

**THE STATE OF SOUTH CAROLINA
In the Supreme Court**

ON CERTIFICATION OF A QUESTION
FROM THE FOURTH CIRCUIT COURT OF APPEALS

United States District Court for the District of South Carolina
Beaufort Division
The Hon. David C. Norton

Appellate Case No. 2018-001170

In re: MT. HAWLEY INSURANCE COMPANY.....Petitioner,

in which

CONTRAVEST, INC., CONTRAVEST CONSTRUCTION COMPANY
AND PLANTATION POINT HORIZONTAL PROPERTY REGIME OWNERS
ASSOCIATION, INC., as assignees are.....Respondents.

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CERTIFIED QUESTION AS DRAFTED

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

DETERMINATIVE ISSUE BEFORE THE CERTIFYING COURT

In the context of an insurance bad faith action, whether “South Carolina law . . . supports the ‘at issue’ exception applied in *City of Myrtle Beach*”¹ such that where a *prima facie* showing of bad faith has been made, there exists a rebuttable presumption that an insurance carrier’s complete claims file is discoverable by its insured.

BACKGROUND/FACTS

This is an insurance bad faith action against Mount Hawley Insurance Company (“Insurer”) for its failure to defend and/or indemnify its insured, Respondent ContraVest Construction Company, Inc. In 2011, Respondent Plantation Point Horizontal Property Regime Owner’s Association, Inc., brought a lawsuit against ContraVest alleging various construction defects (the “Defect Action”). Despite demands from ContraVest, Insurer refused to defend or indemnify Contract Vest against the Defect Action. ContraVest later settled the Defect Action and assigned its bad faith claim against Insured to Plantation Point. In 2014, Plantation Point, as the assignee of ContraVest (“Respondent”) commenced a bad faith action against Insurer in the Court of Common Pleas in Beaufort County, South Carolina. Insurer removed the case to the United States District Court.

Respondent sought discovery of Insurer’s claims files, which Insurer opposed claiming it contained attorney client privileged communications. Respondent moved before the district court to compel the production of the claims file. “Following the approach articulated in *City of Myrtle*

¹ *City of Myrtle Beach v. United Nat’l Ins. Co.*, 2010 U.S. Dist. LEXIS 89725 (D.S.C.)

Beach” the district court conditionally granted the motion to compel “because [Respondent] had established a *prima facie* showing of bad faith” and Insurer further failed to carry its burden of establishing privilege. (Order p. 5). However, the district court did not order that the subject material be produced to Respondent, but instead ordered that it be produced to the court for *in camera* review. (Order p. 6).

Subsequently, the district court denied Insurer’s motion to reconsider as well as its motion to certify four questions to this Court. Because the district court’s order is not typically appealable, Insurer sought a Writ of Mandamus from the Fourth Circuit Court of Appeals, and simultaneously requested the Fourth Circuit to certify the instant question. The Fourth Circuit found that “if South Carolina law does not support the ‘at issue’ exception applied in *City of Myrtle Beach*, the district court’s order granting the motions to compel was erroneous.” (Order p. 6). The Fourth Circuit stated: “We have not found any South Carolina authority that appears to definitively answer this question and believe the issue to be sufficiently debatable to warrant certification.” (Order p. 6). However, the Fourth Circuit certified a different question, instead asking: “Does South Carolina law support application of the ‘at issue’ exception to the attorney client privilege such that a party may waive the privilege by denying liability in its answer?” (Order. p. 1).

SUMMARY OF ARGUMENT

As shown by the entirety of the Fourth Circuit’s order, the text of the certified question fails to address the actual issue that led the Fourth Circuit to certify a question in the first place—whether the “at issue” rule employed by the district court in *City of Myrtle Beach* is consistent with South Carolina law. It is, and to find otherwise would result in this Court recognizing a rule that allows an insurer to cherry pick the information on which it relies and be the gatekeeper of what information should be used to evaluate its own conduct. This is contrary to the settled policy

considerations of this state and the principle that “[w]hether an insurance company is liable for bad faith must be judged by the evidence before it at the time it denied the claim.” *Howard v. State Farm Mut. Auto. Ins. Co.*, 316 S.C. 445, 448, 450 S.E.2d 582, 584 (1994).

This Court should confirm, consistent with *City of Myrtle Beach*, the question of whether an insurer’s claims file is discoverable is, and should remain, a factual question to be determined in the discretion of the trial court. Although Insurer requests the adoption of a new rule in South Carolina, there is no need for this Court to do so because a case-by-case review is necessary. However, to the extent this Court is so inclined, it should adopt a rule like that of *City of Myrtle Beach* or *Cedell v. Farmers Ins. Co. of Wsh.* 176 Wn.2d 686 (Wash. 2013), as both confirm a rebuttable presumption that an insurer’s claims file is discoverable in a bad faith suit and further employ substantial measures to avoid unnecessary or overly broad disclosure of potentially privileged information. Such a rule strikes a balance between the public interest in favor of discovery and protecting insureds, against the public interest served by the attorney client privilege.

ARGUMENT

- I. **Despite being broadly worded, the fundamental question before this Court is whether the “at issue” analysis applied in *City of Myrtle Beach* finding an insurer’s pre-suit claims file to be discoverable in a bad faith action is consistent with South Carolina law.²**

In its Order, the Fourth Circuit plainly articulated its view of the determinative issue that necessitated the certification of a question to this Court:

² *City of Myrtle Beach* spoke of discoverability in the sense of an “implied waiver of privilege,” yet also found the insurer, failed to meet its burden of establishing privilege. *City of Myrtle Beach*. 2010 U.S. Dist. LEXIS 89725, at 20. Practically, there is no difference between information being “not privileged,” as compared to being privileged but waived. In either scenario the information is “discoverable.” Therefore, Respondent generally uses the term “discoverable” to encompass either or both scenarios.

[Insurer] contends, and we agree, that if South Carolina law does not support the ‘at issue’ exception applied in *City of Myrtle Beach*, the district court’s order granting the motions to compel was erroneous. We have not found any South Carolina authority that appears to definitively answer this question and believe the issue to be sufficiently debatable to warrant certification of the question to the Supreme Court.

(Order at p. 6) (emphasis added).

However, rather than certifying a question that focused on the determinative issue stated above, the Fourth Circuit certified a question—drafted by Insurer—which posed a much different and broader inquiry:

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

Couched in this broad language, the certified question is based on a false premise and presents a mere hypothetical. In South Carolina, the existence of privilege is a question of fact for which the proponent (here, Insurer) bears the burden of establishing seven elements, in addition to the absence of waiver. *See generally, State v. Doster*, 276 S.C. 647, 651, 284 S.E.2d 218, 220 (1981) (setting forth eight elements of privilege, only one of which is the absence of waiver); *see also, State v. Love*, 275 S.C. 55, 59, 271 S.E.2d 110, 112 (1980) (privilege “is for the trial judge to decide in the light of a preliminary inquiry into all of the facts and circumstances”) (emphasis added). The question as written, fails to recognize these controlling principles of law, rendering any potential answer to the question as written purely advisory. *Contra e.g., Sangamo Weston v. Nat’l Sur. Corp.*, 307 S.C. 143, 148, 414 S.E.2d 127, 130 (1992) (when answering certified questions, this court will not issue advisory opinions nor alter precedent based on questions presented in the abstract).

Also, in limiting the inquiry only to the denials of liability made in the answer leaves the question of little value to the bench and bar. Whether privilege exists or has been waived is subject to constant change based the circumstances from case to case and even over time within a single case. This demonstrates why, in South Carolina, the question of privileged is a fact-based inquiry left to the sound discretion of the trial judge. *Doster*, at 651, 284 S.E.2d at 220.

