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S.C. SUPREME COURT

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.

RESPONSE TO BRIEF OF AMICUS CURIAE SOUTH CAROLINA ASSOCIATION FOR JUSTICE

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Mt. Hawley hereby responds to The South Carolina Association for Justice's ("SCAJ") amicus brief.[1] The points made by SCAJ are meritless. As did the insured, SCAJ complains about the certified question's language. The Court should answer the certified question as set forth below. Further, SCAJ raises supposed scenarios and problems regarding insurers' invocation of attorney client privilege that are meritless and should be rejected, as set forth herein.

Introduction and Analytical Framework

To start, as stated by the United States Court of Appeals for the Sixth Circuit, "[i]t is not hyperbole to suggest that the attorney-client privilege is a necessary foundation for the adversarial system of justice." *In re Lott*, 424 F.3d 446, 450 (6th Cir. 2005). The attorney-client privilege encourages "full and frank communication between attorneys and their clients and thereby promotes broader public interests in the observance of law and the administration of justice." *Swidler & Berlin v. United States,* 524 U.S. 399, 403 (1998) (quoting *Upjohn Co. v. United States,* 449 U.S. 383, 389 (1981)).

Thus, the first principle this Court should consider when addressing the attorney client privilege implied waiver issue here is whether South Carolina law should be: 1) that this important privilege is easily, even sometimes accidentally, impliedly waived; or 2) that implied waiver of this important privilege is not easily found, will not be based on doubtful acts, and is not to be found simply on the basis of allegation of need for information from the opposing party. In other

[1] SCAJ filed a Motion for Leave to File an Amicus Curiae brief on April 11, 2017 by mail, and Mt. Hawley's counsel received it on one day before the oral argument in this matter. Mt. Hawley responded that same day stating that it would not oppose the motion provided it was given 30 days to file a brief in opposition. The Court granted the motion via Order dated April 16, 2017 but did not specify in the written order any response time. However, at oral argument, the Court stated that it would give Mt. Hawley 10 days in which to respond. Mt. Hawley timely submits this response pursuant to the Court's directive at the oral argument.

words, with this important privilege, should the Court adopt a liberal, pro implied waiver approach, that (as Judge Norton stated in his published district court decision) "damages" the privilege, or should the Court adopt a conservative approach that strives to protect the privilege where possible?

The second principle this Court should employ regarding this matter is that the law and rules should, as a general matter, be universal. Mt. Hawley submits it would be grossly unfair to have a test for implied waiver that changes based on whether a party is an insurance company. All clients have a right to an attorney client privilege. Any implied waiver rule respecting that privilege should be universal.

The third principle this Court should consider in this matter is predictability. The Court should ask whether the law of attorney client privilege (and that of waiver) in South Carolina has traditionally been more akin to the conservative, protective approach to the privilege adopted by some courts, or whether South Carolina has followed the South Carolina federal district court approach historically. "An uncertain privilege—or one which purports to be certain, but rests in widely varying applications by the courts—is little better than no privilege." *Rhone-Poulenc Rorer, Inc. v. Home Indem. Co.,* 32 F.3d 851, 863 (3d Cir. 1994) (quoting *In re von Bulow,* 828 F.2d 94, 100 (2d Cir. 1987)). As set forth in Mt. Hawley's primary brief and by former Chief Justice Pleicones in his dissent and concurrence in *Davis v. Parkview Apts.,* 409 S.C. 266, 762 S.E.2d 535 (2014) (Pleicones, C.J., concurring and dissenting), the federal district courts' citations to one another emanating from the original unpublished magistrate judge's decision in *City of Myrtle Beach v. United Nat. Ins. Co.*, No. 4:08-1183-TLW-SVH, 2010 WL 3420044 (D.S.C. Aug. 27, 2010)[2] are ***inconsistent*** with the historical and conservative approach that South Carolina has

[2] Magistrate Judge Hodges relied on the case of *Hearn v. Rhay*, 68 F.R.D. 574 (E.D. Wash. 1975) for her ruling.

taken to the attorney client privilege and waiver. The Fourth Circuit, by certifying the question presented here, asks this Court to answer this question.

Lastly, the Court should consider whether the conservative approach to implied waiver gives appropriate weight to the proof concerns raised by the SCAJ. Mt. Hawley suggests such concerns raised are overblown and are indeed factually inaccurate in some respects, as described below.

Argument

I. The certified question is proper, but even if the Court limits the question to the bad faith context the result remains the same.

