THE STATE OF SOUTH CAROLINA
In The Supreme Court

CERTIFIED QUESTION FROM THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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, as assignees, are ..... Respondents.

FINAL REPLY BRIEF OF PETITIONER

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Respondents' brief mischaracterizes the issue before the Court by repeatedly discussing the general discoverability of an insurer's claim file and the ***existence*** of privilege. These are ***not*** the issue before the Court. Mt. Hawley did not withhold its entire claim file on the basis of privilege as Respondents seem to suggest, and has never argued that the entire claim file is exempt from disclosure. Rather, Mt. Hawley withheld as privileged certain communications in the claim file between Mt. Hawley and ***its own coverage counsel.*** Respondents challenged the privilege designation. After reviewing the briefing, the District Court found that Mt. Hawley waived privilege pursuant to the "at issue" exception. The applicability of said exception under South Carolina law is the issue before the Court.

Respondents also impermissibly attempt to broaden the scope of the certified question and inject irrelevant matters into the Court's analysis. A central theme of Respondents' brief is that a claim of insurance bad faith is so special and unique that, in essence, an insurer should not be permitted to rely on the attorney-client privilege. This conflicts with established South Carolina law and policy and should be rejected. Respondents' lengthy discussion of the policy behind an insurance bad faith ***claim*** has no bearing on the certified question here regarding the "at issue" exception to the ***privilege***.

Finally, Respondents ignore the real-world impact of their proposed framework. Notably absent from Respondents' analysis is any discussion of how an insurer can ***ever*** maintain a privilege regarding communications with its counsel where bad faith has been alleged. Respondents entirely fail to counter Mt. Hawley's argument detailing how the practical result of Respondents' position would be a wholesale abrogation of the attorney-client privilege for insurers. Respondents simply advocate for their preferred result. Particularly troublesome is that

Respondents' proposed rule would significantly restrict, if not eliminate, the long-standing role of an insurer retaining and relying on the advice of its own outside coverage counsel.

As Mt. Hawley detailed in its opening brief, the District Court's recognition of the "at issue" exception to the attorney-client privilege conflicts with existing South Carolina authority and with a significant body of cases from other jurisdictions, especially with regard to whether the exception would result in a waiver where a party merely denies liability in its answer. This is a purely legal question which does not require a "case-by-case review" of the facts as Respondents have intimated. The Court should answer the certified question "no."

I. The Court should decline Respondents' invitation to recast the certified question.

A. Whether South Carolina recognizes the "at issue" waiver is a question of law for the Court.

Respondents repeatedly misrepresent the certified question as relating to the ***existence*** of privilege rather than the actual inquiry, which is whether the at issue exception to the attorney-client privilege comports with South Carolina law. As the Fourth Circuit explained in its Order, this was the essence of the District Court's holding—that the withheld files were not protected by the attorney client privilege because Mt. Hawley placed them "at issue" by denying liability for bad faith and thereby waived the protection. (Order at p. 3.) The proper question, therefore, is precisely as Mt. Hawley framed it: whether South Carolina law supports application of the "at issue" exception to the attorney-client privilege. (*See* Order at p. 6.) Respondents improperly attempt to shift the Court's attention away from the actual holding.[1]

[1] Respondents' assertion that there is practically "no difference" between non-privileged information and privileged information where the privilege has been waived defies logic. The mere fact that the result of discoverability may be the same in no way renders the concepts the same. This is akin to arguing that selling a broken widget to someone is the same as selling a widget to someone who later breaks it by their own hand because the end result of a broken widget is the same.

Respondents assert that because the existence of privilege is a question for the trial judge in light of the facts and circumstances, the Court should apply a fact-intensive analysis warranting case-by-case consideration. Again, however, the existence of privilege is not the issue before the court. Respondents' argument ignores the important distinction between whether South Carolina law recognizes the exception to privilege and the application of the rule to specific situations. A number of courts have recognized this distinction, finding that the ***scope*** of the attorney-client privilege and the ***contours of any exceptions thereto*** are questions of law for the court. *See, e.g., In re Kipnis Section 3.4 Tr.*, 329 P.3d 1055, 1059 (Ariz. Ct. App. 2014) ("The scope of the attorney-client privilege is a question of law that we review de novo."); *Cox v. Burdick*, 907 A.2d 1282, 1285-86 (Conn. App. Ct. 2006) ("Whether the trial court properly concluded that there is an exception to the attorney-client privilege . . . and, if so, whether it properly delineated the scope and contours of such an exception, are questions of law."); *Leibel v. Gen. Motors Corp.*, 646 N.W.2d 179, 185 (Mich. 2002) ("The question of what constitutes a waiver of the attorney-client privilege is a question of law that we decide de novo.").