To illustrate, consider a possible answer to the certified question of: “No, a denial of liability in the answer does not waive privilege.” This response does not foreclose that other actions, such as pleading various affirmative defenses, counterclaims, or offering certain evidence at trial might later waive privilege. Thus, unless this Court is to endeavor to set forth all the factual scenarios in which waiver might result even though a party denies liability in the answer (including other statements in the same pleading that go beyond a mere denial of liability) then it stands that this issue must remain a factual inquiry which is improper for certification. *See* Rule 244, SCACR (“the Supreme Court in its discretion may answer questions of law certified to it by [another court]”) (emphasis added).

While the drafted question may be read to apply to any case, here the issue must be contemplated within the context of an insurance bad faith action. This context matters as demonstrated by the balance of the Fourth Circuit’s order which makes clear the issue for which certification was truly sought is to inquire of the application of the “at issue” doctrine in a bad faith action. The quotation marks around the phrase “at issue” exception demonstrates the phrase is to be defined by reference to the “ ‘at issue’ exception applied by *City of Myrtle Beach*.” (Order p. 6). It is apparent the Fourth Circuit seeks direction on how South Carolina’s laws on the issue of privilege should apply in the context of a bad faith action, framing the argument under

consideration as: “In the present case, the district court rejected [Insurer’s] argument that *City of Myrtle Beach* was inconsistent with South Carolina law[.]” (Order p. 5).

This Court appears to have previously acknowledged that in the face of an ambiguous certified question it should consider “the question (and hence [the] answer) in the context” from which it arises. *See e.g., Hartsock v. Goodyear Dunlop Tires N. Am. Ltd.*, 422 S.C. 643, 653, 813 S.E.2d 696, 702, n. 5 (2018) (Few, J., dissenting, but also recognizing that the reason a certifying court asks a question will help frame the answer). Thus, to be dispositive of the real inquiry and have any value to the bench and bar, the certified question must be read within the context of what the Fourth Circuit found to be the determinative issue and acknowledge that the “at issue” rule referenced in the certified question is that set out in *City of Myrtle Beach*. *See* Rule 244(a), SCACR (the certified question should address the determinative issue of law); *see also Peagler v. USAA Ins. Co.*, 368 S.C. 153, 157, 628 S.E.2d 475, 477 (2006) (in addressing a certified question, this Court is to safeguard the public interest, the policies of this state, and this “Court’s sense of law, justice and right.”); *accord Reynolds v. Ryland Group, Inc.*, 340 S.C. 331, 332, 531 S.E.2d 917, 918 (2000) (demonstrating that certification of a question is a matter within the original jurisdiction of the Supreme Court); *and* Rule 245(a), SCACR (the exercise of original jurisdiction should serve the public interest); *See e.g., Muhler Co. v. State Farm Fire & Cas. Co.*, 2018 U.S. Dist. LEXIS 163798, *7 at n. 1 (D.S.C. September 25, 2018) (signaling the federal district court understands that the question certified in the instant case inquires of the application of privilege as between “an insurance company and its own coverage counsel” in “a bad faith suit”).

Therefore, the fundamental question before this Court is whether *City of Myrtle Beach* (and its progeny) is consistent with South Carolina law. It is.

II. Consistent with the law and policy of South Carolina, this Court should confirm that in an insurance bad faith action there is a rebuttable presumption in favor of discoverability of an insurer's complete claims file, including attorney client communications therein that are relative to the fulfillment of the insurer's legal obligation of good faith.

A. Discovery and Privilege in South Carolina.

“In South Carolina the scope of discovery is very broad.” *Samples v. Mitchell*, 329 S.C. 105, 110, 495 S.E.2d 213, 215 (Ct. App. 1997) (quoting J. Flanagan, *South Carolina Civil Procedure* 216 (2d ed. 1996)). While policy dictates that “the public has a right to every man’s evidence,” privilege—including attorney client privilege—exists as “an exception” to this general rule that all relevant evidence is discoverable. *See Hartsock*, 422 S.C. at 647, 813 S.E.2d at 699 (stating “privilege allows a specified person to refuse to provide [] or . . . disclose[evidence],” and finding that privilege is “an exception” to “the normally predominant principle of utilizing all rational means for ascertaining truth”) (quoting *Jaffee v. Redmond*, 518 U.S. 1, 9 (1996) (emphasis added)).

“The purpose of the attorney client privilege is to encourage full and frank communication between attorneys and client and thereby promote broader public interest in the observance of law and administration of justice.” *Id.* at n. 1, quoting *Jaffee*, 518 U.S. at 10. Itself a means of promoting public policy, application of “[a]n asserted privilege must also serve public ends.” *Hartsock*, 422 S.C. at 647, 813 S.E.2d at 699 (internal quotations omitted) (emphasis added). In South Carolina privilege is to be “interpreted by the courts in the light of reason and experience.” Rule 501, SCRE; *Hartsock*, 422 S.C. at 649, 813 S.E.2d at 699 (“Unlike other jurisdictions, South Carolina does not delineate specific privilege through its rules of evidence.”) To establish privilege the proponent must:

“(1) [seek] legal advice of any kind [] (2) from a professional legal adviser in his capacity as such, (3) the communications relating to

that purpose (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) except the protection be waived.”

Id. at 530 citing *Doster*, 276 S.C. 647, 284 S.E.2d 218.³

However, in South Carolina “not every communication within the attorney client relationship is privileged,” instead, “the public policy protecting confidential communication must be balanced against the public interest in the administration of justice.” *Doster*, at 651, 284 S.E.2d at 220. (emphasis added). When interpreting the privilege, it must be narrowly “tailored to protect only confidences disclosed within the relationship.” *Id.*

Privilege is not absolute and will not operate to prevent disclosure where the facts suggest it has been expressly or implicitly waived. See *Tobacoville USA, Inc. v. McMaster*, 387 S.C. 287, 293, 692 S.E.2d 526, 530 (2010); *Doster*, 276 S.C. 647, 284 S.E.2d 218; *Floyd v. Floyd*, 365 S.C. 56, 88-90, 615 S.E.2d 465, 483 (Ct. App. 2005) (citing *South Carolina State Highway Dep't v. Booker*, 260 S.C. 245, 254, 195 S.E.2d 615, 620 (1973)) (all confirming that attorney client privilege is not absolute, and is waivable, and the burden is on the party claiming privilege to demonstrate the absence of waiver); see also *State v. Thompson*, 329 S.C. 72, 76-77, 495 S.E.2d 437, 439 (1998) (recognizing implied waiver); *Davis v. Parkview Apts.*, 409 S.C. 266, 293, 762 S.E.2d 535, 550 (2014) (Pleicones J., dissenting) (“it is widely recognized that a client [can] impliedly waive[] the privilege.”). Where privilege has been waived it is waived as to all communication on the same subject. *Marshall v. Marshall*, 282 S.C. 534, 538, 320 S.E.2d 44, 46-47 (Ct. App. 1984).

³ Although distinct from the attorney work-product doctrine, privilege will extend to communications originating from the lawyer rather than the client only if the communication is “based on confidential information provided by the client.” *Brinton v. Department of State*, 204 U.S. App. D.C. 328, 636 F.2d 600 (C.A.D.C. 1980).

The party asserting privilege as a basis to avoid discovery bears the burden of establishing the privilege. *See Love*, 275 S.C. at 59, 271 S.E.2d at 112 (emphasis added). This is a fact-based inquiry. Whether the burden has been met “is for the trial judge to decide in the light of a preliminary inquiry into all of the facts and circumstances.” *Id.* (emphasis added). The failure of the asserting party to establish the privilege and demonstrate that its application serves the public interest leaves the material discoverable. Thus, the law recognizes a rebuttable presumption that information is discoverable—*i.e.*, not privileged. *See Jowers v. S.C. Dep’t of Health & Env’tl. Control*, 423 S.C. 343, 359, 815 S.E.2d 446, 454, n. 13 (2018) (“A rebuttable presumption is defined as an “inference drawn from certain facts . . . which may be overcome by the introduction of contrary evidence.”) (citing *Rebuttable Presumption*, Black’s Law Dictionary (10th ed. 2014).

