Between a Rock and a Hard Place:
Protecting Privilege While Preserving Coverage

by John Buchanan and Wendy Feng

I. Introduction

Liability insurance for a large, complex claim is often a love-hate relationship. On the one hand, the policyholder and the insurer may stand on common ground in their adversity to the underlying claimant. On the other hand, the policyholder may find that the insurer – though the enemy of his enemy – is not necessarily his friend. The bigger and thornier the claim, the more likely that the insurer will reserve its rights to deny coverage. That reservation of rights often results in the policyholder defending the underlying litigation with independent counsel, while facing actual or potential coverage litigation with the insurer. This is hardly the “common interest” defense relationship found in a simple auto accident or slip-and-fall claim, where the insurer accepts its duty to defend without reservation and hires counsel to defend its policyholder in the underlying litigation.

During the course of this ambivalent, rights-reserved insurance claims relationship, the insurer is still likely to ask the policyholder or its defense counsel for work product or privileged information about the underlying case. The policyholder may want to provide that information, for a variety of good reasons: to get its defense costs paid; to elicit the insurer’s expertise in defending the claim; or to avoid the risk of motivating the insurer to assert a new coverage defense alleging breach of the so-called cooperation clause in its policy. The insurer’s motives in requesting the information may range from fulfilling its duty to pay reasonable defense costs, to offering useful input on settlement evaluation, to setting its own reserves, to discovering ammunition for its coverage defenses.

Meanwhile, given the actual or potential adversity between the policyholder and the insurer, the policyholder’s in-house and outside counsel confront a grave risk on another front: the underlying plaintiff might successfully claim that when the policyholder disclosed documents from defense counsel’s confidential files to a less-than-friendly insurer, it waived all attorney-client privilege and work product protection attaching to them.

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2 John Buchanan is Senior Counsel in the Washington, D.C. office of Covington & Burling LLP, and Wendy Feng is Of Counsel in the firm’s San Francisco office. They represent policyholders exclusively in coverage litigation. The opinions stated in this paper are those of the authors only and should not be attributed either to their law firm or to its clients.
In short, the policyholder and its counsel are caught between the risk of impairing coverage (for cooperating too little with the insurer) and the risk of waiving privilege (for cooperating too much). Tacking to compensate for the risk on one side may simply enhance the risk on the other. The classically inclined might describe this dilemma as “sailing ’twixt Scylla and Charybdis.” We call it “caught between a rock and a hard place.”

That awkward position is the focus of this article. In Part II we pose a simplified hypothetical to provide more context for the dilemma that policyholders and their counsel face. Part III then analyzes relevant case law and statutes that shed light on how the dilemma is currently addressed – or ignored – in various jurisdictions. Finally, again in the context of the hypothetical, Part IV concludes with a few practical tips for navigating the straits between cooperation clause violations and privilege waivers.

II. The Hypothetical and the Dilemma

Here is a common scenario in a disputed coverage claim: Assume that a policyholder – call it CleanChem, Inc. – produces chemicals through processes that involve heating and refining petroleum-based feedstock. Assume that the Wenopayah Insurance Co. is CleanChem’s general liability insurer. CleanChem’s policy with Wenopayah is written on a standard Commercial General Liability form. By the terms of this policy, the insurer promises to pay those sums that the insured becomes legally obligated to pay as damages because of covered bodily injury or property damage; and it has the right and duty to defend the policyholder against any suit seeking those damages. The policy excludes the release or escape of pollutants, but an exception to that exclusion permits coverage for bodily injury or property damage arising out of “smoke or fumes from a ‘hostile fire’,” which is defined as a fire that “becomes uncontrollable or breaks out from where it was intended to be.”