It is only when applying those legal parameters to the specifics of a case that the issue becomes a factual question. *See, e.g., Shaffer v. Am. Med. Ass'n*, 662 F.3d 439, 446 (7th Cir. 2011) ("The scope of the attorney-client privilege is a question of law we review de novo, while we review the district court's findings of fact and application of law to fact for clear error."); *Katz v. AT&T Corp.*, 191 F.R.D. 433, 436 (E.D. Pa. 2000) ("The Court of Appeals for the Third Circuit has held that 'the applicability of a privilege is a factual question' and the determination of 'the scope of the privilege is a question of law.'").

Where the analysis begins with the protective blanket of privilege, the question turns on whether the privilege-holder has taken actions consistent with maintaining the confidentiality of the information. If something was never privileged, however, the party's actions to maintain confidentiality are irrelevant.

Mt. Hawley carefully framed, and the Fourth Circuit adopted, the certified question. This is a quintessential question of law—does South Carolina law recognize the "at issue" exception to the attorney-client privilege and, if so, what are its contours? The Fourth Circuit did not ask this Court to look at the existence of the privilege under the specific facts of this case. Rather, the Fourth Circuit and District Court will be tasked with addressing this issue after the Court addresses the legal question certified.[2]

B. The Fourth Circuit's formulation of the certified question is correct and will be dispositive of the appeal before it.

Respondents also take issue with the structure of the certified question, incorrectly asserting that the question presents a mere hypothetical. This is not the case. The District Court found that Mt. Hawley waived the attorney-client privilege by placing the subject communications at issue via its denial of liability in its answer. Answering the certified question would in no way be advisory. Instead, it would be dispositive of Mt. Hawley's mandamus petition pending before the Fourth Circuit, which raises this exact issue.

The certified question is structured correctly. The Court will necessarily have to address the broad issue of whether South Carolina law recognizes the exception. Then, if the Court determines that it does, it will have to detail the applicable test. That test would govern whether denial of liability in an answer constitutes a waiver. The certified question in no way requires

[2] Although from a different context, this Court's recent opinion in *Hartsock v. Goodyear Dunlop Tires N. Am. Ltd.*, 422 S.C. 643, 813 S.E.2d 696 (2018) is instructive. In *Hartsock*, the Court addressed the question of whether South Carolina recognizes an evidentiary privilege for trade secrets, finding that there was a qualified privilege and detailing its contours. *See generally id.* The Fourth Circuit then applied that holding and determined the District Court should conduct additional proceedings applying the parameters detailed by the Supreme Court to the discovery issue at hand. *See Hartsock v. Goodyear Dunlop Tires N. Am. Ltd.*, 723 F. App'x 224, 225 (4th Cir. 2018).

that the Court address every possible application of the legal test to various factual scenarios as Respondents contend.

The formulation of the certified question is correct and will clarify South Carolina law on a specific legal principle. Therefore, Respondents' argument is without merit.

C. The certified question is the proper issue for the Court's consideration and cannot be reframed in any event.

Respondents next contend that the Court should reframe the certified question to solely address bad faith actions. In addition to being procedurally improper, it presupposes the existence and applicability of the at issue exception under South Carolina law. The Court must necessarily address the more general question first.

The parties previously submitted a full round of briefing to the Fourth Circuit on Mt. Hawley's motion to certify the question presented. After considering the parties' respective arguments, the Fourth Circuit agreed with Mt. Hawley that the question presented is an issue of first impression of South Carolina law and that it would be dispositive of Mt. Hawley's appeal. Accordingly, the Fourth Circuit issued its Order certifying the question to this Court. Respondents did not take any action in response to this Order, and did not request that the Fourth Circuit reframe the certified question.

The South Carolina Appellate Court Rules, adopted by this Court, do not provide any mechanism for the Court to alter or amend the certified question. Rather, the only action permitted aside from addressing the certified question and ruling on the merits is rescission of certification. Rule 244(f), SCACR. This is logical, because the appeal—Mt. Hawley's Petition for a Writ of Mandamus—is pending before the Fourth Circuit, not this court. The Fourth Circuit is best equipped to determine if the certified question will resolve the appeal before it and how that question should be framed. *See Hartsock*, 422 S.C. at 653 n.5, 813 S.E.2d 702 n.5

(explaining the Court's view that the proper approach is to "answer the question and, if the Fourth Circuit really intended to ask a different question," it will "seek clarification, or reframe the question"). Any motion to reconsider, amend, or withdraw the certified question should have been made to the Fourth Circuit. Respondents improperly ask this Court to reformulate the certified question into something that was not requested by the Fourth Circuit.

Additionally, Respondents' argument that the certified question should be confined to the applicability of the "at-issue" waiver in the insurance bad faith context ignores that South Carolina law has never recognized the doctrine ***in any context***. *See Davis v. Parkview Apartments*, 409 S.C. 266, 293-94, 762 S.E.2d 535, 550 (2012) (Pleicones, J., concurring in part and dissenting in part) (analyzing the exception and contending that it does not comport with South Carolina law). Therefore, the certified question inevitably requires a broader analysis. The Court's answer to the certified question will resolve the appeal before the Fourth Circuit, and thus is the critical focus of the proceedings before this Court.

