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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 Pointe Horizontal Property Regime, as assignees, are .... Respondents

BRIEF OF *AMICUS CURIAE* THE SOUTH CAROLINA ASSOCIATION FOR JUSTICE

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INTRODUCTION

Pursuant to Rule 213, SCACR, the South Carolina Association of Justice ("SCAJ") conditionally files this brief in the event the Court grants its motion to appear as *Amicus Curiae*.

The certified question, as phrased by the Fourth Circuit Court of Appeals, is broader than necessary for the present case and, as framed, does not help resolve the important issue before the Court. This action involves a claim for insurance bad faith, the details of which are discussed by the United States District Court in *Contravest, Inc. v. Mt. Hawley Ins. Co.*, 273 F. Supp. 3d 607 (D.S.C. 2017). Because bad faith actions present unique considerations in the analysis of an insurer's claim of attorney-client privilege, and since it is unnecessary for the Court to address the certified question beyond the context of bad faith claims, *see Concerned Dunes West Residents, Inc. v. Georgia-Pacific Corp.*, 349 S.C. 251, 261, 562 S.E.2d 633, 639 (2002) (declining to answer certified questions because the Court will not issue advisory opinions), SCAJ limits its discussion herein to the specific question posed as that question is applicable to bad faith actions.

SCAJ respectfully submits the Court should confirm that, in the context of a bad faith action, communications between an insurer and its attorney about a claim *prior* to the insurer's bad faith denial of or other adverse decision regarding the claim or coverage (hereinafter collectively referred to as "adverse decision") can be subject to discovery – or, at a minimum, subject to an *in camera* review by the trial court as ordered in this case – rather than protected from disclosure by an *ipse dixit* assertion of the attorney-client privilege.

ARGUMENT

I. General Considerations

A starting point for the Court's analysis should be the scope of information that is protected by the attorney-client privilege generally—and what is not. By initially separating the categories of insurer-attorney communications by their nature and then narrowing its focus to exclude matters that are clearly not privileged, the Court will be able to consider more easily and precisely whether the remaining types of communications may be privileged and, if so, whether the privilege is waived in the context of a bad faith action such as this one.

The fact that a party simply consulted with or retained an attorney, and the general purpose for the consultation or engagement, are not privileged matters. *In re Grand Jury Subpoena Served upon Doe,* 781 F.2d 238 (2nd Cir. 1985) *(en banc), cert denied sub nom. Roe v. United States,* 475 U. S. 1108 (1986); *Humphreys, Hutcheson, & Moseley v. Donovan,* 755 F.2d 1211 (6th Cir. 1985). A party claiming some other communication is subject to the attorney-client privilege must demonstrate, among other things, that the communication relates to a *fact* of which the attorney was informed *by the client* for the purpose of securing primarily legal advice but *not for the purpose of committing a prospective tort.* *In re Allen,* 106 F.3d 582, 600-05 (4th Cir. 1997).[1] (emphasis added).

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[1] The *Allen* court described all the required elements of the privilege as follows:

> A party asserting the privilege must demonstrate:
>
> (1) the asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the bar of a court, or his subordinate and (b) in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers (c) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the

Assuming an adverse decision is made by the insurer, an insured is entitled to know whether the insurer consulted with an attorney regarding its adverse decision.[2] The question then becomes whether communications between the insurer and its counsel on this topic are entitled to protection under the attorney-client privilege. This inquiry involves considerations of the *nature* of the communications as well as the *purpose* of the communications.

1. Nature of Insurer-Attorney Communications

   a. Types of information generally communicated

An analysis of the nature of attorney-client communications requires some insight as to the types of information they contain. Generally, a communication between an insurer and its attorney regarding coverage may contain the following categories of information:

- Factual information provided by the insurer to its attorney that the insurer has disclosed to others;
- Confidential factual information from the insurer to its attorney that has not been disclosed to others;
- Communication from the attorney to the insurer that does not provide advice but includes factual information that the insurer has disclosed to others;
- Communication from the attorney to the insurer that does not provide advice but includes confidential factual information that has not been disclosed to others;
- Legal advice from the attorney to the insurer that includes factual information the insurer has disclosed to others; and
- Legal advice from the attorney to the insurer that includes confidential factual information the insurer has not disclosed to others.

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purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client.

106 F.3d at 600.

[2] Petitioner more or less concedes, and the SCAJ agrees, that when an insurer asserts advice of counsel as a defense, the privilege is indisputably waived; therefore, the remainder of this brief is devoted to circumstances where an insurer consulted with counsel but does not assert the advice of counsel defense.

