the court determines that the file contains evidence of the insurance company's lack of good faith, that information is discoverable notwithstanding the fact that it may come in the form of attorney-client privileged communications. According to the *Vanliner* court, any attorney-client communications showing a lack of good faith are unworthy of protection through any form of privilege. The court implicitly adopted a *per se* rule of discoverability by analogizing insurance bad-faith cases to fraud. The Ohio courts have a crime or fraud exception to the attorney-client privilege. By making insurance bad-faith claims synonymous with fraud, the court has rendered discoverable attorney-client privileged communications upon the mere allegation of bad faith without a supporting analytic framework.

A preliminary determination should be made as to whether fraudulent conduct on the part of the insurance company has occurred and whether such conduct was sufficient to overcome the privilege before permitting discovery of attorney-client privileged communications. A factual showing adequate to support a good faith belief by a reasonable person that wrongful conduct of a sufficient magnitude has taken place should be a preliminary trial court determination. Upon this determination, the court should then subject the claims file to an *in camera* inspection to determine whether there is a "foundation in fact" to overcome the privilege based upon an allegation of fraud. This approach is different than that used by the Delaware court in *Tackett* and the Ohio court in *Vanliner*. In *Tackett* and *Vanliner*, the courts invoked the *in camera* examination process upon mere allegation or minimal showing of

misconduct. Under this approach, to assess the question of discoverability, a court then injects itself into the attorney-client relationship between the insurance company and its outside counsel. Discoverability is not based upon the concept of necessity. Nor is discoverability based on an opponent's true need to have access to privileged material in order to rebut direct assertions made by the insurance company in the course of litigation. Rather, discoverability is based upon the concept of relevancy. In *Lee*, the Arizona court held that fairness of the judicial process requires implied waiver whenever the insurance company "claims its conduct was proper and permitted by law and based in whole or in part on its evaluation of the state of the law."<sup>307</sup> A pointed dissent in *Lee* delivered a eulogy for attorney-client privilege in Arizona, in insurance bad-faith cases, as a result of the majority's decision. In essence, the dissent observed that a plaintiff may abrogate the insurance company's attorney-client privilege simply by raising a bad-faith claim on any matter regarding an interpretation of the law.

The decisions in *Tackett*, *Lee*, and *Vanliner* have introduced uncertainty into the attorney-client relationship in insurance bad-faith cases, and discourage insurance companies from seeking needed legal advice because they cannot assume the advice will remain confidential. These decisions have imposed a separate standard for waiver in the insurance bad-faith context than currently exists in other more generalized civil matters outside of the insurance context. The chilling effect of these decisions can only be predicted on a theoretical basis: one can predict that the expansion of implied waiver reflected by these decisions will have an adverse effect upon the attorney-client relationship between insurance companies and their outside counsel. Certainly there is a chill in the air in Delaware, Arizona, and Ohio. The question remains as to whether winter will be coming to the American insurance landscape.

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<sup>307</sup> State Farm Mut. Auto. Ins. Co. v. Lee, 13 P.3d 1169, 1179 (Ariz. 2000).