II. Respondents' proposed framework is ineffectual and would destroy the attorney-client privilege between an insurer and its counsel in this State.

The predominant theme of Respondents' brief is that where an insurer's bad faith has been alleged, the analysis respecting privilege and waiver should be modified. This premise is not supported by existing South Carolina precedent or case law from other jurisdictions analyzing the issue in the bad faith context. The underlying policy concerns detailed by Mt. Hawley warrant rejection of the at issue exception as the District of South Carolina has applied it.

A. Respondents' recitation of the applicable privilege law misconstrues the issue before the Court.

Respondents in their brief continue to attempt to obfuscate the real issue before this Court. Respondents repeatedly characterize the appropriate question as whether the privilege ***exists***, but that is ***not the proper question*** for this Court. Waiver is a wholly different question from whether a privilege ever existed in the first place, and there is no finding before the Court suggesting that privilege did not exist here.

Respondents also omit any discussion of South Carolina's well-established precedent detailing the standard for waiver of the attorney-client privilege. As this Court has explained, "[a]lthough a client may waive his attorney-client privilege, the ***waiver must be distinct and unequivocal.***" *State v. Thompson*, 329 S.C. 72, 76, 495 S.E.2d 437, 439 (1998) (emphasis added). Moreover, "[w]here an implied waiver is claimed, ***caution must be exercised, for waiver will not be implied from doubtful acts.***" *Id.* at 440 (quoting 28 Am. Jur. 2d *Estoppel and Waiver* § 160 (1966)) (emphasis added). As Mt. Hawley detailed in its opening brief Respondents would bear the burden of proving wavier. *See SPUR at Williams Brice Owners Ass'n, Inc. v. Lalla*, 415 S.C. 72, 91, 781 S.E.2d 115, 125 (Ct. App. 2015) (discussing the doctrine of waiver generally and explaining that "[t]he party asserting waiver has the burden of proof"). Regardless of burden of proof, South Carolina courts cast a wary eye on a claim that a party waived the attorney-client privilege. Respondents seek to abrogate this long standing principle.

Additionally, even assuming Mt. Hawley bears the burden of establishing privilege and lack of waiver, the ruling of the District Court is erroneous. If simply denying allegations in a complaint waives the privilege, it is difficult to see how the insurer could ever meet its burden. Respondents' position, in effect, reverses the burden of proof of bad faith by relieving the

insured of having to prove bad faith and shifting the burden to the insurer to prove a negative—*i.e.*, that it did not act in bad faith. This is an impractical burden.

B. The "special relationship" between insurers and their insureds has no bearing on the standard.

1. The "relationship" is irrelevant to the certified question.

South Carolina courts have never held that the insurer-insured relationship in any way deprives the insurer of the right to confidential legal advice. Moreover, contrary to Respondents' assertion, the insurer-insured is not the only relationship that gives rise to an action sounding in tort separate and apart from contractual duties.[3] As the District of South Carolina has explained, South Carolina courts have recognized such special relationships "between design professionals and general contractors who work under their supervision, between lawyers and their clients, and between corporate consultants and a state agency that is the subject of a report prepared by those consultants." *Bahringer v. ADT Sec. Servs., Inc.*, 942 F. Supp. 2d 585, 589 (D.S.C. 2013). In other words, this Court has found a special relationship "where the parties' relationship was one marked by professional duty . . . or by supervisor-supervisee relations." *Id.* If a "special relationship" could deprive a party of the right to confidential legal advice, the rule will extend to professionals and supervisors, and the attorney-client privilege as we know it would be greatly

[3] Respondents also incorrectly state that the Court of Appeals has described the insurer-insured relationship as "quasi-fiduciary." The case cited for this proposition was discussing, in dicta, the relationship between an insurer and an insured. *See Pitts v. Jackson Nat'l Life Ins. Co.*, 352 S.C. 319, 330, 574 S.E.2d 502, 507 (Ct. App. 2002). The *Pitts* court explained that "[t]he conduct at issue in the ['special relationship'] cases arose based on the insurer's established contractual obligations." *Id.* The court cited to a South Carolina case discussing the duty of good faith and fair dealing and then gave a "*see also*" cite to a Colorado case holding that "tort liability for breach of implied duty of good faith and fair dealing is based on the quasi-fiduciary nature of insurance relationship and is predicated on parties' contractual responsibilities." *Id.* (citing *Lira v. Shelter Ins. Co.*, 913 P.2d 514 (Colo. 1996)). The court in no way suggested that South Carolina law viewed the relationship as "quasi-fiduciary."

altered. South Carolina courts have never suggested that ***any*** such relationship would have an impact on the attorney-client privilege.

