The Corporate Attorney-Client Privilege & it's Erosion in the Insurance Context

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Avoid privilege pitfalls—easier said than done, especially for in-house counsel. While the attorney–client privilege appears simple when considering one lawyer representing one client, the complexities increase exponentially when lawyers represent corporate entities acting through various executives, employees, and third-party agents. And courts introduce additional uncertainties by often assuming that in-house lawyers supply business advice as much or more than legal advice.

It is important for corporate counsel to remain abreast of this ever-evolving—and sometimes surprising—area of privilege law. To that end, this paper reminds readers of their ethical obligations of confidentiality, provides a brief overview of the corporate attorney–client privilege, and then highlights recent case-law developments on some particularly thorny issues in the insurance context.

1. Ethics: Rules of Confidentiality for the Corporate Lawyer

Confidentiality rules differ from evidentiary privileges, such as the attorney–client privilege. Confidentiality rules, found in statutes and regulations, preclude one from voluntarily disclosing the confidential information. A confidentiality rule, however, generally does not overcome compelled disclosure via a court order such as a subpoena. A privilege, by contrast, not only prevents one from voluntarily disclosing confidential information, but also precludes compelled disclosure. Confidentiality rules are generally broader than privileges, meaning they cover a greater amount of information, but simultaneously are narrower because they give way in the face of a subpoena.

Lawyers must be aware of this broader/narrower dichotomy with respect to the confidentiality and privileged nature of their client's information. Model Rule of Professional Conduct 1.6 provides that a "lawyer shall not reveal information relating to the representation of a client" unless certain exceptions are met. The attorney–client privilege protects from compelled disclosure communications between a lawyer and her client. The ethical rule of confidentiality—which covers all "information"—is broader than the attorney–client privilege—which covers only client communications made for purposes of the lawyer rendering legal advice. So, while a court could compel non-privileged client information, a lawyer would violate Rule 1.6 if she voluntarily disclosed client information without consent.

Just like Rule 1.6, Rule 1.9(c)(2) similarly prohibits lawyers from disclosing a former client's confidential information without authorization. Many conflate the ethical rules of confidentiality with the mandates of the attorney–client privilege. Lawyers should know, however, that ethical confidentiality requirements are broader than the privilege—after all, the privilege applies to a client's *communications* while the confidentiality rule applies to the client's *information*.

But ethical rules banning unauthorized disclosure of client confidences certainly *include* privileged communications, as one Minnesota attorney unfortunately discovered in 2017 after the Minnesota Supreme Court upheld a sanction against him for doing just that.[1]

In that situation, the attorney represented his client in seeking a pre-suit settlement with an insurance company for injuries sustained in a car accident. The client wanted $50,000 but the insurance adjuster would only offer $20,000. The attorney relayed the client's acceptance of the $20,000, but the client later recanted, arguing he never agreed to such a paltry amount. When the attorney told the client he already accepted the adjuster's offer, and that the insurance company would file suit to enforce the settlement, the client fired him.

The attorney then sent this email to the adjuster:

> I was notified my [sic] [client] yesterday that he is terminating my representation and that he is not accepting the settlement offer. He got upset apparently that Medicare is taking a while, as it always does, and now doesn't want the settlement. I advised him that he already accepted it, there is no rescinding his acceptance. He is picking his file up today apparently. I'm going to send a lien for our fees and costs to you. I'm assuming you will be having legal bring a motion to enforce the settlement. He's been advised of all of this. Sorry for the inconvenience but he is a very difficult client. Let me know if you have any questions.

The client filed an ethics complaint with the Lawyers Professional Responsibility Board stating that he never agreed to the $20K settlement. The Board rejected that claim, but noticed the attorney's email and found that it violated Rule 1.9's prohibition against disclosing client's confidential, privileged information.

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[1] *In re: Charges of Unprofessional Conduct in Panel File No. 41310*, 899 S.W.2d 821 (Minn. Aug. 2, 2017).

The attorney argued to the Minnesota Supreme Court that no violation occurred because the email was not "that much of a revelation" and had no effect on the client's claim. The Court rejected this argument, stating that "the rules protecting client confidences oblige a lawyer to maintain *all* client confidences, significant or insignificant." The Court affirmed the Board's sanction of a private admonition. While the "cumulative weight of the misconduct" was minimal (one email), "this type of disclosure harms the legal profession because it undercuts the public's trust in attorneys."

This ethical rule of confidentiality becomes more complex when a lawyer represents an organizational client such as a corporation or limited liability company. Model Rule of Professional Conduct 1.13 provides that a "lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents." Obviously, organizational clients speak through many voices, and the question arises whether information a lawyer receives from these many voices falls within Rule 1.6's confidentiality requirements.