B. The “special” relationship between an insurer and an insured in South Carolina.

Much like the law regarding the broad scope of discovery and the establishment of privilege, the law relating to the special relationship between an insured and insurer—particularly in the bad faith context—is driven by public policy.

Since 1933, South Carolina has consistently recognized the insurer/insured relationship to be “special.” *See Tyger River Pine Co. v. Maryland Cas. Co.*, 170 S.C. 286, 170 S.E. 346 (1933) (establishing the well-known *Tyger River* doctrine). This “special” relationship imposes, as a matter of law, certain duties on an insurer that are not imposed on any other entities or in any other commercial transaction in this state. *See Tadlock Painting Co. v. Maryland Cas. Co.*, 322 S.C. 498, 500, 473 S.E.2d 52, 53 (1996); *Nichols v. State Farm Mut. Auto. Ins. Co.*, 279 S.C. 336, 306 S.E.2d 616 (1983) (both recognizing the special relationship between insurer and insured as the impetus for creating a unique bad faith cause of action in tort rather than contract). This stems from the unique nature of an insurance contract, through which (unlike other transactions) the

insured does not contract for any commercial advantage but instead contracts simply for protection from loss or harm. *Hinds v. United Ins. Co. of America*, 248 S.C. 285, 149 S.E.2d 771 (1966). Our Courts have acknowledged that the benefit of the insured's bargain is "peace of mind." *Tadlock*, 322 S.C. at 501, 473 S.E.2d at 54 (the insured is entitled to receive the "security from financial loss" as well as "the additional security of knowing [they] will be dealt with fairly and in good faith.")

This unique, special relationship justifies the heightened duties placed on and accepted by insurers in this state, in order to promote the strong public interest in protecting insureds. *Williams v. Riedman*, 339 S.C. 251, 269, 529 S.E.2d 28, 37 (Ct. App. 2000) (citing *Hinds v. United Ins. Co. of America*, 248 S.C. 285, 149 S.E.2d 771 (1966)). For instance, this Court has acknowledged decisions should be tailored to allay the threat that an "insurance company can, with complete impunity, deny any claim they wish, whether valid or not" while simultaneously retaining "the benefit of profiting on the use of the insured's money." *Nichols*, 279 S.C. at 340, 306 S.E.2d at 619. These heightened duties have led South Carolina Courts to describe this "special" relationship as "quasi-fiduciary." *Pitts v. Jackson Nat'l Life Ins. Co.*, 352 S.C. 319, 333, 574 S.E.2d 502, 507 (Ct. App. 2002) citing *Lira v. Shelter Ins. Co.*, 913 P.2d 514 (Colo. 1996) (emphasis added).

The significance of the public policy implications is no more apparent than when considering that South Carolina recognizes a cause of action in tort for bad faith based upon the "special" or "quasi-fiduciary relationship" between an insured and an insurer. *Williams*, 339 S.C. at 268, 529 S.E.2d at 36-37 (emphasis added). The insurer/insured relationship stands alone as the only relationship that gives rise to such an action sounding in tort. *Id.* (confirming that a claim in

tort for bad faith lies only within the context of an insurer/insured relationship and not employer/employee). This Court has established:

The elements of a cause of action for bad faith refusal to pay first party benefits under a contract of insurance are: (1) the existence of a mutually binding contract of insurance between the plaintiff and the defendant; (2) refusal by the insurer to pay benefits due under the contract; (3) resulting from the insurer's bad faith or unreasonable action in breach of an implied covenant of good faith and fair dealing arising on the contract; (4) causing damage to the insured.

Crossley v. State Farm Mut. Auto. Ins. Co., 307 S.C. 354, 359, 415 S.E.2d 393, 396-97 (1992).

Importantly, the “good faith obligation includes an insurer’s duty to investigate a claim.” *BMW of N. Am., LLC v. Complete Auto Recon Servs.*, 399 S.C. 444, 453, 731 S.E.2d 902, 907 (Ct. App. 2012) citing *Flynn v. Nationwide Mut. Ins. Co.*, 281 S.C. 391, 395, 315 S.E.2d 817, 820 (Ct. App. 1984). The duty of good faith that gives rise to a claim in tort extends to “all obligations undertaken by the insurer for the insured,” and claims for bad faith are independent and mutually exclusive of any claim based in contract. *Tadlock*, 322 S.C. at 501, 473 S.E.2d at 54 (italics in original).

It is paramount to recognize that our courts have set out that bad faith requires evaluation of what information was available to an insurance company. “Whether an insurance company is liable for bad faith must be judged by the evidence before it at the time it denied the claim.” *Howard*, 316 S.C. at 448, 450 S.E.2d at 584 (emphasis added). The entire contents of its claims file is the “evidence” that was “before it” when Insurer chose to deny the claim here. Importantly, nothing in this settled law requires that the insurer affirmatively rely on any particular evidence, but just that it be “before it.” Thus, regardless of what an insurer might have relied on in making its decision, its conduct must still be measured based on all the evidence that was available to be “before it at the time it denied the claim.” *Id.*; see also *Doe v. S.C. Med. Malpractice Liab. Joint*

Underwriting Ass'n, 947 S.C. 642, 649, 557 S.E.2d 670, 674 (2001) (recognizing that a bad faith claim lies against an insurance carrier for the failure to make an honest and informed judgment in processing a claim, and where there is no reasonable basis supporting the coverage decision, or when it fails to settle within policy limits if settlement is the reasonable thing to do).

Further underscoring the significance of the public interest is the fact that an insurer's heightened duties to an insured extend beyond the common law. An insurer additionally owes statutory duties which govern the fulfillment of its duty of good faith to its insured. Specifically, S.C. Code Ann. § 38-59-20 sets forth a non-exhaustive list of duties which constitute presumptive bad faith and "Improper Claims Practices." Among other things, these requirements prohibit: "providing deceptive or misleading information with respect to coverages" (S.C. Code Ann. § 38-59-20(1)); failing to "implement reasonable standards for the [] investigation and settlement of claims" (§ 38-59-20(3)); failing to make a good faith effort to achieve "a prompt fair and equitable settlement" (§ 38-59-20(4)); or invoking or threatening coverage defenses without a good faith basis or "reasonable expectation of prevailing" on that defense (S.C. Code Ann. § 38-59-20 (7)).

This special relationship and the inherent public policy considerations associated with it continue to remain at the forefront of this State's jurisprudence, and admittedly can generate "awkward" confluences of law and public interest. *See e.g., Sentry Select Ins. Co. v. Maybank Law Firm, LLC*, Op. No. 27806, Sherouse Adv. Sht. No. 22, May 30, 2018, p. 31, at 35 (in addressing a certified question, which remains under advisement, which implicates the policy considerations inherent in the insurance industry). The common theme that runs through South Carolina's jurisprudence is that where the interest of the insured and the insurer may diverge, public policy commands that the interests of the insurer yield to those of the insured. *See Hinds*, 248 S.C. 285, 149 S.E.2d 771 (the nature of the relationship implicates the need that public policy protects the

insured) *accord Sentry Select*, Op. No. 27806, Sherouse Adv. Sht. No. 22, at p. 34 (in a matter still pending, but noting the action by insurer should not be permitted where its interest were even “the slightest bit inconsistent with” the insured’s).

Against this established backdrop of public policy this Court should weigh the public’s interest in broad discovery, the observance of law, the administration of justice, and protection from unfair insurance claims practices, against an insurer’s interest in maintaining a wall of confidentiality around its claims file in order to keep aspects of its claims practices hidden. Specifically, this Court must decide, in the face of overwhelming public policy to the contrary, whether carving out a special exception to make an insurance company immune from the burden of proving its claims file is protect by privileged, serves and promotes public ends. *See Hartsock*, 422 S.C. at 647, 813 S.E.2d at 699 (“[a]n asserted privilege must also serve public ends.”). It does not.