Respondents, nevertheless, conclude that in light of this relationship, the attorney-client privilege should essentially be abrogated where a claimant alleges insurance bad faith due to the duties owed to the insured. This ignores the significant impact to insurance companies under this rule. In particular, Respondents fail to explain how their position would avoid eliminating the long-standing role of an insurer's reliance on the advice of its outside coverage counsel. If the communications are highly likely to be discoverable and not privileged, these communications would simply be used as ammunition against the insurer. The insurer would thus be incented not to seek legal advice regarding its decisions—surely a policy which should not be supported by the Court.

The rule advocated by Respondents will impose an unfair, unrealistic system on insurers and fundamentally alter their relationship with counsel. In particular, it will run afoul of South Carolina's well-established policy favoring full and frank communication between attorney and client. *See Hartsock v. Goodyear Dunlop Tires N. Am. Ltd.*, 422 S.C. 643, 648 n.1, 813 S.E.2d 696, 699 n.1 (2014) (quoting *Jaffee v. Redmond*, 518 U.S. 1, 10 (1996)). Why, for example, would coverage counsel, in the context of a coverage opinion, tell the insurer it was wrong and it needs to reverse its decision on coverage, knowing that his or her thoughts could be used to impose punitive damages on the client? Similarly, why, knowing this, would an insurer even seek independent advice about whether it was doing the correct thing? In this sense, what Respondents propose might actually facilitate bad faith rather than restricting it. Additionally, why would counsel give a frank assessment of the claimant's counsel and her theories if he

knows that it may ultimately be disclosed? Confidentiality is a crucial component of any such opinion, and Respondents' position answers none of these important questions.

Additionally, Respondents do not discuss the logical extension of their position. If written communications from the insurer's own counsel are discoverable, it seems to necessarily follow that the author of the communications can be deposed. And if written communications are discoverable, why would oral communications not also be discoverable? Even if counsel furnished an oral opinion, this would not be protected under Respondents' position. The result is the demise of any pre-litigation attorney-client relationship between an insurer and its counsel.

This Court should adhere to its long-standing precedent and reject the position of the Respondents. Further, were it to consider adopting some form of Respondents' position and altering its long-standing precedent—essentially a wholesale abrogation of the privilege for insurers—it should leave such to the province of the General Assembly. *Cf. Gov't Employees Ins. Co. v. Poole*, 424 S.C. 1, 8, 817 S.E.2d 283, 287 (2018) (finding in a certified question matter that the General Assembly was in the best position to determine whether South Carolina policy requires the apportionment of punitive damages in the UIM context "given its ability to conduct studies, collect information about insurance rates, and weigh the various courses of action").

2. Respondents' policy arguments are misplaced.

Respondents' discussion of the public policy underpinning insurance claims practices again misses the point. Mt. Hawley has not contended that the claim file as a whole is exempt from discovery and is in no way trying to maintain a "wall of confidentiality." Rather, Mt. Hawley withheld certain documents in the claim file ***because they were protected by the attorney-client privilege***. Mt. Hawley does not dispute that the claim file, excepting privileged

communications with counsel or documents with work product protection, may be generally discoverable.

Likewise, Mt. Hawley has not sought to act as a "gatekeeper" of what information is discoverable any more than any person who seeks to maintain the confidentiality of legal advice. Either something is privileged or it is not. If something is privileged, a party should be able to assert that it is exempt from discovery as Mt. Hawley did here. Any such withholding must be justified by the insurer's representatives, who are duty-bound under the Rules of Professional Conduct to display candor to the Court and refrain from making any legal argument based on knowingly false representations. *See* Rule 3.3(a)(1), RPC, Rule 407, SCACR; *see also Heisenger v. Cleary*, No. X04HHDCV126049497S, 2014 WL 4413515, at *5 (Conn. Super. Ct. July 29, 2014) (explaining the court had no reason to doubt counsel's claim of privilege, as "[i]t long has been the practice that a trial court may rely upon certain representations made to it by attorneys, ***who are officers of the court and bound to make truthful statements of fact or law to the court***" (emphasis added) (quoting *State v. Smith*, 960 A.2d 993, 1003 (Conn. 2008))). If the opposing party disagrees, it has the right to challenge the designation and litigate the issue before the trial judge. Mt. Hawley did not "pick" what was discoverable—if something is privileged, it is not discoverable. Respondents' supposed policy concern rings hollow.

Additionally, Respondents' suggestion that anything less than complete discoverability will allow insurers to deny any claim "with complete impunity" is utterly devoid of any support. This disregards the law governing the duty of good faith and fair dealing requiring insurers to justify and defend their decisions. Moreover, it ignores the multitude of South Carolina statutes and regulations governing insurers' conduct, as well as oversight by the South Carolina Department of Insurance. Insurers have strong incentives to have a defensible justification for

coverage decisions. Reaffirming that insurers are entitled to rely on the attorney-client privilege where bad faith has been alleged will not change that fact.