Comments to Rule 1.13 explain that "[o]fficers, directors, employees, and shareholders are the constituents of the corporate organizational client." Rule 1.6 cmt. 1. And for organizational clients that are not corporations, such as unincorporated associations, the constituents are persons in positions that are equivalent to officers, directors, employees, and shareholders. *Id.* When any of these constituents communicate with the organization's lawyer, "the communication is protected by Rule 1.6." *Id.* In other words, lawyers representing organizations have an ethical duty to maintain the confidentiality of all information received from any representative of his client, and the failure to do so violates Rule 1.6's confidentiality requirements.

Application of the attorney–client privilege in the corporate or other organizational setting differs from the ethical confidentiality rules. Many issues arise in this privilege situation and the topics below address many of those concerns.

2. Corporate Attorney–Client Privilege

The corporate attorney–client privilege applies to confidential communications between employees and corporate counsel made for the purposes of the corporate lawyer rendering legal advice or implementing legal advice. A threshold component is that an attorney–client relationship must exist between the corporate lawyer and the company. And this is not always a throw-away component, particularly where in-house lawyers provide legal advice to subsidiaries and other affiliated companies that do not actually employ them.

The privilege's confidential component contains two elements:

1. Corporate lawyers must communicate in a confidential setting. Practically, this element means that the corporate lawyer should not include unnecessary recipients on email communications; nor should she hold verbal conversations with employees in the presence of third parties or even in the presence of other employees who do not have a need to know the conversation's substance.

2. Corporate lawyers must communicate with the intent that the emails or other correspondence remain confidential. The confidential, one-on-one email may lose its confidentiality—and thus the privilege—if the recipient forwards it to third-parties or unnecessary internal employees.

The legal-advice component is even more troublesome for corporate lawyers, especially in-house counsel. While many courts presume a legal-advice purpose when an employee communicates with outside counsel, that same presumption evaporates when the employee communicates with in-house attorneys. Courts recognize that many in-house lawyers communicate about business-related issues and legal-related issues, and therefore will not assume that a communication involves legal issues simply because an in-house lawyer is present.

For this same business–legal reason, many courts effectively apply a heightened legal-advice standard to in-house lawyer communications. When a party challenges an in-house lawyer's privilege assertion, courts want to see the in-house lawyer's sworn declaration explaining—in a specific, non-conclusory manner—why the communication pertained to legal, rather than business, advice.

Even if the in-house lawyer meticulously meets the privilege's foundational elements, jurisdictional choice-of-law issues could derail her privilege assertion. Many jurisdictions follow the subject-matter test, which applies the privilege to counsel's discussions with *any* employee so long as the discussion pertains to issues within the scope of the employee's employment.

Other jurisdictions follow the control-group test, which generally holds that the privilege covers counsel's communications with an employee if the employee is in a position to take action based on the lawyer's advice. The control-group test's scope is narrow, meaning that the privilege will not shelter corporate counsel's communications with lower-level employees.

Federal courts employ the common-law subject-matter test in federal-question cases. Federal courts utilize state privilege law in diversity cases. Some states follow the narrow control-group test, others follow the subject-matter test, while other states remain undecided. The take-away for in-house lawyers is that one may not know at the time of the communication whether the narrow control-group test, or the broader subject-matter test, will apply.

3. Affiliated Companies

A tricky issue is whether the attorney–client privilege protects communications (involving legal counsel) shared between a company and an affiliated company, such as in a parent–subsidiary relationship. And if so, what degree of relationship does the privilege require? Does the privilege extend to a wholly owned subsidiary? A minority corporate owner? Two companies with common ownership?

In the 2013 case, *SCR–Tech LLC v. Evonik Energy Servs.,* LLC,[2] the North Carolina Superior Court held that the attorney–client privilege extends to legal-advice communications between a company and one of its minority corporate owners. And importantly, the court included a good discussion of the interplay between the joint–client doctrine and the common–interest doctrine.

Ebinger, a German corporation, owned 37% of another German corporation, SCR–Tech GmbH which, in turn, owned 100% of a North Carolina company, SCR–Tech LLC. Ebinger, SCR–Tech LLC, and legal counsel engaged in several communications pertaining to negotiations that ultimately led to the sale of SCR–Tech LLC to an unrelated third entity. In subsequent litigation, the defendant moved to compel these communications, claiming that Ebinger was not SCR–Tech LLC's parent for purposes of extending the attorney–client privilege. The court disagreed and invoked joint–client and common–interest concepts to support its decision.

[2] 2013 WL 4134602 (N.C. Super. Ct. Aug. 13, 2013)

The court noted that many lawyers and courts improperly interchange the joint–client doctrine and the common–interest doctrine. These concepts are distinct and contain “analytical differences.” The joint–client doctrine focuses on client identity and the relationship between two entities. The common–interest doctrine focuses on the common legal interests between two entities regardless of their relationship. The doctrine is not an independent privilege, but rather a non-waiver doctrine that allows parties with aligned legal interests to share privileged information without waiving the privilege.