The bedrock of a bad faith action inquires of the evidence before an insurer when it denied the claim, regardless of what evidence Insurer relied on in making its decision. An insurer should not retain full decision-making authority on coverage issues and likewise be the gatekeeper on what information will be discoverable when its claims practice is challenged in tort. To interpret the attorney client privilege to allow an insurer to cherry pick what is discoverable does a disservice to all insureds, the attorney client relationship in general, and promotes bad faith by letting insurers, “with complete impunity, deny any claim they wish, whether valid or not.” *Contra Nichols*, 279 S.C. at 340, 306 S.E.2d at 619.

C. Application of South Carolina’s laws and public policy exceptions to claims of privilege in an insurance bad faith action.

Insurer argues it has not placed its “good faith” at issue by expressly relying on any attorney client privilege communication. Rather, Insurer maintains the denial of bad faith is not the

equivalent of affirmatively asserting good faith.⁴ While this may be true in many cases, it simply cannot be true in the context of an insurance bad faith action, where the duties which have alleged to be breached arise, as a matter of law and statute, only *after* the event that creates the liability or damage to the insured, and specifically require certain objective means of investigating and evaluating the claim which must necessarily be measured by the information that was available to the insurer at the time.

Generally, the “at issue” exception focuses on the action of a party within the confines of the litigation. However, unlike a typical scenario in which the parties become adverse through the initiation of a lawsuit, the interests of an insurer and insured become adverse the moment an insurer denies a claim.⁵ Because the claims adjusting process creates the potential for conflicting interests, Insurer’s good faith was “at issue” the moment it received notice of the claim. This good faith is precisely what an insured—like Respondent—bargains for. To deny an insurer the right to investigate what information was before an insurer when denying coverage is to deny an insured of the benefit of its bargain.

The law places a duty of good faith on Insurer in investigating and deciding coverage and the law prohibits the denial of a claim in the absence of good faith. Thus, Insurer’s denial of coverage stands as an affirmation to its insured that it fulfilled this duty. Although the insured may initiate the suit, their interests became adverse when the claim was reviewed and denied. Focusing on whether Insurer’s answer placed its good faith further at issue is misguided because

⁴ This assumes there has been no counterclaims or affirmative defenses that implicate Insurer’s assertion of good faith. This is an assumption that cannot be born out from the Record as the pleadings are not before this Court.

⁵ Or sooner to the extent an insurer engages in bad faith, although an insured would not be aware of this at the time.

it was Insurer's act of denying coverage based on the evidence and information before it that placed its good faith "at issue" at the only time that matters—*i.e.*, when the claim was denied. From the moment Insurer received notice of the claim it was aware that all further efforts to investigate and evaluate coverage were subject to evaluation for its good faith. Knowing this, Insurer it elected to rest upon the sufficiency of its investigation, which was exclusively within its control. Public policy should not allow an insurer to retain the financial benefit of denying coverage while simultaneously retaining a litigation benefit of denying its insured access to the evidence Insurer compiled in furtherance of its duties of good faith. The law and public policy support that the entirety of this material should be discoverable unless Insurer carries the burden of demonstrating otherwise.

D. *City of Myrtle Beach is consistent with South Carolina's law and public policy.*

As the Fourth Circuit explained, the district court's ruling here relied on *City of Myrtle Beach*, which was a first party insurance bad faith action under South Carolina law. *City of Myrtle Beach*, 2010 U.S. Dist. LEXIS 8972 at 1-2. There, the question before the court was whether the insurance company's correspondence with coverage counsel contained in its claims file was immune from discovery based on attorney client privilege. *Id.* at 5-7. The *City of Myrtle Beach* Court began its analysis by recognizing that some jurisdictions recognize a *per se* rule that privilege is unavailable in a bad faith action. *Id.* at 9-10. However, because the issue of privilege in South Carolina is a factual question, the Court rejected this approach. *Id.* Instead, it focused on the "special" relationship and the significant public policy considerations implicated. *Id.* at 11-13.

In finding the claims file discoverable, the *City of Myrtle Beach* court recognized that although there is a public interest served by attorney client privilege, not all communication is presumed privileged, nor is it presumed that the privilege is absolute. *Id.* at 12. Rather, privilege

must yield to public policy, most notably by ensuring that privilege will not extend to the furtherance of tortious conduct. *Id. citing Ross v. Med. Univ. of South Carolina*, 317 S.C. 377, 384, 453 S.E.2d 880, 884-85 (1994). The special relationship also precludes either party from doing “anything to impair the other’s rights to receive benefits under the contract.” *Id.* at 11; quoting *Nichols*, 279 S.C. at 340. 306 S.E.2d at 619.

Important to the *City of Myrtle Beach*'s analysis was two significant aspects of South Carolina law, the first is that an insurance bad faith claim is to be adjudicated based on the information before the insurer at the time of its coverage decision. *Id.* at 13. Second was that South Carolina law places the burden of establishing privilege on the asserting party. *Id.* at 14. Accordingly, the district court concluded that because the insured made a *prima facie* showing of the insurer’s bad faith, it was consistent with South Carolina law that the “burden of establishing the applicability of the privilege [including] the burden of establishing no waiver of the privilege” was on the insurer. *Id.* at 20. Finding the insurer failed to carry its burden, the Court in *City of Myrtle Beach* ordered the production of the claims file, subject to *in camera* review. *Id.* at 20-23.

Although *City of Myrtle Beach* does not directly reference the “at issue” rule first set out in *Hearn*, it does reference the idea that “a party’s assertion of a new position of law or fact may be the basis of waiver” provided it does not upset the balance of the competing public interests. *Id.* at 14-15 (citing *Hearn v. Rhay*, 68, F.R.D. 574 (E.D. Wash. 1975)). However, *City of Myrtle Beach* demonstrates that in the context of a bad faith action, the “voluntary injecting” of an issue into the dispute is not necessarily limited to the confines of the pleadings, or the confines of the litigation. *Id.* at 14-15. Therefore, even though the insurer did not expressly rely on the advice of counsel as an affirmative defense in the litigation, the Court found the claims file discoverable. *Id.* at 19-20.

The Court's decision in *City of Myrtle Beach* promotes the overarching public interest in the discoverability of relevant information, the administration of justice and adherence to the law. It is consistent with the well-settled policy of this State not to create a scenario that would foster bad faith conduct on the part of an insurer by shielding parts of its claims file from review. It also gives heed to the public's interest in preventing the use of privilege to facilitate tortious conduct. Moreover, because every act—including an insurer's investigation of the claim—must be performed in service of its good faith obligations to its insured, public policy is not offended by subjecting the complete claims file to disclosure. An insured can have no peace of mind if it is denied access to all the information for which it specifically bargained for—*i.e.*, a good faith investigation and decision by the insurer. See *Tadlock*, 322 S.C. at 501, 473 S.E.2d at 54 (finding that peace of mind and the expectation to be dealt with in good faith is an insured's benefit of the bargain under an insurance contract) *Howard*, 316 S.C. at 448, 450 S.E.2d at 584 (“Whether an insurance company is liable for bad faith must be judged by the evidence before it at the time it denied the claim.”).

By requiring both a *prima facie* showing of bad faith and an *in camera* review prior to disclosure, *City of Myrtle Beach* strikes a fair balance between the public's interest in discoverability and an insurer's interest in seeking confidential counsel for issues outside the scope of its good faith obligations to its insured. Contrary to Insurer's suggestion, *City of Myrtle Beach* does not grant an insured full access to all an insurer's attorney client communication. Rather it is limited only to that information that was acquired by the insured between the time it received notice of the claim and the time it denied the claim. See *City of Myrtle Beach*. (*supra*). Further still, it allows an insurer the opportunity to demonstrate that certain communications are outside the scope of what should be discoverable by showing the information is unrelated to fulfillment of

its good faith duties. Finally, it allows the trial court, through *in camera* review to be the gatekeeper of what information will be discoverable. This is entirely consistent with South Carolina law. *See Love*, 275 S.C. at 59, 271 S.E.2d at 112 (discoverability “is for the trial judge to decide in the light of a preliminary inquiry into all of the facts and circumstances.”).