C. Respondents' proposed framework is unfair and unworkable.

Respondents assert that the waiver analysis should begin with the denial of coverage. Respondents do not provide any citation or supporting authority for this position, and it is in conflict with the body of case law discussed by Mt. Hawley in its opening brief which, at a minimum, began the analysis by looking at the pleadings.

Additionally, this suggestion suffers from the same deficiencies as a denial of liability in an answer resulting in a waiver. In either case, Respondents' scheme presumes that the insurer's denial of the claim or denial that it acted in bad faith was incorrect. Once more, the end result is essentially a blanket waiver of privilege when a claim is denied. Regardless of whether it is the denial of a claim or the denial of liability, Respondents are attempting to create a trap where insurers cannot avoid waiver.[4]

D. *City of Myrtle Beach* does not comport with South Carolina law and policy.

Aside from all of the problems with *City of Myrtle Beach* that Mt. Hawley detailed in its opening brief—particularly, that it adopted an exception to the attorney-client privilege not recognized by the appellate courts of this state and utilized a confusing and outdated standard—*City of Myrtle Beach* is not the panacea that Respondents contend.

First, Respondents are incorrect that the subject communications in that case were merely between the insurer and its "coverage counsel." *City of Myrtle Beach* involved a dispute over a

[4] Respondents also contend that it is against public policy to allow an insurer to deny coverage while also "denying the insured access to evidence." Again, the subject of this dispute is not merely "evidence" relating to the claims adjusting process that is at issue. These are documents and communications with the privileged advice of the insurer's ***own*** counsel. An insurer may choose to make communications with counsel "evidence" by pleading the advice of counsel defense, whereby there would be an express waiver of the privilege.

reimbursement provision in the insurer's policy, with the insured seeking reimbursement for certain attorneys' fees expended in the defense of a lawsuit against it. *See City of Myrtle Beach v. United Nat. Ins. Co.*, No. 4:08-1183, 2010 WL 3420044, at *1-2 (D.S.C. Aug. 27, 2010). The insurer retained outside counsel to review the bills from the insured's counsel and communicate directly with the insured about why the insurer was not reimbursing it. *See id.* at *2. The court found that the information at issue in two key respects. First, the insured asserted affirmative defenses contending that it acted in good faith. *See id.* at *7. Second, and most importantly, the court found that the insurer's counsel was not merely acting as coverage counsel. *See id.* The insurer's adjuster specifically testified that counsel was "***acting in her place***." *Id.* Moreover, the attorneys ***directly communicated with the insured*** about the claim. *Id.* Therefore, the attorneys were involved with the claims adjusting process and were acting beyond the traditional coverage counsel role of providing independent legal advice. To the extent *City of Myrtle Beach* stands for the proposition of "at issue" waiver as argued by the Respondents, it should be rejected by this Court for the reasons set forth by Mt. Hawley in its briefing.

The other case that Respondents urge the Court to adopt is *Cedell v. Farmers Ins. Co. of Wash.*, 295 P.3d 239, 246 (Wash. 2013). The *Cedell* court reasoned that the claim file is generally discoverable, but an insurer may overcome this presumption "by showing its attorney was not engaged in the quasi-fiduciary tasks of ***investigating and evaluating or processing the claim***, but instead in providing the insurer with counsel as to its ***own potential liability***; for example, ***whether or not coverage exists*** under the law." *Id.* at 246 (emphasis added).

This point is key. Providing legal advice to an insurer about coverage is much different from investigating and adjusting a claim.

Respondents fail to appreciate the differences between the situations. Mt. Hawley has never contended that any underlying facts are exempt from discovery. It is a well-established principle of privilege law that the facts themselves are not cloaked by privilege. Respondents' erroneous position is that outside counsel's independent analysis and opinion regarding these underlying facts ***is itself a discoverable fact***. No South Carolina authority provides support for this proposition. This is why Respondents' proposed framework would, in essence, eviscerate the attorney-client privilege for insurers if the Court were to adopt it.

E. The "balancing" test proposed by Respondents is fundamentally unfair.

Moreover, as Mt. Hawley detailed in its opening brief, the prima facie test articulated by *City of Myrtle Beach* is nothing more than a façade concealing a blanket waiver. Establishing a prima facie case would be a minor roadblock either satisfied by the allegations of the complaint itself or an affidavit from an expert. Notably absent from Respondents' analysis is any concrete explanation of how an insurer could rebut this. Respondents contend it can be done by showing that outside counsel's advice was independent of the insurer's good faith duties. However, a coverage opinion and related communications offering advice about the claim could never be independent of this duty. Respondents propose a rebuttable presumption which, in practicality, is insuperable.