Rather than drawing a bright-line rule that a corporation must own a certain percentage of an affiliated corporate entity before the joint–client doctrine applies, the court looked at the totality of circumstances to determine whether the entities “are sufficiently united such they may properly be considered joint clients.” If the degree of common ownership is sufficient to evidence control of the subject matter of the putatively privileged communications, then the court will apply the joint–client doctrine and consider both entities as one client for privilege purposes. But if the circumstances reveal that the relationship does not rise to that level, then the court will look more at the common legal interest between the two entities to determine whether the common interest doctrine protects the sharing of privileged information.

The *SCR–Tech* court followed what is, in effect, a proportional analysis. The privilege’s application will not depend on whether one corporate entity owns or controls a certain percentage of another. Rather, the court will look at the identity of legal interest, including the percentage ownership, to determine whether it should consider both entities as one client for privilege purposes. The greater the ownership interest, the greater likelihood of sustaining the privilege under the joint client doctrine. The lesser the ownership interest, then the less likelihood that the joint–client doctrine applies.

4. Internal Investigations & Privilege Waiver

In a significant 2017 ruling that provides lessons for corporate lawyers conducting internal investigations, a Texas federal court rejected Baylor University’s “unsupported and unconvincing” privilege argument and ordered it to produce “all materials, communications, and information" provided to its investigating law firm.[3] The court held that Baylor's intentional release of the law firm's factual findings and recommendations necessarily disclosed attorney–client communications and constituted privilege waiver.

In that case, when sexual-assault allegations surfaced, Baylor retained the Pepper Hamilton (PH) law firm to conduct an "independent and external review of Baylor University's institutional responses to Title IX and related compliance issues." The Title IX plaintiffs moved to compel Baylor to produce documents provided to PH.

Baylor argued that the attorney–client privilege protected all documents, interviewees, and communications provided to PH. The plaintiffs countered that Baylor retained PH to conduct an investigation—not provide legal advice—and that Baylor waived the privilege by, among other disclosures, intentionally releasing PH's "Findings of Fact" and "Recommendations" for public consumption.

Baylor had the burden of proving that the privilege applied and achieved some success. The plaintiffs argued that Baylor retained PH to conduct a factual investigation, not provide legal advice, and cited PH's two engagement letters as support. The court rejected this assertion, noting that law firms are not required to use "magic phrases" in their engagement letters to invoke the attorney–client privilege.

And Baylor achieved at least short-term success in protecting PH's self-created documents—memoranda, notes, emails, and presentations—not previously released. The court held that the work-product doctrine, which carries a narrow waiver analysis, precluded disclosure of these documents, but left the door open for future challenge should Baylor assert the PH investigation as an affirmative defense or if the plaintiffs show a substantial need for the information.

The court, however, found that Baylor waived the attorney–client privilege over information that it supplied to PH for internal-investigation purposes. While PH provided Baylor's Board of Regents with an oral, rather than written, report, it prepared "Findings of Fact" and "Recommendations" that Baylor released to the public.

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[3] *Doe v. Baylor Univ.*, No. 16–CV–173–RP (W.D. Tex. Aug. 11, 2017).

Baylor argued that these documents contained facts, not confidential communications, rendering waiver inapplicable. But the court found that these findings and recommendations were essentially "a publication of evidence of communications." And the court rejected as "unconvincing and unsupported by case law" Baylor's argument that, because PH drafted these documents "for the express purpose of public release," they necessarily cannot reveal confidential communications. The court also found privilege waiver arising from Baylor's Answer in *Shillinglaw v. Baylor Univ*., then a pending state-court lawsuit, which specifically described sexual-assault reports and communications among Baylor personnel that the PH investigation uncovered.[4]

The court found that Baylor representatives publicly described the released Findings of Fact and Recommendations as "fully reflect[ing] the themes, core findings, and failings identified in the investigation," an "unprecedented *mea culpa* within higher education," and "a self-critical summary on the subject of Title IX compliance." The court therefore invoked the subject-matter-waiver doctrine, found that the waiver "encompasses the entire scope of the investigation," and ordered Baylor to produce "all materials, communications, and information provided to Pepper Hamilton."

Organizations conducting internal investigations, particularly high-profile or otherwise complex investigations, cannot lose sight of the simple privilege maxim that disclosure of privileged information to third-parties waives the privilege. Understandably, organizations may choose to release internal-investigation results to achieve goodwill or other benefits—such as disclosing a report to a government-enforcement agency to gain cooperation credit or, as in Baylor's case, making disclosures for public-relations purposes.

But the take-away from the court's decision is that entities cannot half-produce investigation reports and expect to maintain privilege protections. And with the draconian subject-matter-waiver doctrine lurking as a potential penalty, organizations must make the disclosure decision with eyes wide open.

Since then, proceedings from this lawsuit are reported at *Shillinglaw v. Baylor University*, 2018 WL 3062451 (Court of Appeals of Texas, 2018).

5. Developments for *Upjohn* Warnings

Whether, and more importantly, how to give Upjohn warnings before interviewing an employee continues to perplex corporate lawyers.