When one considers, individually, each of the types of information that may be contained within insurer-attorney communications, it becomes apparent that most are either not privileged initially or are subject to an express waiver of privilege. The remainder should be discoverable as consistent with this State's public policy interests in the insurance context and subject to an implied waiver of the privilege.

b. Previously disclosed factual information

To the extent it is relevant to the bad faith claim, factual information the insurer provides to its attorney that it has disclosed to others is information which should be contained within the insurer's claim file. If the factual information consists of documents the insurer sent to the attorney, this information is not privileged simply because it accompanied an attorney-client communication (unless the documents are independently privileged). *Sneider v. Kimberly Clark Corp.*, 191 F.R.D. 1 (N.D. Ill. 1980). Regardless, this factual evidence – in any form – is clearly discoverable (and has likely already been produced by the insurer) as it reflects the "evidence [the insurer had] before it" when it made the adverse decision. *See Howard v. State Farm Mut. Auto. Ins. Co.,* 316 S.C. 445, 448, 450 S.E.2d 582, 584 (1994). Finally, the insurer has waived any claim of privilege as to this information by disclosing it to third parties. Consequently, there is no reason for the Court to protect from discovery any such information contained within an insurer's communication with its attorney.

c. Previously undisclosed factual information

An insurer may provide confidential factual information to its attorney that it has not otherwise disclosed. However, because an insured is entitled in a bad faith action to know the evidence before the insurer when it made its adverse decision, this factual information is relevant and should have been produced by the insurer as part of its claim file; therefore, it cannot

legitimately be confidential. As a result, the only way relevant factual information could fit within this category is if the insurer did not document the factual information in its claim file but only included it in the communication with its attorney—and the only reason for the insurer to do so would be out of concern that the information may undermine or otherwise negatively affect the defense of its adverse decision. This is neither fair nor appropriate. It is instead a perversion of the policies behind the attorney-client privilege.

Moreover, a rigid application of the attorney-client privilege as sought by the Petitioner would shield this information from the insured and require it to litigate the question of bad faith without knowledge of all the facts before the insurer when it made its adverse decision. This would result in an incomplete, sanitized version of what the insurer knew when it made its adverse decision. Such a result thwarts this State's public policy regarding the duty of good faith and fair dealing in the insurance context and allows insurance companies to secretly hide relevant information. In addition, the insurer's effort to protect the information by including it only in a communication with its attorney should be regarded as a communication for the purpose of committing the tort of bad faith (discussed further below) or considered an implied waiver of any privilege.

d. Factual information in attorney's communication to insurer

When applying the privilege analysis to communications from the attorney to the insurer, the Court must focus on whether to protect facts that the attorney learned from the client. Where the attorney's communication does not provide legal advice but includes factual information that the insurer has disclosed to others, those facts are discoverable for the reasons discussed under heading "b" above. Similarly, the discussion under heading "c" above applies to previously

undisclosed factual information the attorney received from the insurer and included in his communication to the insurer. Simply put, the facts are not privileged.

e. Legal advice from attorney to insurer

When an attorney's communication to the insurer includes both factual information and legal advice, the Court must distinguish between the portion of the communication that discloses factual information and the part that is purely legal advice. The considerations for factual information are discussed under the above headings. The discoverability of the legal advice requires a different analysis.

An attorney's advice to the insurer is itself "evidence before" the insurer when the insurer made its adverse claim decision. *See State Farm Mut. Auto. Ins. Co. v. Lee*, 188 Ariz. 52, 58, 13 P.3d 1169, 1175 (2000) ("[W]hat information could be more important to determining what these employees and managers actually knew and reasonably believed than the advice they obtained from counsel with respect to the validity of stacking claims?"). In fact, it is evidence the insurer specifically requested to rely upon in making that decision. The trial court should conduct an *in camera* review regarding possible production of this evidence because it goes to the heart of the insurer's position that it acted in good faith when it made the adverse decision.

Via *in camera* review, the Court can determine whether the advice is consistent with the insurer's adverse decision. To the extent that review reveals the attorney's advice is consistent with the adverse decision, it arguably only strengthens the insurer's defense of good faith and production of the advice will not be prejudicial to the insurer; or, alternatively, the court need not compel its production because such an order would not prejudice the insured. But, if *in camera* review reveals the insurer chose to act contrary to its attorney's advice, this is direct evidence to which the insured should be entitled to prove bad faith. "[W]hen a litigant seeks to establish its

mental state by asserting that it acted after investigating the law and reaching a well-founded belief that the law permitted the action it took, then the extent of its investigation and the basis for its subjective evaluation are called into question." *Lee*, 188 Ariz. at 60, 13 P.3d at 1177, *quoted in City of Myrtle Beach v. United Ins. Co.*, 2010 WL 3420044 at *5 (D.S.C. 2010) (hereinafter "*City of Myrtle Beach*").