Along those lines, the supposed mitigating factor of the court's in camera review is irrelevant if Respondents' standard is adopted. Again, there is no discussion of what sorts of communications would actually go beyond the scope of the insured's "fulfillment of its good faith duties." Obtaining the advice of outside counsel about coverage of a claim would almost certainly not be outside this scope.

The proposed burden shifting is also fundamentally unfair, particularly in the context of a discovery dispute. Respondents' position, in effect, would quickly relieve the burden on the insured of meeting a minimal prima facie hurdle. Then, the insurer would have to prove a negative—*i.e.*, that it did not act in bad faith—to avoid disclosure of its confidential communications with counsel. This will be fundamentally unfair and highly difficult, particularly in the confines of a discovery dispute.

Finally, the supposed "balancing" test is far from a true balance. Respondents contend that the public interest of "protecting insureds" should be balanced against the public interest served by the attorney-client privilege. In addition to failing to describe how Mt. Hawley's position would harm the insured in any way—as noted, nothing would prohibit a claimant from ***factual*** discovery—it ignores the fact that the public interest of protecting insureds is already accomplished via the tort of bad faith, the numerous statutes and regulations governing the conduct of insurers in this State, and the oversight of the Department of Insurance. There is simply no support for the notion that permitting insurers to maintain the confidentiality of their communications with their own outside counsel will harm insureds or foster bad faith. Likewise, it is incredulous to suggest that the obtaining of privileged communications between an insurer and its own counsel is contemplated as part of the insurance contract between insurer and insured. Respondents offer no support for such a proposition.

Therefore, for all these reasons, the Court should reject the "balancing" test Respondents propose.

F. The *Davis* dissent is a clear repudiation of the "at issue" waiver.

Although not binding precedent, former Chief Justice Pleicones's dissent in *Davis v. Parkview Apartments* offered a resounding rebuke of the "at issue" exception and detailed its

lack of compatibility with South Carolina law. As Justice Pleicones explained, the privilege order was "largely predicated on the circuit court's determination that appellants had waived their attorney-client privilege, applying the test for waiver derived from *Hearn v. Rhay*, 68 F.R.D. 574 (E.D. Wash. 1975)." *Davis v. Parkview Apartments*, 409 S.C. 266, 291, 762 S.E.2d 535, 549 (2014) (Pleicones, J., dissenting). He looked to South Carolina law governing privilege and waiver thereof, and determined that the at issue exception was in conflict with these principles. As he explained, "in my view the *Hearn* at-issue waiver rule sweeps far too broadly, eviscerating the attorney-client privilege without regard to the weighty public interest it serves." *Id.* at 295, 762 S.E.2d at 551. This is precise answer that Mt. Hawley urges the Court to give to the certified question here. *Davis* gives no support for the notion that the "nature of the case" would somehow change the result.

G. The Court should adopt the *Rhone-Poulenc* test if a test is necessary.

The at issue exception conflicts with ***existing*** South Carolina attorney-client privilege and waiver law. However, to the extent the Court is inclined to recognize a test for the exception, Mt. Hawley urged the Court to adopt the test from *Rhone-Poulenc Rorer Inc. v. Home Indem. Co.*, 32 F.3d 851 (3d Cir. 1994), as it aligns most closely with this precedent. Respondents admit that authorities have recognized the deficiencies with the *Hearn* test. However, they contend that because *Rhone-Poulenc* and some of the cases cited by Mt. Hawley did not involve a claim of bad faith, they are not applicable here. This is belied by the case law.

1. Decisions applying *Rhone-Poulenc* support that the test is equally applicable in bad faith cases.

A number of courts have applied *Rhone-Poulenc* or a similar test in the bad faith context. For example, the Eastern District of Louisiana relied on *Rhone-Poulenc* in *Dixie Mill Supply Co. v. Cont'l Cas. Co.*, 168 F.R.D. 554, 557 (E.D. La. 1996), and explicitly rejected the insured's

contention that the analysis should differ in the bad faith context. The plaintiff in *Dixie Mill* argued that bad faith litigation necessarily required an investigation into the insurer's state of mind and that the insurer placed "at issue" its "state of mind and its knowledge of Louisiana law, which was derived from its attorneys," by asserting its good faith. *Id.* at 556. The court rejected this argument, finding it swept too broadly and noting that to endorse such an argument would permit the plaintiff to force the defendant to "abrogate its privileges simply by asserting in the complaint that the defendant acted in bad faith, which the defendant then denies and says that, to the contrary, it acted in good faith." *Id.* Louisiana courts recognize the "at issue" waiver, but apply the more restrictive *Rhone-Poulenc* test since the fundamental policy underlying the waiver is "designed to prevent the unfairness that would arise from permitting a client to insist on the privilege when he or she intends to use the privileged information at trial." *La. Cni, LLC v. Landmark Am. Ins. Co.*, No. CV 06-112-D-M2, 2006 WL 8435025, at *4 (M.D. La. Aug. 17, 2006).