In *United States v. Blumberg*,[5] the federal court in New Jersey ruled in 2017 that a company's former CEO did not have waiver power over putatively privileged communications with the company's counsel. The court issued this ruling even though the former CEO claimed to have never received an *Upjohn* warning. Despite a dispute over *Upjohn* warnings, the court found that the CEO's conversations pertained to company—not personal—matters and held it was the company's privilege to waive.

The U.S. Government filed criminal charges against Anthony Blumberg, former CEO of a global business unit for ConvergEx, alleging that he defrauded institutional investors with hidden investment fees. The government served a third-party subpoena on ConvergEx which covered information, including attorneys' notes, arising from two pre-indictment meetings Blumberg held with Bracewell LLP—ConvergEx's counsel.

Blumberg moved for a protective order claiming that (1) Bracewell represented him and ConvergEx, (2) the attorney–client privilege belonged to Blumberg, and (3) he had not waived it. ConvergEx claimed that its lawyers administered standard *Upjohn* warnings to Blumberg, thereby negating any argument that its attorneys had an attorney–client relationship with him. In fact, three Bracewell lawyers submitted sworn declarations—and contemporaneous notes from their formal interview memoranda—stating that they gave proper *Upjohn* warnings.

Blumberg, however, submitted competing declarations disputing that the Bracewell lawyers provided him with *Upjohn* warnings. The court declined to make a "credibility determination" between the two versions and did not rule whether ConvergEx's lawyers gave an *Upjohn* warning.

[5] 2017 WL 1170851 (D.N.J. Mar. 27, 2017).

The court, instead, applied the five-factor test approved in the Third Circuit's decision *In re Bevill, Bresler & Schulman Asset Mgmt. Corp.*,[6] to determine whether Blumberg could successfully claim privilege over his Bracewell meetings. The *Bevill* test required the privilege proponent—here Blumberg—to prove:

1. He approached company counsel to seek legal advice;
2. He made it clear he was seeking legal advice in an individual—not representative—capacity;
3. Counsel decided to communicate with the corporate officer knowing a conflict may arise;
4. The conversations were confidential; and
5. The substance of conversations with counsel did *not* concern general affairs of the company.

As to the factor No. 5, Blumberg declared that he consulted with ConvergEx counsel to assess his personal liability. But the court noted that the factor does not asked *why* Blumberg consulted with the lawyers, but the *substance* of their actual communications. Blumberg simply had insufficient evidence that his communications related to anything other than company affairs—despite his alleged personal purpose for attending the meeting. With Blumberg without an attorney-client privilege, ConvergEx could produce notes from its lawyers' meetings with Blumberg.

So, what is the take-away? The court would not have applied the *Bevill* analysis if ConvergEx could have proven, with certainty, that its lawyers provided an *Upjohn* warning to Blumberg. One would think that three lawyers' declarations—plus contemporaneous notes—would suffice. But, with a former corporate officer declaring the contrary under oath, it appears only a signed acknowledgement of receiving the warning from Blumberg would have convinced the court.

[6] 805 F.2d 120 (3d Cir. 1986).

The concern with requiring a corporate officer to acknowledge in writing receipt of an *Upjohn* warning is that it will chill the officer's candid discussions. The *Blumberg* decision, however, may persuade corporate lawyers to weigh this risk–benefit analysis in favor of a signed acknowledgement.

6. Cooperating with Government Agencies

The question arises whether disclosing privileged information to governmental agencies waives the privilege, rendering the privilege information subject to disclosure in other litigation. Two cases illustrate this waiver issue and provide at least one avenue for a non-waiver argument.

The court's decision in *Dresser-Rand Co. v. Schutte & Koerting Acquisition Co.*,[7] provides a cautionary tale about sharing your work-product with prosecutors. Dresser-Rand Company (DR) sued two former employees and their new employer, a competitor, for misappropriating trade secrets. Allegedly, these employees downloaded proprietary information about DR's Gimpel valve and, just a few months later, the competitor offered a similar valve for sale.

DR retained a law firm that directed a forensic investigation into the matter. The investigating firm produced a report, and DR disclosed the report to the U.S. Attorney's Office "in an attempt to have that office initiate a criminal prosecution" of the two former employees. The competitor and former employees moved to compel the investigation report and all correspondence between DR and federal prosecutors. DR claimed the report constituted work-product, and that the joint–prosecution privilege permitted it to share the report with prosecutors without waiving the work-product protection.

The so-called joint–prosecution privilege is simply a different name for the common–interest doctrine, which generally permits two or more parties represented by separate counsel to share privileged information regarding a matter of common interest without waiving the privilege. The "joint–prosecution" moniker, of course, refers to a private party sharing information with a government-enforcement agency.

[7] 2017 WL 2304443 (S.D. Tex. Mar. 15, 2017).

