Litigation

Losing Confidence in Confidentiality: Do Expanding Exceptions to the Attorney-Client Privilege Gut Its Purpose?

*By Raymond J. Tittmann**

True or false: attorney-client communications, simply speaking, are privileged? False, both under law and—more importantly—in practice.

That answer may surprise clients and even many lawyers. If it does, these clients have a problem: sensitive communications transmitted on the assumption of confidentiality may one day be ordered produced under a multitude of exceptions that now exist under the law. As the law has developed to erode the privilege, lawyers and clients—and especially insurance companies and their lawyers—may decide to operate on the assumption they will one day be compelled to produce their communications. They may prefer to avoid frank communication out of concern for creating written communications that could be troublesome in future litigation.

Confidence in Confidentiality Is the Cornerstone of the Privilege and Necessary to Achieve Its Purpose

Distrust in the attorney-client privilege guts its purpose. The purpose of the attorney-client privilege is:

> 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. The privilege recognizes that sound legal advice or advocacy serves public ends and that such advice or advocacy depends upon the lawyer's being fully informed by the client.[1]

But this purpose cannot be achieved if the participants do not have full confidence that confidentiality will be preserved. "The free-flow of information and the twin tributary of advice are the hallmarks of the privilege. For all of this to occur, there must be a zone of safety for each to participate without apprehension that such sensitive information and advice would be shared with others without their consent."[2]

When attorneys and clients lack confidence in the privilege, the value dissipates. They simply will not engage in the desired "full and frank" communications if the law creates a realistic possibility that a court will one day force disclosure. When the law reaches the point where the risk of disclosure makes frank communication too dangerous, lawyers and clients will operate on the assumption that the communication will be produced. For the reasons discussed below, we are nearing that point. Indeed, some lawyers have already concluded that it is no longer safe to count on the attorney-client privilege.

Attorney-Client Communications, Without More, Are Not Privileged

Many regard the strict confidentiality of attorney-client communications as a truism, a mantra repeated in television legal drama, higher education, and even in the highest courts of the land. "The attorney-client privilege is the oldest of the privileges for confidential communications known to the common law."[3] So the assumption that these communications are privileged is sensible and justified.

But that assumption is still wrong, or at least imprudent:

> Contrary to modern yet ill-informed perceptions, the attorney-client privilege is often "[n]arrowly defined, riddled with exceptions, and subject to continuing criticism." Grand as the privilege stands in our legal lexicon, it is nonetheless narrowly defined by both scholars and the courts. The attorney-client privilege is not given broad, unfettered latitude to every communication with a lawyer, but is to be narrowly construed to meet this narrowest of missions.[4]

Under the California Evidence Code, for example, a communication between an attorney and client, without more, satisfies only the first three of six elements required to establish the privilege. The party claiming privilege must show:

(1) Attorney: a person authorized to practice law;[5]

(2) Client: a person who consults a lawyer to secure legal service;[6]

(3) Information transmitted between a client and lawyer;

(4) In the course of that relationship;

(5) In confidence by a means which discloses the information to no third persons, and

(6) Includes a legal opinion formed and the advice given by the lawyer.[7]

If any of the last three conditions are not satisfied, the attorney-client communication is not privileged. And even if all six conditions are satisfied, parties seeking production of the communication have a multitude of waiver theories at their disposal.

Insurance Companies in Particular Face Hurdles in Preserving the Privilege

Insurance lawyers and clients should be especially concerned with the erosion of the attorney-client privilege due to three common situations that lead to production of their communications: (1) the "at issue" waiver, e.g., when the insurance company seeks to defend a bad-faith claim by asserting that they reasonably relied on the advice of counsel; (2) the implied waiver, i.e., when a court finds that merely denying bad faith (or general assertions that the claim was handled properly under the law) automatically puts the attorney's advice at issue; and (3) when the attorney is not serving in the role of an attorney as defined by the last three legal elements, e.g.,

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when they conduct a factual investigation or offer guidance on company policy or give business advice, rather than legal advice.

Insurance companies and their lawyers can take steps to increase the likelihood of preserving the privilege, as discussed further below. But, despite best efforts, the law does not give sufficient clarity and certitude in the ultimate confidentiality sufficient to justify the risk of frank communication. They are thus tempted to take the safer route of assuming disclosure. This article addresses each of these situations and recommends steps to help preserve the privilege, but nevertheless recognizes that the law is, in certain contexts, too inconclusive to give the confidence necessary to serve the purpose of the privilege.