The Northern District of Georgia reached a similar conclusion in the *Liberty Mut. Fire Ins. Co. v. APAC-Se., Inc.*, No. 1:07-CV-1516-JEC, 2008 WL 11320055 (N.D. Ga. May 16, 2008) case discussed in Mt. Hawley's opening brief. This case was originally a declaratory judgment action, but the insured counterclaimed for breach of contractual duties and bad faith. The court applied a test similar to *Rhone-Poulenc*, requiring a party to affirmatively assert that it relied on the advice of counsel in attempting to prove its claim or defense to find that a waiver occurred. *Id.* at *5-6. The fact that the case involved a claim of bad faith did not change the analysis. *See id.* at *4 (reiterating that in the context of a bad faith claim, "although the entire insurance claims file may be relevant, the party seeking discovery is not entitled to documents protected by the attorney-client privilege"). Moreover, the court found that the insurer's denial

that it acted in bad faith was "not sufficient to waive the privilege," as adopting this argument would "would result in a de facto rule that every time a party denies that it acted in bad faith in refusing to settle a lawsuit, the advice of counsel is in issue and the attorney-client privilege is waived." *Id.* at *6 n.12. As Mt. Hawley detailed here, under such a system a party accused of bad faith "would be forced to refrain from denying the allegations, or else waive the attorney-client privilege." *Id.*

Another case Mt. Hawley relied on in its brief, *Everest Indem. Ins. Co. v. Rea*, 342 P.3d 417, 420 (Ariz. Ct. App. 2015), also supports that the *Rhone-Poulenc* test applies in the bad faith context. The *Everest* court explained that under Arizona law, a "party must make ***an affirmative claim that its conduct was based on its understanding of the advice of counsel***—it is not sufficient that the party consult with counsel and receive advice" to waive privilege, even where bad faith is asserted. *Id.* (emphasis added). The court cited with approval a prior Arizona decision, which explained that assertion of a subjective good faith defense "coupled with consultation with counsel did not, without more, waive the attorney-client privilege." *Id.* (citing *State Farm Mut. Auto. Ins. Co. v. Lee*, 13 P.3d 1169, 1179 (Ariz. 2000)). As the *Lee* court explained:

> We assume client and counsel will confer in every case, trading information for advice. ***This does not waive the privilege.*** We assume most if not all actions taken will be based on counsel's advice. ***This does not waive the privilege.*** Based on counsel's advice, the client will always have subjective evaluations of its claims and defenses. ***This does not waive the privilege.*** All of this occurred in the present case, and ***none of it, separately or together, created an implied waiver.***

Lee, 13 P.3d at 1183 (emphasis added).

Finally, *N.J. Manufacturers Ins. Co. v. Brady*, No. 3:15-CV-02236, 2017 WL 264457 (M.D. Pa. Jan. 20, 2017) likewise applied *Rhone-Poulenc* in the bad faith context. *See id.* at *12.

The court explained that the mere fact that an attorney's advice may be relevant or might affect the client's state of mind in a relevant manner in a bad faith case ***does not*** place the advice at issue. *See id.* (quoting *Rhone-Poulenc*, 32 F.3d at 863). The *Brady* court explained that the insurer in that case did not take an affirmative step to prove a claim or defense by disclosing or describing an attorney-client communication, and it was in fact the opposing party who was attempting to prove his defense by using such communications. *See id.* at *13. Thus, no waiver occurred. *See id.*

As these cases support, Respondents' suggestion that *Rhone-Poulenc* is inapplicable in the bad faith context is simply wrong. If the Court is to adopt a test, *Rhone-Poulenc* is most in line with South Carolina law as Mt. Hawley detailed in its opening brief.

2. *Cedell* does not comport with South Carolina law.

The cases detailed by Mt. Hawley provide ample support for the Court's rejection of *City of Myrtle Beach* and, by extension, the *Hearn* test. The Court should likewise reject the analogous *Cedell* approach recommended by Respondents.

First, *Cedell* is distinguishable because it did not concern the "at issue" exception to the attorney-client privilege. Rather, *Cedell* analyzed at the scope of the privilege of an insurer's claim file generally, as the insurer in that case withheld most of its claim file. *See* 295 P.3d at 241-42. Ultimately, the Washington court articulated a new test for determining whether the claim file was privileged in the first instance where bad faith was alleged. *See id.*

By relying on this case, Respondents falls into the same trap as much of their argument—it conflates the question of whether privilege exists with the question of whether privilege was waived. Here, the District Court found that the subject communications were privileged, but that disclosure was appropriate because they were placed at issue and thus the privilege was waived.