The “privilege”—really a non-waiver doctrine—sees application most often in *qui tam* actions, such as claims arising under the *False Claims Act*.[8] In those situations, the government and the private party, as a relator, share a common interest in seeking retribution for wrongdoing. The *Dresser-Rand* court, however, found no common interest between DR and the government. Citing opinions from the 1st, 3d, and D.C. Circuits, the court held that DR’s disclosure of privileged information to a government agency waived the work-product protection.

Here, DR “made a calculated disclosure to further the government’s inclination to prosecute the two employees,” and “there is no joint prosecution privilege.” The court ordered DR to disclose the forensic investigation report *and* all correspondence between it and the government.

The *Dresser-Rand* case shows that, generally, there is no common-law selective-waiver doctrine. The U.S. District Court for the Southern District of New York, however, in In re: *Ex Parte Application of financialright GmbH*,[9] found no privilege waiver when Volkswagen’s lawyers disclosed privileged information to the Justice Department under a Non-Disclosure Agreement.

Volkswagen’s 2015 emissions scandal—where it inserted software to circumvent U.S. emissions tests—is well known. VW retained Jones Day, which conducted an extensive factual investigation as part of its representation. Jones Day analyzed millions of documents and interviewed hundreds of VW employees.

As part of its VW engagement, Jones Day agreed to represent VW “vis-à-vis U.S. authorities.” In this regard, Jones Day cooperated with the Justice Department’s criminal investigation and entered into a privilege non-waiver agreement with DOJ.

The DOJ agreement stated that VW, through counsel, would provide oral briefings regarding its investigation and may furnish documents related to these briefings. The agreement also provided that, even though disclosing privileged materials, VW “does not intend to waive the protection of the attorney work product doctrine, attorney–client privilege, or any other privilege.” For its

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[8] 31 U.S.C. §§ 3729 – 3733.

[9] 2017 WL 2879696 (SDNY June 23, 2017).

part, the DOJ agreed to keep VW's privileged materials confidential, except to the extent that it determined in its sole discretion that disclosure would further DOJ's duties and responsibilities.

A group of plaintiffs wanting to sue VW in Germany over the emissions scandal sought the Jones Day documents through an application under 28 U.S.C. § 1782. The applicants argued, in part, that VW waived the privilege over Jones Day's investigative documents by disclosing privileged material to the DOJ.

The court recognized that, normally, voluntary disclosure of privileged material to an adversary waives the privilege. The Second Circuit, however, "has declined to adopt a 'rigid rule' in situations where a government agency and the disclosing party have entered into an explicit agreement that the agency will maintain the confidentiality of the records."

Although noting that courts must make privilege-waiver decisions on a case-by-case basis, the court refused to apply the "rigid" waiver doctrine because VW and DOJ had entered into a non-waiver agreement. The court issued the non-waiver ruling because of the "strong public interest in encouraging disclosure and cooperation with law enforcement agencies." The court effectively reasoned that applying the waiver doctrine would reduce companies' desire to cooperate, which is contrary to the public interest.

It is true that the VW/DOJ agreement provided DOJ with unilateral discretion to further disclose VW's privileged material. The applicants argued that this fact made the non-disclosure agreement illusory. The court was not persuaded, noting that the DOJ's disclosure discretion is "cabined" by a requirement that DOJ can only disclose "in furtherance of its duties."

7. Erosion in the Insurance Context

Many argue that courts have eroded the attorney-client privilege in the insurance context, too often finding that no privilege or work-product protect exists and ordering production of sensitive insurance-related files. For example, courts have issued privilege opinions for setting reserve amounts, communications between insurer's counsel and the insured, claims files, and for communications involving claims adjusters, including claims adjusters who are attorneys. We explore these decisions below.

A. <u>Privilege for Setting Reserve Amounts</u>

If an insurance company may have to pay a claim, it typically sets aside a sum of money—the reserve—to fund that claim if and when payment becomes necessary. And if the company's in-house claims counsel decides the reserve amount, the question arises whether the attorney–client privilege or work-product doctrine protects that decision from discovery.

The Arizona federal court, applying federal law, rejected a surety company's privilege and work-product arguments, and ordered it to disclose its reserve amount to its adversary. The court made this ruling even though the company's Senior Claims Counsel "solely" set the amount "in his capacity as legal counsel." [10]

An Arizona general contractor, Select Development & Construction, entered into three road-construction projects with Pima County, Arizona. Western Surety Co. (WSC) and Employers Mutual Casualty Co. (EMC) provided Select with performance and payment bonds for these projects, naming Pima County as obligee.

Select failed to comply with its contractual obligations on the three road projects, resulting in losses to WSC and EMC as sureties. Pima County settled with WSC for $1.3M, but EMC claimed that it should receive these funds. Pima County "threw up its hands" and deposited the funds into the court treasury to let WSC and EMC "duke it out".