The fundamental question is whether South Carolina law supports the District of South Carolina's application of the "at issue" waiver to the attorney-client privilege, which adopted and further extended the already liberal *Hearn* test. The question presented here was designed to capture the circumstances presented in this case. Here, Judge Norton determined that the unpublished magistrate judge's decision in *City of Myrtle Beach* (which itself adopted and expanded the *Hearn* test) applied, and that pursuant to that test Mt. Hawley waived the attorney-client privilege by placing privileged information "at issue" by denying liability its answer. The certified question presented was designed to address the circumstances of this case while also recognizing that the Court will have to address the broader question of whether the "at issue" waiver even comports with South Carolina law and, if so, whether the test applied by the District Court is correct. The Fourth Circuit, in essence, is asking whether the District Court's ruling is really consistent with South Carolina law.

SCAJ and Respondents both asserted that the question should be limited to the bad faith context. Mt. Hawley does not object to the Court clarifying that it is answering the current question

subject to any limitations or explanation detailed in its opinion. The insurance bad faith context is already implied by the certified question and by the discussion in the Fourth Circuit's certification order. If the question is causing too much difficulty, another way to state it would be:

> In this insurance bad faith action, did Mt. Hawley impliedly waive the attorney-client privilege by denying liability in its answer and therefore placing privileged information "at issue"?

The answer to this recast question remains "no" because South Carolina would and should follow the *Rhone* test or, failing that, the *County of Erie* test. Furthermore, the answer remains "no" even if the Court adopts the *Hearn* test, because even under that liberal test the mere denial of bad faith in an answer does not place privileged information "at issue."

If the answer to the question is no, then it means the District Court misapplied South Carolina privilege law and Mt. Hawley is entitled to mandamus relief. As Mt. Hawley detailed in its merits briefing, this is the proper result.

As Mt. Hawley set forth in its primary brief, the three tests that are generally recognized on implied "at issue" waiver are:

1. The three factor test from *Hearn v. Rhay*, 68 F.R.D. 574, 581 (E.D. Wash. 1975):

> Privilege may be waived when a party places privileged communications "at issue" and the following three factors are met: (1) assertion of the privilege was a result of some affirmative act, such as filing suit, by the asserting party; (2) through this affirmative act, the asserting party put the protected information at issue by making it relevant to the case; and (3) application of the privilege would have denied the opposing party access to information vital to his defense. *Hearn v.* 68 F.R.D. at 581. If the exception applies, the party seeking the information must also make a "substantial showing of merit" to its case before the court should apply the exception. *Id.* at 582.

2. The test from *In re County of Erie*, 546 F.3d 222 (2d Cir. 2008):

> For a waiver to occur, "a party must ***rely on privileged advice from his counsel to make his claim or defense.***" *Id.* The *In re County of Erie* court did not specify the degree of reliance required, but noted that privilege was not waived in the case before it because the petitioners did not "rely upon the advice of counsel in asserting their defense." *Id.*

3. The test from *Rhone-Poulenc Rorer Inc. v. Home Indemnity Co.*, 32 F.3d 851 (3d Cir. 1994):

> Even where advice of counsel is relevant to a party's state of mind, there is no waiver unless the party "interjected the advice of counsel as an essential element of a claim in this case." *Id.* "The ***advice of counsel is placed in issue where the client asserts a claim or defense, and attempts to prove that claim or defense by disclosing or describing an attorney client communication.***" *Id.* at 863 (emphasis added).[3]

Mt. Hawley suggests the Court should answer the certified question as follows: "No, because South Carolina follows the *Rhone* test and Mt. Hawley did not impliedly waive the attorney client privilege as it has not interjected the advice of counsel as an essential element of a claim or defense, and has made no attempt to prove any claim or defense by disclosing or describing an attorney client communication." South Carolina law is aligned with the *Rhone* test. As stated by former Chief Justice Pleicones, "[w]hile the client may waive the privilege, the rule in South Carolina has been that such a 'waiver must be distinct and unequivocal[,]' and we have held that a claim of implied waiver should be treated with caution." *Davis,* 409 S.C. at 292, 762 S.E.2d at 549 (quoting *State v. Thompson,* 329 S.C. 72, 76-77, 495 S.E.2d 437, 439 (1998); *Drayton v. Industrial Life & Health Ins.*, 205 S.C. 98, 108, 31 S.E.2d 148, 152 (1944)). Further, ordinarily in South Carolina, "waiver" is the intentional relinquishment or abandonment of a known right. *Janisik v. Fairway*

[3] *See also* Douglas R. Richmond, *The Frightening at-Issue Exception to the Attorney-Client Privilege*, 121 Penn St. L. Rev. 1 (2016).