Practical considerations also support the discovery of the claims file. Consider that the attorney client communication within the claims file is likely to show one of two alternatives, either the insurer was advised it had no duty to defend and indemnify, or conversely, it was advised it had such a duty and ignored the advice. In the former, disclosure causes no prejudice to the insurer. But, denying discoverability of the latter enables an insurer to deny coverage with impunity. The analysis and ruling set out in *City of Myrtle Beach*'s limits an insurer's ability to use privilege to facilitate tortious conduct by disclosing its bad faith and is consistent with South Carolina law. *See Ross*, 317 S.C. at 384, 453 S.E.2d at 884-85 (privilege will not be applied to permit the furtherance of tortious conduct); *Hartsock*, 422 S.C. at 647, 813 S.E.2d at 699 (the purpose of privilege is to “promote broader public interest in the observance of law”); *Nichols*, 279 S.C. at 340, 306 S.E.2d at 619 (public policy will not facilitate the ability of an insurance company to deny claims with impunity); *accord e.g., Tobaccoville*, 387 S.C. at 293, 692 S.E.2d at 530 (privilege to be decided in the discretion of the trial court).

Ultimately *City of Myrtle Beach* rejects the notion that an insurer should get special treatment, instead supporting the equal application of South Carolina law by requiring the party asserting privilege to satisfy the burden of establishing the information should not be disclosed. It is not for an insured to establish the information is not privileged. Instead the opposite is true. Insurer has the burden. Leaving the issue for determination by the trial court, subject to *in camera*

review, enables for fair treatment of the issue for both Insurer and Respondent in a manner that is consistent with South Carolina law and promotes the public policy interests our State embraces.

E. The Davis dissent does not alter the analysis.

The *City of Myrtle Beach* opinion traces the path of how the public policy considerations regarding the insurance industry have manifested into the law and articulated clearly how these good faith duties interact with the policy considerations regarding discovery and privilege. Nonetheless, in support of its argument that *City of Myrtle Beach* is inconsistent with South Carolina law, Insurer relies on Justice Pleicones' dissent in *Davis*, 409 S.C. 266, 762 S.E.2d 535. However, the *Davis* dissent does not address *City of Myrtle Beach*, but rather the decision in *Hearn v. Rhay*, 68 F.R.D. 574 (E.D. Wash 1975). Contrary to Insurer's suggestion, the *Davis* dissent supports the analysis of *City of Myrtle Beach*, even assuming this dissenting opinion has precedential value.

Davis involved a dispute among business partners in which the defendants asserted the statute of limitations as a defense. Defendants therefore sought communications between plaintiff and their counsel related in any way to the plaintiff's discovery of the cause of action, claiming this was relevant to the issue of the statute of limitations. *Davis*, 409 S.C. at 271-80, 762 S.E.2d at 537-42. Apparently relying (at least in part) on *Hearn*, the trial court permitted discovery of the communication. *Id.* at 292, 762 S.E.2d at 549 (Pleicones J., dissenting). While the majority declined to address the issue, the dissent was critical of the trial court's application of *Hearn*. *Id.*

By way of background, in *Hearn*, the plaintiff brought suit against certain government employees alleging violation of §1983 of the Civil Rights Act. *Hearn*, at 577-78. The defendants, in answering, asserted "good faith immunity" as a statutory affirmative defense. *Id.* Consequently, the *Hearn* court held that by asserting this affirmative defense the defendants had waived privilege

as to communications between them and the Washington Attorney General. *Id.* at 580-83. Specifically, the court concluded the defendants had interjected these communications into the case by asserting their good faith, and the public policy implications favored the discoverability of this evidence as a result. *Id.* at 582.

The *Davis* dissent was critical of the application of the *Hearn* ruling to the facts and circumstances of *Davis*. Specifically, the dissent complained that application of the *Hearn* test to the facts of *Davis* resulted in an apparent broadening of the “traditional implied waiver standard.” *Davis*, 409 S.C. at 293, 762 S.E.2d at 550. The dissent described this broadening as “[r]ather than being limited to situations in which the client inserts the privileged *communications* into the controversy, waiver is expanded to situations in which the client raises any *issue* to which the privileged communication is relevant.” *Id.* at 293-94, 762 S.E.2d at 550 (italics original) The dissent opined that without regard to the “important public [policy] interests that privilege is designed to protect,” the interest served by disclosure could not reasonably outweigh the interests served by the privilege, particularly where the issues was discovery of plaintiff’s attorney client communication predicated on the very common scenario in which a defendant asserts the statute of limitations as a defense. *Id.*

To illustrate its concerns, the dissent pointed out that application of the *Hearn* test in the context of a statute of limitations claim meant that “in virtually every case in which the statute of limitations is pleaded as a defense . . . the [] party [asserting the defense] would be able to inquire of the [opposition’s] counsel: Did your client tell you anything in confident about what he or she knew that differs from or contradicts what he or she stated[?]” *Id.* at 295, 762 S.E.2d at 550 (internal quotation and citations omitted). The dissent found this result did not serve the public interest. *Id.*

While *City of Myrtle Beach* cited to *Hearn* it did not rely on *Hearn*. Regardless, the primary critique of *Hearn* is that the conclusion regarding discoverability is based on relevance, and “relevance is not the standard for determining whether or not evidence should be protected from disclosure as privileged.” *Rhone-Poulenc Rorer v. Home Indem. Co.*, 32 F.3d 851, 864 (3rd Cir. 1994). The *Davis* dissent was wary of predicating discoverability on relevance “because the definition of what may be relevant and discoverable from those consultations may depend on the facts and circumstances of as yet unfiled litigation, [and] 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.” *Davis* (supra) (citing *id.* at 864).

While a reasonable criticism in the context of most cases, this concern cannot logically apply to a bad faith claim in South Carolina. At the time it receives notice of a claim, an insurer is aware of the duties to investigate and reasonably evaluate the claim. See S.C. Code Ann. § 38-59-20 (setting out statutory “improper claims practices”); *Tadlock*, 322 S.C. at 501, 473 S.E.2d at 54 (describing that an insurer must fulfill its duties of good faith in “all obligations undertaken by the insurer for the insured”). Moreover, at the time it elects to deny coverage it does so knowing the contents of its claims file and knowing that whether or not it has fulfilled its duties to the insured may be subject to scrutiny. Further still, in the bad faith context, whether its claims file will be discoverable is not left to some uncertain future occurrence outside its control. Instead, discoverability of the claims file is based on an insurer’s coverage decision which is controlled exclusively by the insurer.

Thus, the overarching concern expressed by the *Davis* dissent is not that privilege cannot be implicitly waived. Rather, Justice Pleicones simply explained his view that such waiver should not be established “without taking into account the public policy” ramifications of such waiver as

balanced against the purpose for which privilege exists. *Davis*, at 294, 762 S.E.2d at 550 (Pleicones J., dissenting). The *Davis* dissent demonstrates why contemplation of the nature of the case is paramount. In relying on the *Davis* dissent, Insurer is hoisted by its own petard because this is precisely what *City of Myrtle Beach* did.

The logic of the *Davis* dissent and the basis for its criticism of *Hearn*, are simply not applicable in the context of an insurance bad faith action. Instead, just the opposite. The considerations that caused the *Davis* dissent concern, particularly the finding of implicit waiver without the balancing of the implicated policy ramifications are allayed by *City of Myrtle Beach*. Compare *id.* at 292, 762 S.E.2d at 549; with *City of Myrtle Beach* 2010 U.S. Dist. LEXIS 89725, at 20 (holding it was the insurer's conduct in failing to meet its burden that rendered the information discoverable, and this finding was consistent with the balance of the relevant policy considerations and the law of South Carolina).

F. Because application of privilege is a question of fact, no rule must be adopted; however, to the extent this Court elects to do so, it should adopt a rule that confirms a rebuttable presumption in favor of disclosure of the claims file similar to that set out in City of Myrtle Beach or Cedell v. Farmers Ins. Co. of Washington.⁶

Although Insurer encourages the adoption of the *Rhone-Poulenc* test, there is no need for this Court to adopt any particular test.