2. Purpose of the Insurer-Attorney Communication

A review of the purpose for the attorney-client communications is necessary to determine whether the insurer sought advice for the purpose of committing the tort of bad faith. This can only best be accomplished by an *in camera* review as allowed by *City of Myrtle Beach* and as contemplated by the District Court in this case.

II. **The Formulistic Tests from *In re County of Erie* and *Rhone-Poulenc* are subject to Abuse**

The formulistic tests set forth in *In re Cnty. of Erie*, 546 F.3d 222 (2nd Cir. 2008) (hereinafter "*In re County of Erie*") and *Rhone-Poulenc Rorer, Inc. v. Home Indem. Co.*, 32 F.3d 851 (3rd Cir. 1994) (hereinafter "*Rhone-Poulenc*") are unfair and improper because they effectively give insurers the option to disclose an attorney's advice when the advice is helpful, but also the option to keep an attorney's advice secret when it is harmful.

As correctly described by Petitioner, both the *In re County of Erie* and the *Rhone-Poulenc* tests provide that communications between an insurer and its attorney are not subject to disclosure unless the insurer interjects the advice of counsel as an essential element of a claim, and then attempts to prove that claim or defense by disclosing or describing an attorney-client communication. Petitioner's Brief p. 12-13. What this means is that the insurer can choose whether to disclose attorney-client communications based upon its own financial needs and without regard to its special duties to its insured. This is unfair as an insurer will only choose to

interject the advice from its attorney into the bad faith case and rely on that advice to defend the case when the attorney's advice is consistent with the insurer's adverse decision. This rule places the insurer in the position of using the attorney's advice as a sword during litigation when it benefits the insurer, yet gives the insurer the right to shield harmful advice from discovery when doing so will benefit the insurer. In essence, this rule gives the insurer another weapon in bad faith litigation that significantly tips the scale in favor of the insurer. Such a rule actually fosters using the advice of counsel to commit the tort of bad faith and protects that use when bad faith litigation ensues.

For example, assume an insurer hires an attorney to advise it whether a claim should be paid. The attorney advises the claim should be immediately paid. The insurer rejects the attorney's advice and denies the claim. Under both the *In re County of Erie* and the *Rhone-Poulenc* tests, the insurer would hold the key to whether the attorney's advice is interjected as an essential element of the claim and used to prove its defense. Obviously in this situation, the insurer would choose not to disclose the advice because doing so would be harmful. However, assume the attorney's advice is that the claim is not due to be paid. Under this scenario, the insurer would choose to disclose the advice and defend its actions by contending it relied on the advice of learned counsel. From a policy standpoint, why should an insurance company have the right to disclose advice when the advice is helpful but not disclose the advice when it is harmful? This is exactly what both the *In re County of Erie* and the *Rhone-Poulenc* tests allow. Such a result is contrary to public policy in South Carolina, is at odds with long-standing South Carolina precedent that recognizes the special relationship between an insured and an insurer, and erodes the ability of an insured and the court to determine the gravamen of any insurance bad faith case: Based upon the evidence before the insurer, did it act reasonably in denying the claim? Allowing the insurer to use an

attorney's advice when it is helpful and shield it when it is harmful runs contrary to the fundamental analysis before the court in these types of cases, and significantly erodes the special relationship between the insurer and the insured.

III. Other Examples of Abuse

One need not stray too far into the realm of hypothetical to see how such a rule could be abused by insurers. Assume an insurer denies an insurance claim for lack of coverage and bad faith litigation ensues. During discovery, the insurer changes its position, admits coverage, and takes the position that the initial denial was a simple mistake. Further assume that the insurer consulted an attorney before the denial and the communications between the insurer and counsel conclusively demonstrate the denial of coverage was not a mistake at all.

Under both the *In re County of Erie* test and the *Rhone-Poulenc* test, if the insurer does not choose to interject the attorney's advice as an essential element of its defense – which it never would – all communications with its attorney remain privileged. Even if, for example, the communications conclusively show that the initial denial was not a mistake but was intentional and that counsel advised the insurer to pay the claim at the outset. Taken to its logical extreme, insurers could deny any claim despite being advised by counsel to pay it, just to see if the insured would sue. Then, once suit is filed, the insurer can assert that the initial denial was a mistake without any concern that its true motives – as reflected by the attorney-client communications – will ever be discovered. This scenario would allow every insurance company to initially deny coverage to see how an insured reacts, subsequently change its position and concede coverage if litigation is filed, camouflage the initial denial by asserting a simple mistake, and hide its bad faith state of mind from its insured by not interjecting the attorney's advice as an essential element of its defense. This should not be allowed in any court and certainly not in South Carolina.