Oaks Villas Horiz. Prop. Reg., 307 S.C. 339, 344, 415 S.E.2d 384, 387 (1992). Thus, the Court would properly answer the certified question as set forth above.

Failing the above, the Court might also answer the certified question as follows: "No, because South Carolina follows the *County of Erie* test and Mt. Hawley did not impliedly waive the attorney client privilege as it has not relied on privileged advice of counsel to make a claim or defense." If this Court declines to follow *Rhone*, the next best test in terms of protecting the privilege from liberal implied waiver is the *County of Erie* test.

Failing the above two responses, the Court might also answer the certified question as follows: "No, because even if South Carolina followed the *Hearn* test, the first factor of the *Hearn* test is not met by the mere denial of bad faith in the Answer of Mt. Hawley."

Some observations about the *Hearn* test. It has been heavily criticized by academics and courts. Further, it is not clear that Judge Neill in the *Hearn* case in 1975 ever meant for his opinion to be used as it has by various courts. In *Hearn*, the judge said that, based on the evolution of the "qualified immunity" defense, *"this court is compelled to recognize a new and* ***narrowly limited*** *exception to the AC privilege,* ***which applies to civil rights suits*** *against state officials under 42 U.S.C. § 1983,* ***wherein the defendant asserts the affirmative defense of good faith immunity***." *Hearn v. Rhay*, 68 F.R.D. 574, 580 (E.D. Wash. 1975) (emphasis added). Judge Neill also stated: ***"However, a major limitation on this exception must be emphasized. A substantial showing of merit to plaintiff's case must be made*** *before a court should apply the exception to the AC privilege defined herein." Id.* at 582 (emphasis added). Over time, as can be seen by the cases, these statements by Judge Neill have been ignored. Judge Neill's multi-factor test enunciated later in his opinion is what is cited by the courts, and that test has been applied to all types of cases. It has not been "narrowly limited" to the civil rights suits where the affirmative good faith immunity

defense is asserted. Finally, the "substantial showing of merit" which Judge Neill said "must be emphasized" to justify finding an implied privilege waiver has morphed along the way into the barely there "prima facie" showing of the "bad faith element" requirement applied by Judge Norton here. Hence, it appears the *Hearn* test has been too broadly and erroneously applied even in those courts that still follow the criticized test.

Lastly, fundamentally, *Hearn* is a "needs" based test creating a waiver based on the alleged "need" for information by the person seeking to invade the privilege, rather than on the traditional actions of abandonment by the privilege holder. *Hearn*[4] is thus at odds with traditional South Carolina waiver and privilege law, and should be rejected.

II. SCAJ's brief fails to recognize how the waiver issue arose in this litigation.

SCAJ's brief does not contemplate how a privilege question should be addressed in the bad faith litigation context and how it was actually addressed here. The typical circumstances would be:

1. A claim is filed asserting that the insurer acted in bad faith.
2. The insurer denies liability in its answer.
3. The claimant serves discovery requests which seek matters within the scope of discovery, but which include within its scope privileged communications between the insurer and its counsel.
4. The insurer provides the discovery responses, along with a privilege log detailing the documents and communications for which privilege is claimed.

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[4] Some jurisdictions that once followed *Hearn* have since departed from it. *See, e.g.*, *Gates Corp. v. CRP Indus., Inc.*, No. 1:16-CV-01145-KLM, 2018 WL 4697326, at *9-10 (D. Colo. Aug. 10, 2018) (explaining that Colorado's Supreme Court adopted *Hearn* in 1989 but subsequent precedent has brought the test in line with *Rhone*); *Bertelsen v. Allstate Ins. Co.*, 796 N.W.2d 685, 703 (S.D. 2011); *Jackson v. Greger*, 854 N.E.2d 487, 491 (Ohio 2006).

5. If the insured is unsatisfied by the log and privilege assertion, it may choose to file a motion to compel. It may also assert that the privilege has been waived.
6. This motion is fully briefed and the court will likely hold a hearing.
7. The Judge reviews and considers the arguments of the parties and the privilege log.
8. If necessary, the court conducts an in-camera review of the documents for privilege. If the court has found a blanket waiver to exist, this review may be unnecessary.

SCAJ misstates what actually happened here. Each of these steps were met. Here, the District Court determined that Mt. Hawley waived the attorney-client privilege by placing the communications "at issue," which was achieved by virtue of Mt. Hawley denying the allegations of bad faith made in the Complaint in its Answer.