Whether material is discoverable or subject to attorney client privilege should remain, as it has always been, a question of fact to be decided in the discretion of the trial court. *Accord, Love*, 275 S.C. at 59, 271 S.E.2d at 112 (the existence of privilege is “for the trial judge to decide in the light of a preliminary inquiry into all of the facts and circumstances”). This Court has recently confirmed that although the issue of attorney client privilege in the context of the insurance industry might create “awkward” balancing acts, this Court has signaled it has not lost confidence

⁶ 176 Wn.2d 686 (2013).

in the trial court's ability to resolve any conflicts. *Sentry Select*, Op. No. 27806, Sherouse Adv. Sht. No. 22, May 30, 2018, at 35 (“We are confident the trial court of this State are well-equipped to protect the attorney client privilege according to law if any dispute over it arises.”) (petition for rehearing granted); accord e.g., *Tobaccoville*, 387 S.C. 287, 692 S.E.2d 526 (privilege to be decided in the discretion of the trial court); Rule 501, SCRE (privilege to be “interpreted by the courts in the light of reason and experience”).

If this Court is inclined to adopt a rule, it should reject the approach suggested by Insurer and adopt a rule which is consistent with South Carolina law and policy by confirming that the burden of establishing the asserted privilege rests on the Insurer. Any test adopted should be similar to that applied in *City of Myrtle Beach*, or *Cedell v. Farmers Ins. Co. of Wash.* 176 Wn.2d 686 (2013), where the Supreme Court of Washington confronted a nearly identical circumstance.

1. *The Rhone-Poulenc test proposed by Insurer is inapplicable to an insurance bad faith action and fails to promote South Carolina's public policy considerations.*

Insurer discusses three commonly applied tests: (1) the *Hearn* test; (2) the *County of Erie* test; and finally (3) the *Rhone-Poulenc* test, which it encourages this Court to adopt.⁷ None of these tests is consistent with South Carolina law, and more importantly, none of them consider, much less preserve, the significant policy considerations of the insurer/insured relationship that are implicated by a bad faith action in South Carolina.

In the simplest sense, the tests cited by Insurer purport to represent the sliding scale between an implicit waiver (in the case of *Hearn*) and an expressed waiver, for instance in the case of *County of Erie* and *Rhone-Poulenc*. It has been said (sometimes critically) that to apply *Hearn*, beyond its limited scope results in waiver being premised on the fact the subject material is relevant

⁷ See *Hearn v. Rhay*, 68 F.R.d. 574 (E.D. Wash 1975); *In re County of Erie*, 546 F.3d 222 (2d. Cir. 2008); *Rhone-Poulenc Rorer Inc. v. Home Indemnity Co.*, 32 F.3d 851 (3rd Cir. 1994).

to the asserting party's claims or defenses. See e.g. *Rhone-Poulenc Rorer*, 32 F.3d at 862-4; and *Davis*, (Pleicones J., dissenting, *supra*). *County of Erie* and *Rhone-Poulenc* seek to limit this criticism. For instance, in *County of Erie*, which like *Hearn* was a Civil Rights case, the Court declined to extend the *Hearn* exception where the defendants did not allege good faith immunity. *In re County of Erie*, 546 F.3d at 228-9. The Court determined that while relevance remained a consideration, waiver should not apply where the facts did not show reliance on the privileged communication. *Id.* at 229. However, the Court declined to delineate what "degree of reliance is required." *Id.* Thus, *County of Erie* finds that implicit waiver may be found where there is some—undefined—reliance on the privileged material. *Id.*

Rhone-Poulenc went further and found that relevance is not a consideration in whether there has been a waiver by placing something at issue, which instead requires the party actually "attempt[] to prove [its] claim or defense by disclosing or describing an attorney client communication." See *Rhone-Poulenc*, 32 F.3d at 863. Although *Rhone-Poulenc* presented a dispute between an insurer and insured, it did not involve the question of the insurer's bad faith. Rather, it was a simple declaratory judgment action through which the insurer claimed there had been no "occurrence" under the policy as a result of the insured's alleged fraud in the formation of the contract.

In *Rhone-Poulenc*, the insurer alleged its insured was aware its product was defective and causing harm prior to purchasing the insurance contract and sought to compel discovery of communications between the insured and its attorney to determine whether the insured had such knowledge. *Id.* at 864. Finding the insured had not specifically relied on communications with its counsel in its defenses, the *Rhone-Poulenc* Court declined to find the correspondence discoverable. *Id.* Significantly, the dispute sounded in contract (not tort) and the Court's analysis was focused

on communication between the insured and its counsel which occurred before the purchase of the insurance policy—in other words, before any special relationship arose between the insurer and the insured. Thus, the *Rhone-Poulenc* Court did not endeavor to weigh any of the public policy considerations which are implicated by an insurance bad faith action. *See id.* at 862-64.

Because *Rhone-Poulenc* presents a scenario that is no different than any other contract dispute, it was unreasonable to find the insured could not rely on the privilege considering it was not sufficiently foreseeable at the time the communications were made that they might someday become relevant to a legal defense asserted by a future insurer concerning a claim that had not yet arisen. *Id.* at 862-63. Under those facts and circumstances, the *Rhone-Poulenc* Court required the waiver of privilege to be express, rather than implied. *See id.* at 864-66. However, this analysis does not apply in the context of an insurance bad faith action.

First, *Rhone-Poulenc* is inconsistent with South Carolina law to the extent it fails to recognize the applicability of implicit waiver, and further fails to address the policy implications inherent in an insurance bad faith action. *See e.g., Thompson*, 329 S.C. at 76-77, 495 S.E.2d at 439; *Davis*, 409 S.C. at 293, 762 S.E.2d at 550 (Pleicones J., dissenting) (both recognizing implicit waiver). Further, even if *Rhone-Poulenc* were applied to an insurance bad faith action it would likely lead to the same result as *City of Myrtle Beach*, because *Rhone-Poulenc* draws a sharp distinction between the discoverable “facts” that might be contained in an attorney client communication, and the communication itself. *Rhone-Poulenc*, 32 F.3d at 862 (“The protection of the privilege extends only to *communications* and not to facts.”) (emphasis original) (citation omitted).

In *Rhone-Poulenc*, although the Court found the communications between the insured and its counsel were not discoverable, the Court made sure to “emphasize that [its] holding is not meant

to preclude disclosure of the knowledge the insureds possessed” at the relevant time. *Id* at 864 (emphasis added). Thus, while the communications might be privileged, the facts contained in those communications were discoverable.⁸ The *Rhone-Poulenc* Court was clear on this, “[a] litigant cannot shield from discovery the knowledge it possessed by claiming it has been communicated to its lawyer; nor can a litigant refuse to disclose facts simply because that information came from a lawyer.” *Id.* (emphasis added). This point is fatal to Insurer’s position.

Just as the knowledge possessed by the insured in *Rhone-Poulenc* at the relevant time was discoverable, here the complete claims file must likewise be discoverable because “[w]hether an insurance company is liable for bad faith must be judged by the evidence before it at the time it denied the claim.” *Howard*, 316 S.C. at 448, 450 S.E.2d at 584 (emphasis added). In *Rhone-Poulenc*, as here, the penultimate question is what a party knew and when they knew it, and under the direction of *Rhone-Poulenc*, such facts cannot be concealed even if they formed part of a communication with a lawyer. *Rhone-Poulenc*, 32 F.3d at 862 (a litigant cannot refuse to disclose facts “simply because that information came from a lawyer”). Applying this conclusion to the context of an insurance bad faith claim suggests a broader swath of information is available here because the legal conclusions are entirely inseparable from the facts known or available to the insurer. The question is not whether the legal conclusion an insurer might receive from its counsel is reasonable, but instead whether the action the insurer takes while in possession of that legal conclusion, and all other “evidence before it,” was reasonable. There is little distinction between a fact and legal conclusion in a bad faith action because the insurer has a statutory obligation to

⁸ The *Rhone-Poulenc Court* directed that the subpoenaed information be produced to show the facts known by the plaintiff, while redacting the privilege material—which it noted consists of the legal conclusions. *Id.* (“it [suffices] to say that each subpoena seeks the production of both privileged and discoverable documents [and] it would be appropriate . . . to redact them accordingly.”)

investigate and will be evaluated based on the fruits of that investigation. *See* S.C. Code Ann. §39-59-20(3) and *Howard*, (*supra*). In this way, whether Insurer possessed a legal conclusion—or other communication from its counsel—that if known might lead a reasonable person to conclude that Insurer had an obligation to cover the claim, this is a fact that Respondent can discover.