Insurance (and surety) companies typically set a so-called "reserve amount" in advance of paying any claim, with the reserve equal to an amount the company deems sufficient to fund the claim, if necessary. EMC requested that WSC produce documents related to the reserve amounts WSC set regarding the Select claim. WSC refused on relevancy, attorney–client privilege, and work-product grounds.

Although noting that courts disagree whether reserve amounts are relevant in insurance bad-faith cases, it found WSC's reserve amount relevant because EMC claimed that WSC did not suffer the amounts alleged, and the reserve amount would shed light on that issue. With the relevance

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[10] *Western Surety Co. v. United States*, 2018 WL 6788665 (D. Ariz. Dec. 26, 2018).

issue concluded, the remaining question was whether the privilege and/or work-product doctrine protected the reserve information from discovery.

WSC told the court that its Senior Claims Counsel, "in his capacity as legal counsel, solely set the reserves pertaining to the bonds issued to Select." And this lawyer, WSC claimed, "was certainly aware of the possibility of litigation." WSC then cited a handful of cases that it said held that the privilege or work-product doctrine protected reserve information from discovery.

EMC distinguished WSC's cases, argued that the privilege and work-product protections did not apply to reserve amounts, and, curiously, that WSC placed its reserve amount "at issue," resulting in privilege waiver. The court recited the privilege elements and determined that the "threshold question here is whether or not the setting of a surety reserve is 'legal advice.'" WSC had the burden of demonstrating that "the primary purpose of the communication was securing legal advice."

The court found that, other than stating that its in-house claims counsel set the reserve, WSC "provided no evidence that the setting of its reserves by an attorney constitutes legal advice." Noting that in-house counsel "frequently serve as integral players in business decisions," the court held that WSC failed to show that "its reserve information was anything but 'business advice.'"

But it wasn't just the lack of proof; the court relied on the tried-and-true policy that corporate entities "may not conduct their business affairs in private simply by staffing a transaction with attorneys." Sanctioning privilege protection "each time legal counsel became involved in a matter," the court stated, would "impermissibly magnif[y]" the privilege and "permit corporations to offensively wield the privilege and successfully object to any discovery request involving their attorneys."

WSC's work-product objection met the same fate. WSC merely stated, without any supporting evidence or detail, that its Senior Claims Counsel was aware of the "possibility of litigation." But the question, the court held, was whether the lawyer set the reserve amount "in anticipation of litigation or trial." The court found that "surety companies set reserve amounts as a course of business," and then issued this conclusion:

> The mere fact that in-house counsel was aware of the possibility of litigation is not sufficient to apply the work-product doctrine….It is highly likely that every corporate representative is aware that any business transaction can result in litigation.

B. <u>Insured and Broker Communications</u>

In an insured's bad-faith claim against its insurer, the USDC for the Western District of Kentucky (Louisville) rejected attorney-client privilege and work-product assertions over communications between the insured and its broker. In doing so, the court ruled that the communications did not pertain to legal advice even though the broker "shepherded the insured through the claims process."[11]

Cardinal Aluminum Co. sued Continental Casualty Co. claiming breach-of-contract and bad faith after Continental rejected Cardinal's coverage claim for a crack in a piece of industrial equipment. Continental subpoenaed Cardinal's insurance broker seeking opinions, reports, and examinations related to the equipment and all documents related to the case.

Cardinal filed a motion to quash and filed in support its CFO's affidavit. The CFO stated that the broker "shepherded Cardinal through the eleven-month claims process," negotiated with Continental on Cardinal's behalf, met with Cardinal's lawyer "to develop strategies," and "acted to protect and advance Cardinal's legal interests." The broker was clearly involved with Cardinal's counsel, and it is easy to see why Cardinal fought so hard to protect these communications.

In this diversity case, the federal court correctly applied Kentucky state privilege law to Cardinal's privilege assertions over its broker communications. Kentucky Rule of Evidence 503 requires the privilege proponent to prove that the communication was confidential, for purposes of legal advice, and made between two of these four parties: client, client's representatives, the lawyer, or the lawyer's representatives.

Cardinal argued that its broker was a "client representative" under Kentucky's privilege rule. After reading the CFO's affidavit, however, the court ruled that the broker's actions "do

[11] *Cardinal Aluminum Co. v. Cont'l Cas. Co.*, 2015 WL 4483991 (WD Ky. July 22, 2015).

not amount to legal advice." And the broker's negotiations with Continental over the policy "were not undertaken to obtain legal advice, but rather to secure insurance coverage." In short, the court found that, contrary to an attorney–client relationship, "the broker–insured relationship arises simply from a commercial transaction for the sale of insurance."

Contrary to the privilege conflict-of-law result, federal law governs work-product claims in federal court. Cardinal claimed that the work-product doctrine protected communications with its broker arising after the date it submitted its claim to Continental. The court rejected this assertion, however, stating that Cardinal failed to prove that the broker prepared the documents in anticipation of litigation. Indeed, the CFO's affidavit was silent in this regard. The court further noted:

> Documents prepared as part of the ordinary business functions of an insurance broker are not prepared as a result of anticipated litigation.