The "At Issue" Waiver: Advice of Counsel Defense

The attorney-client privilege is waived when the client puts the privileged communication at issue in litigation. For example, a client can be held to have waived the privilege when it alleges that it relied on the advice of counsel, misunderstood terms of an agreement, or diligently investigated a claim with the assistance of counsel.[8]

Courts generally apply a three-part test to determine whether a party has put the advice at issue: (1) a party asserting privilege must take an affirmative act that (2) makes the protected information relevant to the case, and (3) application of the privilege would deny the opposing party access to information vital to defending against the affirmative assertion.[9]

Other courts say this "relevance" standard is too broad, and require that the party asserting the privilege specifically rely on privileged communications for a claim or defense or as an element of a claim or defense.[10]

Either way, merely denying an allegation does not result in an "at issue" waiver under this rule.[11] Where the opponent injects attorney-client communication into the case, the privilege has not been waived.[12]

For insurance companies, at-issue waiver occurs most commonly when the company argues that it had a good-faith reason to deny coverage because it reasonably relied on the advice of its counsel. Ideally, the company would decide at the outset of the claim whether to assert the defense, and hire counsel specifically for this purpose, rather than hiring the attorneys it intends to use for future coverage litigation. Under this scenario, both attorneys and clients can conduct their communications with full recognition of the likely disclosure.

However, even if this decision is not made at the outset, attorneys and clients must always recognize the possibility that circumstances may arise in the future to justify assertion of this defense. Indeed, a lack of care in these communications during the claim may limit the client's future options in asserting this defense. Accordingly, clients and lawyers are well-advised to assume throughout the claim process that the communications will be released.

Implied Waiver: Some Jurisdictions Find that Simply Opposing a Claim of Bad Faith Waives Privilege

The most significant erosion of the attorney-client privilege over the last twenty years arises from the implied-waiver doctrine. Courts in Ohio, Delaware, and Arizona hold that insurance companies can waive the privilege even without asserting the advice-of-counsel defense.[13]

In *Tackett v. State Farm*, State Farm denied that there was "any unreasonable justification for denying" coverage. The Delaware Supreme Court ruled that State Farm's denial put the privileged communications at issue, as counsel's advice could lead a jury to find against State Farm on its "assertion" (i.e., its denial of the allegation).

> 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 assertions in order to contradict them.[14]

In *Boone v. Vanliner* and *Moskovitz v. Mt. Sinai Medical Center*, the Supreme Court of Ohio ruled that the attorney-client privilege did not protect communications if they were conducted in the context of claims handling and could be used to show bad faith: "Documents 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." Thus, "neither the attorney-client privilege nor the so-called work production exception precludes discovery of the contents of an insurer's claims file."[15]

In *Boone*, the Ohio Supreme Court clarified that the doctrine applies to pre-denial communications: "[W]e hold 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."[16]

In *State Farm v. Lee*, State Farm argued that it was acting on its good-faith understanding of the law, but it did *not* argue that it was relying on its lawyer's advice. The Arizona Supreme Court found the two arguments inseparable: a client's reliance on its understanding of the law puts at issue its attorney's advice on that law. The Arizona Supreme Court did not purport to apply the implied waiver theory: "We also agree that mere denial of the allegations in the complaint, or an assertion that the denial was in good faith, is not an implied waiver."[17]

Yet implied waiver was, in effect, the consequence:

> But as our cases have shown, a litigant's affirmative disavowal of express reliance on the privileged communication is not enough to prevent a finding of waiver. When a litigant seeks to establish its mental state by asserting that it acted after investigating the law and reaching a well-founded belief that the law permitted the action it took, then the extent of its investigation and the basis for its subjective evaluation are called into question. Thus, the advice received from counsel as part of its investigation and evaluation is not only relevant but, on an issue such as this, inextricably intertwined with the court's truth-seeking functions.[18]

The Arizona Supreme Court's finding in *Lee* makes sense in theory, but in practice it puts the insurance company in a precarious situation as to what it might say in litigation that

a court could find puts counsel's advice at issue. An insurance company cannot know in advance whether a court might apply *Lee* to find a waiver in a multitude of circumstances: if an adjuster testifies in deposition that she sought guidance from the legal department before denying; if she testifies about the company's reasoned practice in interpreting and applying a policy exclusion; or if she testifies that she conducted a full claim investigation. At the time of the communication, the attorney and client have no idea what future statement might be made in litigation that could be construed as a waiver under this rule.