Unlike *Rhone-Poulenc*, the actual communications in the present case (i.e., between Insurer and its counsel) were made with the knowledge these communications would form a part of the “evidence before it at the time it denied coverage.” *Howard*, 316 S.C. at 448, 450 S.E.2d at 584. Insurer’s decision to accept or deny coverage—a decision exclusively within its own control—must unquestionably comport with the insurer’s quasi-fiduciary duty of good faith to the insured under settled South Carolina law. Thus, unlike *Rhone-Poulenc*, without discovery of the complete claims file here, there is no other means to obtain the facts regarding what evidence Insurer had before it when it denied the claim.

By its own reasoning, *Rhone-Poulenc* is incapable of addressing the issue of privilege in the context of the “quasi-fiduciary” relationship that applies in an insurer’s claims analysis, and the “competing public interests” that are implicated by an insurance bad faith action. Instead, it would offer insurance companies an end-run around the law of South Carolina. Therefore, to the extent a test is desired, a different test is needed to strike the proper balance among the competing policy considerations. Such an approach is set out in *Cedell*. 176 Wn.2d 686, where the Supreme Court of Washington confronted a nearly identical circumstance. Similar to *City of Myrtle Beach*, the *Cedell* Court held there is a rebuttable presumption in favor of disclosure of the complete claims file, but even if the insurer overcomes the presumption the analysis does not end there, and the claims file (or portions thereof) may still be discoverable if the plaintiff makes a *prima facie*

showing of bad faith and an *in camera* review of the documents evidences a factual foundation to support a claim for bad faith.

2. ***The rule set forth in Cedell is consistent with South Carolina law.***

In *Cedell*, the insured brought a bad faith action against its insurer for failing to pay a claim. *Id.* Finding implied waiver, the trial court granted the insured’s motion to compel the production of the claims file, which insurer alleged was privileged. *Id.* at 687-95. Underlying the Washington Supreme Court’s ruling was the recognition that in any insurance bad faith action, “unique considerations arise.” *Id.* at 696. The Court determined that “[i]mplicit in an insurance company’s handling of a claim is litigation or the threat of litigation that involves the advice of counsel.” *Id.* (emphasis added). This is the same as South Carolina’s view that what matters is the “evidence before [Insurer] at the time it denied the claim.” *Howard*, 316 S.C. at 448, 450 S.E.2d at 584.

In order to serve the public interest by preventing an insurer from “unreasonably obstruct[ing] discovery of meritorious claims and conceal[ing] unwarranted practices[,]” the *Cedell* Court adopted a rebuttable presumption in favor of the disclosure of the claims file. *Cedell*, at 696-99 (“To protect these principle . . . [w]e start from the presumption that there is not attorney client privilege relevant . . . in the claims adjusting process.”). The insurer may rebut this presumption by showing “the attorney was providing counsel to the insurer” for reasons independent of the insurer’s good faith duties. *Id.* at 700 (emphasis added). However, even if insurer carries this burden, “the insured may be entitled to pierce the attorney client privilege” if it has made “a [prima facie] showing that . . . an act of bad faith has occurred,” and the trial court thereafter determines, through *in camera* review, that “there is a foundation to permit a claim of bad faith to proceed.” *Id.* at 700.

In short, the *Cedell* Court set forth two scenarios in which the claims file would be discoverable; first if the asserting party failed to carry its burden of establishing privilege by showing the communication was independent of its duties of good faith; or second, if the insured made a *prima facie* showing of bad faith and a subsequent *in camera* review revealed evidence reasonably supporting the claim of bad faith. *Id.* at 699-701. The Court determined this approach best served the “two important public policy pillars: that an insurance company has a quasi-fiduciary duty to its insured and that insurance contracts, practices and procedures are highly regulated and of substantial public interest.” *Id.* at 699 (emphasis added).

Unlike any rule proposed by Insurer, the legal underpinnings and policy considerations of *Cedell* are precisely aligned with those of South Carolina. Like South Carolina, Washington law requires the proponent of a privilege bear the burden of establishing the privilege. *See id.* at 696 (in Washington the burden is on the asserting party); *see also e.g. Doster*, at 651 and 284 S.E.2d at 220 (in South Carolina the burden is on the asserting party). South Carolina likewise shares in recognizing a substantial public interest implicated in the insurance industry. *Compare Cedell*, at 696-99; *with Nichols*, 279 S.C. 336, 306 S.E. 2d 616. In fact, South Carolina’s policy interests weigh even more heavily in favor of disclosure of the claims file because, unlike Washington, South Carolina recognizes the broader “tort” exception to the attorney client privilege, whereas Washington law is limited to the narrower “fraud” exception. *Compare Ross*, 317 S.C. at 384, 453 S.E.2d at 884-85 (“privilege does not extend to communications in furtherance of criminal tortious or fraudulent conduct”) *with Cedell*, at 709 (Alexander, J. dissenting on the basis that Washington only recognizes a fraud exception to privilege rather than the broader “tort” exception).⁹ This

⁹ Because South Carolina, unlike Washington recognizes the “tort” exception, the arguments offered by the dissent in *Cedell* are inapplicable in South Carolina.

single distinction is significant because it indicates a clear intent on the part of South Carolina to exclude a larger category of communication from privilege—even more than that of Washington.

Ultimately, *Cedell*, like *City of Myrtle Beach*, is consistent with the laws and public policy of South Carolina. The underlying principle of each are the same—there exists a rebuttable presumption in favor of disclosure, and it is Insurer’s burden to establish the material should not be disclosed by showing the act of denying the claim did not render the claims file discoverable. Therefore, upon an insured making a *prima facie* showing of bad faith the trial court should, in its discretion, either order the full claims file produced or alternatively conduct an *in camera* review of the documents and order that any document which may be evidence of insurer’s tortious conduct—*i.e.*, bad faith—be disclosed. The specific parameters of any such rule should be left to this Court to decide, or more properly, be left to be decided in the discretion of the trial court on a case-by-case basis.

3. *Insurer’s argument that City of Myrtle Beach violates equal protection and will have a chilling effect is without merit.*

Insurer claims that application of a rule like *City of Myrtle Beach* that permits the discovery of its full claims file would violate equal protection and further have a chilling effect¹⁰ by discouraging or limiting an insurer’s ability to consult counsel. Neither of these concerns are valid. In fact, the opposite is true.

Turning first to Insurer’s equal protection claim, generally, the “equal protection clause” provides that no “person shall be denied the equal protection of the law.” US Const. Amd. XIV

¹⁰ There is no practical evidence of the chilling effect that Insurer claims. *City of Myrtle Beach* has been the controlling law on this issue in federal court since 2010 and has been applied in a multitude of bad faith actions brought under South Carolina law to hold an insurer’s claims file is discoverable. Yet not only did Insurer elect to remove the matter to federal court, it presents no evidence that the application of *City of Myrtle Beach* over the course of nearly a decade has had any chilling effect on the attorney client relationship in South Carolina.