Finally, Petitioner argues that "[i]n order to establish bad faith, it is entirely unnecessary" to discover the insurer's communications with counsel. Petitioner's Brief at p. 19. This assertion fails to recognize the reality of the way some insurers adjust insurance claims and the significance of communications between an insurer and counsel. All too frequently, claim files are immunized with information, opinions, and positions that go to the heart of an insurer's decision to deny a claim and the meat of the discussions and exchange of information occur under the umbrella of seeking an opinion from counsel. When this occurs, the *only* way to discover the facts or motivations that underpin a coverage decision is to discover the communications with counsel. Therefore, under the appropriate circumstances, not only is the disclosure of these communications critical, the failure to obtain them can be fatal to an insured's case.

IV. Current Rule Protects Both Sides

The facts and issues that can arise in the insurance bad faith context are virtually limitless. Adopting a formulistic *per se* rule for waiver of the attorney-client privilege can and will produce inequitable results. This is precisely why *City of Myrtle Beach* rejected a *per se* rule, recognized that the issue of privilege is factual, and focused on the special relationship between an insurer and the insured. In doing so, *City of Myrtle Beach* required both a *prima facie* showing of bad faith as well as an *in camera* review of any document prior to disclosure. Then, it is only when the Court determines that the advice received by the insurer is "at issue" can arguably privileged communications be discoverable. This in no way "eviscerates the attorney-client privilege" but strikes a fair, highly fact specific analysis that is left up to the careful analysis of a trial court in light of the specific issue in the case. *See Sentry Select Ins. Co. v. Maybank Law Firm,* Op. No. 27806 at p. 6 (S.C. Sup. Ct., Mar. 11, 2019) ("We are confident the trial courts of this State are well-equipped to protect the attorney-client privilege according to law if any dispute over it

arises."). Such a highly specific analysis of each communication and the specific matters at issue in a case is the manner in which privilege disputes are resolved by all courts. Creating a formulistic rule to protect insurers shifts the balance too far in favor of the insurer.

Hearn v. Rhay, 68 F.R.D. 574 (E.D. Wash. 1975) (hereinafter "*Hearn*") was decided in 1975 and has 2,350 published citing references. *City of Myrtle Beach* was decided in 2012 and has been relied on by state and federal court judges throughout South Carolina. The only criticism of *Hearn* from a South Carolina Court has come in a lone dissent[3] in *Davis v. Parkview Apartments,* 409 S.C. 266, 290, 762 S.E.2d 535, 549 (2014), a case that neither involved insurance bad faith at all nor mentioned *City of Myrtle Beach.* There is simply no evidence to support Petitioner's assertion that *City of Myrtle Beach* virtually eliminates the attorney-client privilege or creates an unfair advantage for insureds in bad faith litigation. Rather, it leaves the analysis up to the trial court, requires a *prima facie* showing of bad faith, and then requires that the specific communication be "at issue" in the litigation.

CONCLUSION

Accordingly, the Court should answer the certified question as follows: No, South Carolina law does not support application of an at-issue exception *solely* by denying liability in an answer. The Court should also affirmatively state that *City of Myrtle Beach* is consistent with the law and policy in this state, does not recognize a per se rule that the privilege is unavailable in a bad faith action, and that privilege determinations in these cases require a *prima facia* showing of bad faith and require the specific communication be at issue in the litigation.

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[3] At various points in the litigation of this case, Justice Pleicones' opinion in *Davis* has been characterized as a concurring opinion. In fact, he concurred in part and dissented in part from the majority opinion. His criticism of *Hearn* was clearly in the dissenting portion of his opinion.

Respectfully submitted,

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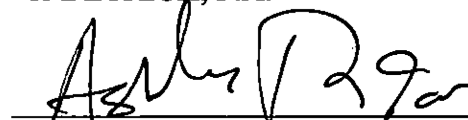
BY: 

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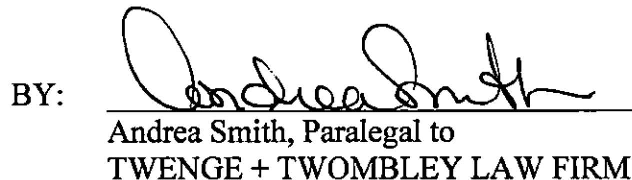
BY: 
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