Although rejecting Cardinal's privilege and work-product claims and ordering the broker's deposition to move forward, the court provided Cardinal some hope. The court permitted Cardinal to review the broker's documents and submit a specific privilege log and to re-assert any privilege or work-product claims. The court's rulings, however, create a high hurdle for any future argument.

C. <u>Claims Adjuster</u>

As a general rule, clients waive the attorney-client privilege when they assert an advice-of-counsel defense and, consequently, must produce their lawyer's advice-related communications. The waiver's scope, however, is not as well-known, so the question is whether the waiver applies to communications with outside counsel *and* in-house lawyers?

The Utah federal court faced this specific question and narrowly construed the scope of waiver. The court held that a client's advice-of-counsel defense waived the privilege over its communications with outside counsel, but that the waiver did not extend to its communications with in-house counsel.[12]

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[12] *Hoopes v. Owners Ins. Co.*, 2018 WL 1183374 (D. Utah Mar. 6, 2018).

An 11-year-old pedestrian sustained severe injuries as a result of a collision with a Geico insured on Main Street in Heber City, Utah. Geico paid its insurance limits, but the child's mother filed breach-of-contract and bad-faith claims against her uninsured-motorist carrier when it failed to promptly settle that matter. The UIM carrier had retained outside counsel to investigate and provide opinion on coverage and payment issues. The carrier asserted the 'advice-of-counsel defense' and agreed that the defense waived the privilege over its communications with outside counsel. The carrier, however, refused to produce communications between its claims adjuster and in-house lawyer.

The mother moved to compel the claims-adjuster–in-house lawyer communications, essentially arguing that waiver is a broad concept and must include all advice-related communications, including those with in-house counsel. She asserted the sword-and-shield argument, complaining that the carrier wished to use 'the reliance-on-outside-counsel defense' as a sword while simultaneously using the privilege to shield discovery of privileged communications with in-house lawyers. The court found this argument "meritless" for two reasons.

First, the court held that a party places privileged communications in issue where it attempts to prove an advice-of-counsel defense by "disclosing or describing an attorney–client communication." Here, the UIM carrier relied on its outside counsel's advice, but did not rely on communications with its in-house counsel to prove the defense.

Second, the court held that the UIM carrier did not waive the privilege over in-house-counsel communications when it waived the privilege for outside-counsel communications. The court applied a narrow waiver doctrine by holding that waiver is "limited to the particular subject" and, importantly, "the conversation disclosed." Because the UIM carrier only relied upon and disclosed communications with outside counsel, that waiver did not extend to the claims adjuster's communications with in-house counsel.

D. Attorney Claims Adjuster

The USDC for the District of Connecticut in the 2013 decision, Mehta v. Ace American Ins. Co.[13] rejected an insurance company's claim that the attorney-client privilege protects emails by

[13] *Mehta v. Ace American Ins. Co.*, 2013 WL 3105215 (D. Conn. June 18, 2013).

and with its claims specialist prior to a coverage decision. And the court rendered this decision even though the claims specialist is an attorney.

In *Mehta*, the plaintiff filed a claim against Ace American Insurance alleging that it breached its uninsured motorist policy by failing to pay a fatality claim. The plaintiff filed a motion to compel when Ace refused to produce emails "by and with [its] claims specialist, an attorney, prior to the coverage decision."

The *Mehta* court granted the motion to compel, stating that "an insurance company may not insulate itself from discovery by hiring an attorney to conduct ordinary claims investigations." The court held that the attorney–client privilege does not apply to attorneys acting as claims adjusters, claims process supervisors, or claims investigation monitors rather than as legal advisors. The court drew a clear distinction between insurance documents representing "truly confidential inquiries or responses to counsel concerning legal advice" and insurance claims investigations.

The court followed the narrow privilege interpretation that many courts apply when analyzing insurance claims adjusters. The attorney–client privilege protects communications to and from attorneys, but only when made for the purpose of rendering legal advice. Courts often view claims adjusters, particularly in coverage cases, as conducting factual investigations that other lawyers in the company will use to complete a legal evaluation. When attorneys act something other than an attorney, her communications simply are not privileged.

E. <u>Claims File</u>

In litigation over an insurance company's denial of a claim, a New York Appellate Court in the 2013 decision, *Melworm v. Encompass Indemnity Co*., ruled that the attorney-client privilege did not protect the insurer's claims file and attorney communications.[14]

The *Melworm* case involved an insurance claim over boat damage. The insured sued for breach of contract after the insurer denied the claim and sought in discovery the insurer's electronic

[14] *Melworm v. Encompass Indemnity Co.*, 977 N.Y.S.2d 321 (App. Div. 2013).

claims diary prepared by an employee. The insured also sought the insurer's attorney's communications during his investigation into the claim.