§1; S.C. Const. art I, §3. However, Insurer fails to acknowledge that “[u]nlike other jurisdictions, South Carolina does not delineate [] privilege” through rule, or statute; instead privilege is applied on a case by case basis as “interpreted by the court in the light of reason and experience.” *Hartsock*, 422 S.C. at 649, 813 S.E.2d at 699; Rule 501, SCRE. Attorney client privilege in South Carolina is applied based entirely on policy that considers how “the interests of society are best promoted.” *Tobaccoville*, 387 S.C. 287, 293, 692 S.E.2d 526, 530 (internal quotations omitted) (emphasis added). The application of privilege must therefore yield in the face of more compelling policy considerations. *See e.g., Doster*, at 651 and 284 S.E.2d at 220 (application of privilege “must be balanced against the public interest in the administration of justice”).

Insurer assumes that equal protection under the *law* requires equal protection under policy. In this context, this is like the tail wagging the dog. Regardless, an equal protection challenge by an insurer is analyzed under the “rational basis” standard. *Harleysville Mut. Ins. Co. v. State*, 401 S.C. 15, 28, 763 S.E.2d 651, 657 (Ct. App. 2012). “Under the rational basis test, the requirements of equal protection are satisfied when: (1) the classification bears a reasonable relation to the legislative purpose sought to be affected; (2) the members of the class are treated alike under similar circumstances and conditions; and, (3) the classification rests on some reasonable basis.” *Id. quoting Denene, Inc. v. City of Charleston*, 359 S.C. 85, 91, 596 S.E.2d 917, 920 (2004) (internal quotations omitted). This State’s long history of legislating the insurance industry and an insurer’s duties to its insured satisfy the first element. Provided the test for application of privilege rests on a factual analysis, as it has historically, the second element of the rational basis test is satisfied. Finally, the very fact that the application of privilege necessarily contemplates the weighing of the public interests served, it stands there is a reasonable basis for the rule, thus satisfying the third element of the rational basis test.

Insurer seeks to support its faulty equal protection challenge with a claim that to allow discovery of its complete claims file somehow places it “at a distinct disadvantage compared to other persons and entities.” (Br. p. 36). Interestingly, Insurer claims that “[it]—alone among the persons and entities who enter contracts in this State every day—would be denied the right to confidential legal advice in connection with those contracts.” *Id.* This ignores the fact that in South Carolina, in an insurance bad faith claim what matters is the evidence before the insurer at the time the claim is denied, along with a host of statutory obligations uniquely required of an insurer in its claims practices. See, e.g., *Howard*, and S.C. Code Ann. §39-59-10 et. seq. (*supra*)

Time and time again, South Carolina has made clear that the relationship between an insurer and an insured is “special.” Simply put, this is not the ordinary contractual relationship like all the other “persons and entities who enter contract in this State every day.” *Contra Williams*, 339 S.C. at 269, 529 S.E.2d at 37 (declining to extend the special duties owed by an insurer to other relationships); see also *Hinds*, 248 S.C. 285, 149 S.E.2d 771 (finding that an insurance contract is unlike any other contractual transaction).

Also unfounded is Insurer’s claim that “every breach of contract claim could support a waiver argument if the plaintiff asserts the defendant acted in bad faith.” (Br. p. 36). Again, this argument highlights a fundamental failure of Insurer’s reasoning that permeates the entirety of its position—there is a clear, recognized difference between the duty of good faith that exists in all contracts and the duty of good faith owed from an insurer to an insured in South Carolina. See *Tadlock*, 322 S.C. at 501, 473 S.E.2d at 54 (affirming that an insurer’s duties of good faith are owed in tort and are mutually exclusive from any claim alleging breach of the insurance contract); see also S.C. Code Ann. §39-59-10 et. seq. (setting forth requirements for claims practices).

Insurer alleges a chilling effect by claiming that to allow discovery of the claims file will deny “it the legal right¹¹ to confidential legal advice in connection with [its insurance] contracts.” (Br. p. 36). This exaggerates the issue significantly. The point before the court is whether the complete claims file is discoverable—which naturally pertains to information regarding adjusting of a known claim after the insurer has received notice of it. An insurance company, like Insurer, cannot reasonably claim that it made its coverage determination without knowledge of the contents of its claims file, or that in so doing it was not affirmatively relying on the sufficiency of its investigation and analysis of the claim. *See Howard*, 316 S.C. at 448, 450 S.E.2d at 584 (fulfilment of good faith is evaluated based on the information before the insurance company at the time it denied the claim, not after acquired information).

Further, as a practical matter, *City of Myrtle Beach* and *Ceddel* relieve the concern of any chilling effect. Under the applicable analysis, if the Insurer can show the information is not related to its good faith obligations to investigate and evaluate the claim then it will not be subject to disclosure. Thus, an insurer can be assured that any confidential information outside the scope of its claim’s practices would remain privileged.

Insurer contends that to allow discovery of an insurer’s claims file would “hamstring the ability of [Insurer] and other insurers to defend against bad faith action . . . and seek legal advice.” (Br. p. 31). This is simply untrue and entirely misstates the issue before this Court, which is limited in time and scope to the contents of Insurer’s claims file at the time it made the decision to deny the claim. Attorney client communications relating to its on-going defense of the bad faith action are not at issue. Permitting discoverability of the complete claims file would only

¹¹ Insurer cites no authority to support it has a “legal right” to confidential legal advice.

“hamstring” an insurer’s attempt to hide its bad faith by concealing the evidence it had before it when it denied the claim. The public policy risks of such a rule are obvious.

Insurer’s assertion that discoverability of the claims file would “effectively prevent an insurer from seeking confidential legal advice on whether a particular action would subject it to liability under South Carolina’s bad faith law” also overstates the issue. An insurer would remain free to seek such advice, and to make whatever decisions it believed would discharge its duty of good faith in light of the advice it receives (along with all other evidence before it at the time). If Insurer has its way and the complete claims file is not discoverable, it would be free to ignore—**with impunity**—any legal advice that a particular claim should be covered. *Contra Nichols*, 279 S.C. at 340, 306 S.E.2d at 619 (an insurer should not be allowed to deny a claim with impunity).

In short, the only chilling effect that comes from discoverability of the claims file is the chilling of insurers acting in bad faith. The knowledge and expectation that the complete claims file will become discoverable if a claim is denied will only strengthen the incentive for insurers to act in good faith. Certainly, this comports with the policies of this State. In the simplest sense, the claims file is the *corpus* of a bad faith claim. By writing an insurance policy in this State, an insurance company knows and agrees that in the event it denies a claim its conduct will be measured against all the information it had before it—including its full claims file—not just the evidence it decides to cherry-pick. *Accord Howard*, 316 S.C. at 448, 450 S.E.2d at 584 (the measure of bad faith is what was before the insurance company at the time it denied the claim).

CONCLUSION

For the reasons stated herein this Court should answer the certified question, if at all, to confirm that *City of Myrtle Beach* is consistent with the laws and policies of South Carolina.

Respectfully submitted,

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**THE STATE OF SOUTH CAROLINA
In the Supreme Court**

ON CERTIFICATION OF A QUESTION
FROM THE FOURTH CIRCUIT COURT OF APPEALS

United States District Court for the District of South Carolina
Beaufort Division
The Hon. David C. Norton

Appellate Case No. 2018-001170

RECEIVED
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S.C. SUPREME COURT

In re: MT. HAWLEY INSURANCE COMPANYPetitioner,

in which

CONTRAVEST, INC., CONTRAVEST CONSTRUCTION COMPANY
AND PLANTATION POINT HORIZONTAL PROPERTY REGIME OWNERS
ASSOCIATION, INC., as assignees are.....Respondents.

PROOF OF SERVICE

As counsel for Respondents, I do hereby certify that I have on this date, served a copy of Respondents' Brief upon all counsel of record by mailing a copy of the same via U.S. Mail, postage prepaid, to the following:

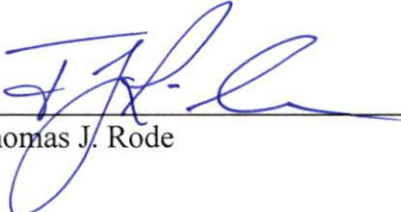
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