This is a different question from whether privilege existed in the first place. South Carolina law already offers a seven factor test for making this determination. *See State v. Doster*, 276 S.C. 647, 651, 284 S.E.2d 218, 219-20 (1981).

The most important distinguishing factor, however, was *Cedell*'s acknowledgement that very different rules apply to situations where the attorney is involved in the claims adjusting process, as discoverability is more likely in those circumstances. *See id.* at 246. In *Cedell*, the attorney did much more than give legal opinions: (1) he assisted in the investigation, (2) took sworn statements from the insured and a witness and corresponded with the insured, (3) wrote the insured to make an offer and threatened denial of coverage if it was not accepted, and (4) negotiated with the insured on behalf of the insurer. *See id.* at 247. Thus, although the attorney was advising the insurer about the law and strategy, "he also performed the functions of investigating, evaluating, negotiating, and processing the claim." *Id.* ***These facts*** are what supported a presumption of discoverability in that case and are why *Cedell* is inapposite.

Respondents' proposed framework of a "rebuttable presumption" and a highly fact specific burden shifting analysis is unwieldy and unnecessary. Moreover, it ultimately has no bearing on the certified question before the Court. The Court should answer "no" to the question as written. If that is insufficient guidance for the Fourth Circuit, then that Court or the District Court may request further clarification. Respondents in their brief shy away from this central issue because, ultimately, existing South Carolina law and a large body of persuasive authority weigh against applying the "at issue" exception in the manner that the District Court applied it.

III. Respondents' argument fails to overcome the equal protection and chilling effect concerns raised by Mt. Hawley.

Respondents begin by making the conclusory claim that there is no evidence of a chilling effect. This argument is disingenuous in several respects. First, Mt. Hawley cannot possibly

prove the effect of the District of South Carolina at issue rule on other insurers. It can only speak to its own experience. Moreover, any such discussion would be inappropriate in light of the narrow nature of the certified question proceedings. Also, the mere fact that something has not happened does not mean it will not happen. Finally, Respondent's contention that the only possible chilling effect is a chill on insurers acting in bad faith totally ignores the chilling effect on both attorneys giving advice to insurers and insurers seeking out that advice. This is the equivalent of saying the attorney-client privilege does not apply in the criminal context if the defendant committed a crime. Coverage counsel often gives very frank and direct advice when rendering a coverage opinion. In fact, frank advice is the sine qua non of a coverage opinion—as it is of all legal advice. How can counsel speak frankly though, knowing that his or her thoughts will ultimately be revealed to the client's adversaries and will likely be used against the client? Adoption of Respondents' position will render the coverage opinion extinct, to the detriment of both insurers and insureds.

Respondents also fail to sufficiently explain why eliminating an insurer's right to rely on the advice of counsel would not deprive the insurer of equal protection. Respondents simply assert that because insurers have special duties under South Carolina law, it is rational to restrict their right to confidential legal advice protected by the attorney-client privilege. South Carolina courts, however, have never singled out a specific type of person or company and restricted that person's attorney-client privilege. Why, for example, would other persons or entities with a "special relationship"—design professionals, attorneys, employers, consultants, etc.—be entitled to confidential legal advice, but insurers would not? For the numerous policy reasons previously detailed by Mt. Hawley, it would be fundamentally unfair to single out insurers like Mt. Haley and deprive them of equal protection under the law. The Court should reject such an invitation.

IV. Respondents' failure to address the prospective/retroactive issue impliedly conceded the point.

Finally, Respondents' brief does not address Mt. Hawley's contention that if the Court formally recognizes the "at issue" exception, it should only apply it prospectively. By failing to address this issue in its brief, the Court may treat this issue as a concession that Mt. Hawley's position is correct. *See First Union Nat'l Bank v. FCVS Commc'ns*, 321 S.C. 496, 502, 469 S.E.2d 613, 617 (Ct. App. 1996) (quoting 5 Am. Jur. 2d *Appellate Review* § 555, at 254 (1995)), *rev'd on other grounds*, 328 S.C. 290, 494 S.E.2d 429 (1997).

CONCLUSION

For the reasons stated in Mt. Hawley's opening brief and herein, the Court should answer "no" to the certified question. Regardless of the test applied, the Court should find that South Carolina law does not 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.

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Respectfully submitted,

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THE STATE OF SOUTH CAROLINA
In The Supreme Court

CERTIFIED QUESTION FROM THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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, as assignees, are..... Respondents.

CERTIFICATE OF COUNSEL

The undersigned certifies that this Final Reply Brief of Petitioner complies with Rule 211(b), SCACR.

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PROOF OF SERVICE

I, the undersigned Attorney of the offices of Nelson Mullins Riley & Scarborough LLP, attorneys for Petitioner, do hereby certify that I have served all counsel in this action with a copy of the pleading(s) hereinbelow specified by mailing a copy of the same by United States Mail, postage prepaid, to the following address(es):

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