The insurer asserted the attorney–client privilege over the claims file and attorney communications, but the Court rejected the privilege claims after an *in camera* review of the documents. The Court noted that the payment or rejection of claims is part of the regular business of an insurance company, and stated:

> Reports prepared by insurance investigators, adjusters, or attorneys before the decision is made to pay or reject a claim are thus not privileged and are discoverable, *even when those reports are mixed/multi-purpose reports, motivated in part by the potential for litigation with the insured.*

The Court ruled that the insurer's employee and attorney prepared the diary entries and letters as part of the insurer's claim investigation and were not "primarily and predominantly of a legal character." This "regular course of business" versus "predominantly legal" analysis went against the insurer in this instance.

Courts reach other conclusions. The USDC for the Western District of Kentucky held in *Shaheen v. Progressive Insurance Co.*,[15] a 2012 decision, that in third-party bad-faith litigation, Kentucky's attorney-client privilege protects an insurer's file from discovery. The administrator of the Nadia Shaheen Estate (the claimant) filed a bad-faith lawsuit against Progressive for its alleged delay in settling an underlying wrongful death case against Progressive's insured. The plaintiff sought production of Progressive's "insurance file," but Progressive refused, arguing that it contained communications between it and its insured.

Kentucky state law was silent on whether the attorney-client privilege covers insurance files from discovery in bad-faith litigation. In predicting how Kentucky state courts would rule, the Kentucky federal court first noted that other courts had taken three different approaches. First, some courts permit discovery of the entire insurance file in third-party bad-faith litigation. Other courts permit insurance companies to preclude disclosure "by rigidly applying the attorney-client privilege." And a third line of courts take the middle-road approach by permitting insurance companies to claim privilege, but allowing a plaintiff to overcome the privilege through a sufficient showing of need.

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15 *Shaheen v. Progressive Insurance Co*., 2012 WL 3644817 (W.D. Ky. Aug. 24, 2012).

Kentucky recognizes an insurer-insured privilege on grounds that the insured assumes that purpose of his communications is to transmit the information to an insurer-selected attorney. And on this basis, the federal court predicted that Kentucky law would extend the attorney-client privilege to an insurance company's file and prohibit compelled disclosure of the file's contents.

F. <u>Communications between Insurer Attorney and Insured</u>

The Texas Supreme Court held in the 2012 decision on a bad faith case, *In re XL Specialty Insurance Company*,[16] that communications between an insurer's attorney and the insured were not protected from discovery by any evidentiary privilege. And in doing so, the court distinguished and offered guidance on the attorney-client privilege and its interplay with the allied litigant doctrine, common-interest doctrine, joint-client doctrine, and insurer-insured privilege.

In that case, an employee of Cintas Corporation brought a workers' compensation claim against Cintas's insurer, XL Specialty, which was resolved after an administrative hearing. During the administrative hearing, XL Specialty's outside counsel communicated about the case to Cintas (not its lawyer). In a subsequent bad faith case brought by the employee against XL Specialty, the employee sought to discover the lawyer's communications with Cintas.

In a thorough opinion, the Court rejected all privilege claims and ordered production. Texas' attorney-client privilege rule, found at Tex. R. Evid. 503, provides, in part, that the privilege protects communications "by the client or representative of the client, or the client's lawyer or a representative of the lawyer, to a lawyer or a representative of a lawyer representing another party *in a pending action* and concerning a *matter of common interest*."

The Court determined that this rule is appropriately termed the "allied litigant privilege" because it contains pending-action and common-interest requirements. The allied litigant privilege thus protects communications made between a client, or the client's lawyer, to another party's lawyer, but not to the other party itself. And because XL's lawyer spoke with Cintas (a nonparty), and not a lawyer for Cintas, the allied litigant doctrine did not apply. The Court recognized that XL

[16] 373 S.W.3d 46 (Tex. 2012).

and Cintas had a shared interest in the underlying workers' compensation claim, but held that the "rule requires that the communication be made to a lawyer or her representative representing another party in a pending action."

The Court also rejected and distinguished other related privileges. According to the Court, the joint client privilege applies when the same attorney simultaneously represents two or more clients on the same matter. And communications made to the lawyer for purpose of rendering legal advice to the clients are privileged except where a controversy erupts between the clients.

The Court noted that many courts and lawyers confuse these two doctrines. While both doctrines apply to communications between parties who have separate counsel, the joint-defense doctrine applies only in the context of litigation when multiple parties communicate for purpose of forming a joint-defense strategy. The common-interest doctrine works similarly, however, it is broader, as it applies to parties sharing a mutual interest regardless of their status in the pleadings (could be plaintiff and defendant) *and*, regardless whether they are involved in litigation.

In interesting comments, the Court stated that Texas does not recognize an insurer-insured privilege, but stated that "under certain circumstances, communications between an insurer and insured may be shielded from discovery by the attorney-client privilege." But because XL did not show that its lawyer's communications with Cintas fell within Rule 503, the Court did not consider this angle.