Whereas the "at issue" waiver doctrine brings certitude at least at the time the insurance company decides to assert the defense, the implied waiver doctrine offers little certitude at any point. For any insurance companies handling claims in states that follow some version of the implied-waiver doctrine, attorneys and clients, to be safe, may simply assume that their communications in claims handling will not be kept confidential.

Lawyer Playing the Role of a Lawyer

While the first two situations discussed are focused on attorneys involved in the underlying claims-handling process, both claims and litigation counsel may lose privilege to the extent they take actions that do not appear connected with legal advice.

As noted above, to be privileged, an attorney-client communication must also meet three additional requirements. The communication must be in the course of that relationship, in confidence by a means which discloses the information to no third persons, and include a legal opinion formed and the advice given by the lawyer.[19]

These elements leave substantial ambiguity concerning how any one jurisdiction might apply them in a particular case.

For example, any communication that appears primarily factual, and not intertwined with legal advice, is at risk. Purely factual documents prepared and sent to a lawyer may be held not to be privileged because facts alone are not privileged.[20] Likewise, a lawyer's interview memorandum in an investigation was held not privileged because no groundwork was laid with the witnesses to ensure confidentiality.[21] Counsel's memoranda that simply transmitted factual information might not be privileged because the lawyer is merely acting as a conduit for factual data.[22]

But if the same documents stated that the factual information was prepared in order to seek or give legal advice, ideally framing or answering a specific legal question in the document itself, it should be preserved as a privileged attorney-client communication.[23] "Factual investigations performed by attorneys *as attorneys* fall comfortably within" the privilege.[24]

It can be difficult to predict where a court will draw the distinction between simply factual information and factual information tied to legal advice. As courts have drawn sometimes subtle distinctions, attorneys and clients have little choice but to err on the side of safety by drafting such communications on the assumption it will be produced.

Similar problems arise when legal advice is distributed broadly. Privilege is not waived just because non-lawyers forward the attorney's legal advice to other non-lawyers, but all recipients must be among those that "need to know" the legal strategy.[25] Otherwise, sharing privileged information too broadly within the company or with people that do not "need to know" defeats or waives the privilege, as it suggests the speakers did not consider the communication to be confidential in the first place.[26] How a court might determine who "needs to know" the advice in any particular case creates uncertainty that further undercuts the purpose of the privilege.

A larger problem occurs when the distinction between legal advice and business advice is blurred. Business advice or statements of corporate policy are not privileged.

There is general agreement that the protection of the privilege applies only if the primary or predominate purpose of the attorney-client consultations is to seek legal advice or assistance. There are substantial policy reasons for holding that business documents submitted for attorney review are not by that virtue automatically exempt as privileged or work product protected communications.[27]

This distinction between business and legal advice is especially difficult for insurance companies because their business requires them to interpret and apply contract terms. In effect, insurance companies are in the business of legal interpretation. Insurance lawyers and clients cannot predict easily whether advice on interpretation of an insurance policy constitutes legal advice or business advice.[28] The attorney can best protect himself by taking extra steps to establish privilege, e.g., by citing case law and expressly characterizing the analysis as a legal opinion.

In-house counsel for insurance companies faces extra scrutiny. The law recognizes a "presumption" that "communications to outside counsel" primarily relate "to legal advice," under Diversified v. Meridith.[29] But the *Diversified* presumption is not "applied to in-house counsel."[30] Though costly, hiring outside counsel automatically increases the likelihood of attorney-client protection.

Conclusion

These cases offer guidance on how corporations can best preserve the attorney-client privilege. In summary, attorneys and clients should do whatever possible to emphasize that the attorney is acting in his or her role as attorney, by asking for and giving legal advice expressly and treating the communications confidentially. However, it is often difficult to know at the time of the communications what precautions will be sufficient, or if any precaution will be sufficient. Therefore, even when taking these precautions, attorneys and clients may choose to assume the worst—that the documents will be produced—and structure their communications accordingly.

These concerns are not merely theoretical. Some insurance attorneys already have resolved not to put any sensitive advice in writing. The risk of future production is too great.