As the Magistrate Judge explained, the Respondents' argument was focused on waiver rather than whether the documents were privileged in the first instance. *ContraVest Inc. v. Mt. Hawley Ins. Co.*, No. 9:15-cv-00304-DCN-MGB, 2016 WL 11200705, at *5 (D.S.C. Dec. 12, 2016), *report and recommendation adopted*, 273 F. Supp. 3d 607 (D.S.C. 2017) (noting Respondents' contended that "to the extent the attorney-client privilege applies, it has been waived"). After reviewing the briefing and considering the parties' arguments, the Magistrate Judge determined that the *Hearn* test had been met and Mt. Hawley waived the attorney-client privilege because it "'injected' issues of law and fact into this case that may be affected by information in the privileged documents." *Id.* at *8. The Magistrate Judge recommended that the District Judge conduct an *in camera* review of the documents, but solely for relevance and work product. She reiterated that the attorney-client privilege had been waived, and thus the "court will not address that issue in its review." *Id.*

The District Court adopted the Magistrate Judge's Report and Recommendation *in toto.* Importantly, the District Court agreed that pursuant to its interpretation of *City of Myrtle Beach* and the *Hearn* test, Mt. Hawley "has waived the attorney-client privilege with respect to the attorney-client communications contained in its claim files—at least to the extent they are relevant to the instant action." *ContraVest Inc. v. Mt. Hawley Ins. Co.*, 273 F. Supp. 3d 607, 622-23 (D.S.C. 2017). The District Court reiterated that it would take the "unusual" step of conducting an *in camera* review for relevance, "despite having already determined that the privilege has been waived." *Id.*

Mt. Hawley moved to reconsider, again raising the myriad of problems with the at issue waiver rule applied by the District Court and noting its conflict with South Carolina law and policy. Mt. Hawley also suggested, in the alternative, that the District Court certify the question to this Court. Finally, Mt. Hawley provided all of the documents *in camera* to Judge Norton pursuant to the directive in the Order. Nevertheless, Judge Norton denied the motion and reaffirmed his finding that Mt. Hawley waived the attorney-client privilege.

Mt. Hawley was required to file a Petition for a Writ of Mandamus with the Fourth Circuit because the District Court unequivocally found that the privilege had been waived. Mt. Hawley had no choice but to seek mandamus relief in order to protect its claim of privilege.

Many of the concerns raised by SCAJ could very well be alleviated by an *in camera* review of the documents for privilege. Mt. Hawley has never contended that such a procedure would be inappropriate prior to making a final determination regarding waiver. However, the fact remains that the District Court here found that *in camera* review for privilege or waiver was unnecessary here—as was the District Court's prerogative since such a review is discretionary—because it

found Mt. Hawley had waived the privilege via its pleading. SCAJ's brief avoids examining what actually happened here.

This brings the issue full circle back to the question presented, which is whether South Carolina law supports application of the "at issue" waiver such that a party may waive privilege by denying liability in its answer.

As detailed above, a waiver of privilege question will not be before the Court until there has been a claim of privilege, a privilege log, a motion to compel, briefing, and most likely a hearing. If a party contends that privilege has been waived because documents and/or communications have been placed at issue, the court may conduct an *in camera* review of the communications in question.

III. SCAJ's concerns regarding prejudice are unfounded.

Much of SCAJ's brief details the supposed prejudice that would result to plaintiffs, and more specially insureds, if the Court reaffirms that an insurance company has the right to rely on advice of its own counsel with the expectation that any communications with its counsel are protected pursuant to the attorney-client privilege. Respectfully, SCAJ's position cannot be the law or else this well-founded expectation of confidentiality will be eviscerated.

SCAJ contends that unless the District Court's view of the law is upheld, an insurer will rely on its advice of counsel as a defense when the advice is favorable, and not rely on it when unfavorable, which, SCAJ complains, is unfair. At the outset, this is simply not factually accurate. The undersigned has been involved with clients who had very favorable attorney client privileged advice and assessments, but who ***did not*** want to waive their privilege. Waiver of the attorney client privilege is a drastic choice which can lead to a host of issues, including making attorneys witnesses, among other things. Further, the attorney's assessment can merely be supportive of the

insurer's already-held belief that its position on coverage or defense is reasonable. Also, the attorney's assessment could be simply in error, and the insurer may not want to disclose it and may not want to use it if such were the case. Ironically, bad advice on coverage from counsel is perhaps more likely to be actually used by the insurer as a "defense" since the plaintiff may present a good argument for the provision of coverage or defense but the insurer could say that at least it did not act in bad faith because it relied on the opinion of counsel—and when the insurer is expressly relying on the advice of counsel as a defense, yes there is an implied waiver in that setting. Finally, even if an insurer has not formed a position on coverage or defense prior to seeking advice from counsel on an issue(s), the insurer must decide, once it receives that advice, whether the advice is correct. As such, the insurer is free to adopt the positions espoused as its own, as it has independently arrived at the same conclusions after review and contemplation.

Therefore, the insurer will simply state the reasons for the denial of coverage or defense and the matter can proceed to litigation, if necessary. For all of these reasons, the SCAJ's concerns are unfounded, inaccurate, or overblown. This Court should expressly adopt the *Rhone* test. The *Rhone* test (or an equivalent) has been applied in insurance bad faith settings without incident. *See N.J. Manufacturers Ins. Co. v. Brady*, No. 3:15-CV-02236, 2017 WL 264457, at *12 (M.D. Pa. Jan. 20, 2017); *Liberty Mut. Fire Ins. Co. v. APAC-Se., Inc.*, No. 1:07-CV-1516-JEC, 2008 WL 11320055, at *5-6 (N.D. Ga. May 16, 2008); *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); *Dixie Mill Supply Co. v. Cont'l Cas. Co.*, 168 F.R.D. 554, 557 (E.D. La. 1996); *Everest Indem. Ins. Co. v. Rea*, 342 P.3d 417, 420 (Ariz. Ct. App. 2015).

Lastly, South Carolina should not devolve into a jurisdiction where implied waivers are constantly in dispute and cases become more about what are supposed to be confidential

communications and less about the merits of the respective legal positions of the parties. What is "good for the goose, must be good for the gander" and a liberal implied waiver test can lead to abuse, needless expense, and frequent discovery battles for insurers and insureds alike.[5] Implied waiver of the attorney client privilege has been the subject of many different types of claims and defenses. Clever counsel can inject issues of state of mind into cases and raise these implied waiver arguments to make cases more complicated, penetrate privileges and confidences, and gain unfair advantages unhinged from the merits issues in the case.

In *Aetna Cas. & Sur. Co. et al. v. Superior Court*, 153 Cal. App. 3d. 467 (Cal. Ct. App. 1984), for example, the plaintiff contended that simply by filing a bad faith action, he put the insurer's state of mind at issue and thus the attorney-client privilege did not apply. The *Aetna* Court rejected this argument, stating:

> This argument is palpably untenable. If we were to adopt such a rule, the attorney-client privilege would have no application in a myriad of actions where state of mind is an issue or could easily be made one.

Id. at 477. The *Aetna* Court further explained that:

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[5] As stated in by this Court in *Tadlock Painting Co. v. Maryland Cas. Co.*, 322 S.C. 498, 473 S.E.2d 52 (1996):

> In *Nichols v. State Farm Mut. Auto. Ins. Co.*, 279 S.C. 336, 306 S.E.2d 616 (1983), we recognized the existence of a cause of action against an insurance company for bad faith refusal to pay first party benefits due under an insurance contract. In so doing we cited with approval the reasoning used in the seminal case of *Gruenberg v. Aetna Ins. Co.*, 9 Cal.3d 566, 108 Cal. Rptr. 480, 510 P.2d 1032 (1973), that ***there is an implied covenant of good faith and fair dealing*** in every insurance contract "***that neither party*** will do anything to impair the other's rights to receive benefits under the contract." *Nichols*, 279 S.C. at 339, 306 S.E.2d at 618.

Id. at 500, 473 S.E.2d at 53 (emphasis added).

> 'Aetna is not saying that their conduct was reasonable *because their counsel opined so,* but rather that their conduct was reasonable because the *facts* indicated that no valid claim existed.' (Italics in original.) Stated differently, Aetna claims it acted as it did not because it was advised to do so, but because the advice was, in its view, correct; and it is prepared to defend itself on the basis of that asserted correctness rather than the mere fact of the advice. Such a defense does not waive the attorney-client privilege.

Id at 473. This is sound reasoning.

Conclusion

Based on the above and on the other briefing and argument before this Court, this Court should expressly adopt *Rhone*, and because of such, answer the certified question "no."

Signature on Following Page

Respectfully submitted,

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PROOF OF SERVICE

I, the undersigned Administrative Assistant 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 U.S. Mail, postage prepaid, to the following address(es):

Pleadings: **Petitioner Mt. Hawley Insurance Company's Response to Brief of Amicus Curiae South Carolina Association for Justice**

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