Endnotes

1 Upjohn v. United States, 449 U.S. 383, 389 (1981).

2 Lugosch v. Congel, 219 F.R.D. 220, 234 (N.D.N.Y. 2003).

3 *Upjohn*, 449 U.S. at 389-90 (citing Hunt v. Blackburn, 128 U.S. 464, 470 (1888)).

4 NXIVM Corp. v. O'Hara, 241 F.R.D. 109, 125-26 (N.D.N.Y. 2007) (citing inter alia Univ. of Pa. v. E.E.O.C., 493 U.S. 182, 189 (1990); Fisher v. United States, 425 U.S. 391 (1976)).

5 Cal. Evid. C. § 950.

6 Cal. Evid. C. § 951.

7 Cal. Evid. C. § 952.

8 *See, e.g.*, United States v. Mendelsohn, 896 F.2d 1183, 1188-89 (9th Cir. 1990) (party waived privilege by asserting reliance on counsel's advice that conduct was legal); Musa-Muaremi v. Florists' Transworld Delivery, Inc., 270 F.R.D. 312, 317-19 (N.D. Ill. 2010) (in an employee discrimination case, employer waived privilege by asserting that it had conducted an adequate investigation); Restatement (Third) of the Law Governing Lawyers § 80(1)(b) (2000).

9 Hearn v. Rhay, 68 F.R.D. 574 (E.D. Wash. 1975).

10 *In re* Erie County, 546 F.3d 222 (2d Cir. 2008).

11 N. River Insur. Co. v. Phila. Reinsur. Corp., 797 F. Supp. 363 (D.N.J. 1992).

12 Parker v. Prudential Insur., 900 F.2d 772, 776 & n.3 (4th Cir. 1990).

13 Tacket v. State Farm Fire & Cas. Ins. Co., 653 A.2d 254 (Del. 1995); Boone v. Vanliner Ins. Co., 744 N.E. 2D 154 (Ohio 2001); Moskovitz v. Mt. Sinai Med. Ctr., 635 N.E. 2D 331 (Ohio 1994); State Farm Mut. Auto. Ins. Co. v. Lee, 13 P.3d 1169 (Ariz. 2000).

14 Tackett v. State Farm Fire & Cas. Ins. Co., 653 A.2d 254, 259 (Del. 1995).

15 *Moskovitz*, 635 N.E.2d at 349.

16 *Boone*, 744 N.E.2d at 158.

17 *Lee*, 13 P.3d at 1175.

18 *Id.* at 1177.

19 Cal. Evid. C. § 952.

20 Hilton-Rorar v. State & Fed. Comms., 2010 WL 1486816 (N.D. Ohio 2010).

21 Gottliev v. Wiles, 143 F.R.D. 241 (D. Colo. 1992).

22 Dawson v. N.Y. Life Ins., 901 F. Supp. 1362 (N.D. Ill. 1995).

23 Gen. Elec. Cap. v. DirectTV, 1998 WL 849389 (D. Conn. 1998).

24 Sandra v. S. Berwyn Sch. Dist., 600 F.3d 612 (7th Cir. 2010) (emphasis in original).

25 Zurich Am. Ins. Co. v. Super. Ct., 66 Cal. Rptr. 3d 833 (Cal. Ct. App. 2007).

26 Muro v. Target Corp., 243 F.R.D. 301 (N.D. Ill. 2007).

27 *In re* Seroquel Prods. Liab. Litig., 2008 WL 1995058, at *4 (M.D. Fla. 2008) (citing Paul R. Rice, Attorney-Client Privilege in the United States § 7.2, 7.5; Visa USA, Inc. v. First Data Corp., 2004 WL 1878209, at *8 (N.D. Cal. 2004)).

28 *See, e.g.*, Arkwright Mut. Ins. Co. v. Nat'l Union, 1994 WL 510043 (S.D.N.Y. 1994) (though an "ordinary claims investigation" would not be protected, the investigation performed as part of a subrogation analysis was protected); Mission Nat'l Ins. Co. v. Lilly, 112 F.R.D. 160, 163 (D. Minn. 1986) (an insurance company may not insulate itself from discovery by hiring an attorney to conduct ordinary claims investigation).

29 572 F.2d 596 (8th Cir. 1977).

30 United States v. Chevron, 1996 WL 264769 (N.D. Cal. 1996).