A stack fire one night at CleanChem’s plant causes the release of a toxic plume that peels the paint off buildings immediately adjacent to the plant. Soon thereafter, I.M. Green, a local plaintiff’s lawyer and environmental activist, files a class action against CleanChem on behalf of a class of area residents. Mr. Green alleges that the toxic particles in the smoke from the stack fire have contaminated homes, yards and groundwater throughout a 10-mile radius and that residents within that area suffer, or fear, various health problems as a result. In addition to standard negligence and strict liability counts in the complaint, a punitive damages count also alleges that for some time CleanChem has been clandestinely burning off the toxic wastes from its production processes whenever its stack scrubbers malfunctioned, and that this environmentally irresponsible practice inevitably resulted in the most recent stack fire and its accompanying toxic discharge.

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3 See George Chapman, trans., The Twelfth Book of Homer’s Odysseys, lines 346-48 (1857) (“I then took a strait/ That gave myself, and some few more, receipt/ ’Twixt Scylla and Charybdis”).

4 See, e.g., Insurance Services Office, Commercial General Liability Policy Form CG 00 01 12 07, an example of which can be found reproduced at http://www.sloanmason.com/files/pdf/ISO%20PDF%20CG%2000%2001%2012%2007.pdf (“CGL Policy”). All policy language quoted in this paper is taken from this form.

5 See CGL Policy, Sections I.2.f.(1)(a)(iii), V.7.
CleanChem tenders the complaint to Wenopayah Insurance for defense and coverage of any liability arising from the underlying plaintiffs’ claims. Wenopayah responds with a tartly-worded letter, reserving its right to deny coverage. It cites as grounds for potential denial not only the policy’s pollution exclusion – questioning whether the “hostile fire” exception to that exclusion would apply if the plaintiffs’ allegations prove true – but also its exclusion for harm “expected or intended from the standpoint of the insured.”

Under applicable law, this reservation of rights is deemed to create a conflict of interest, affording the policyholder a right to select independent defense counsel; and thus Wenopayah Insurance’s letter offers to reimburse CleanChem for the “reasonable and necessary” costs of defense by independent counsel selected by CleanChem. Accordingly, CleanChem hires Bess D. Fence, Esq. to defend the class action. Ina House, Esq. of the CleanChem Law Department oversees the defense effort and communicates with Ms. Fence about the case regularly.

At the outset, Wenopayah Insurance requests that Ms. Fence keep it informed about the progress of CleanChem’s defense. She duly prepares short updates for the insurer once a quarter. After Ms. Fence’s bills exceed the $100,000 deductible under its policy, CleanChem requests reimbursement for the excess defense costs from Wenopayah Insurance. The insurer promptly requests copies of all Ms. Fence’s daily time entries and all other backup for her invoices.

In the meantime, Ms. Fence and Ms. House have agreed that CleanChem should explore early settlement, not only to save rapidly increasing legal expenses on both sides, but also to end the unfavorable publicity that I.M. Green’s periodic press conferences about the class action are generating for the company. CleanChem’s management is eager to settle. Wenopayah Insurance, on the other hand, asserts that CleanChem appears willing to buy off Mr. Green’s clients at virtually any price, and that Ms. Fence appears unprepared to take the case to trial. As the underlying settlement talks progress, the insurer’s demands for information from Ms. Fence become more frequent and more probing. It requests all confidential settlement evaluations that Ms. Fence has prepared for her client, any related correspondence between her and Ms. House regarding the company’s prospects in the litigation, all their notes of witness interviews relating to the stack fire, and Ms. Fence’s draft trial outline.

In sum, Wenopayah Insurance’s information requests have escalated from a quarterly status report, which Ms. Fence could craft in objective terms without disclosing confidential or sensitive information; to her daily time descriptions, some of which may reflect confidential litigation strategy or planned initiatives; to communications between in-house and outside counsel and the most sensitive opinion work product in counsel’s files. Ms. House’s initial reaction is to agree to provide only the portions of her bills that do not show timekeepers’ work descriptions, and to withhold the rest of the requested material. She points out that Wenopayah Insurance has never committed to cover the claim, nor ever paid its first dollar of defense, and that I.M. Green would aggressively assert in the underlying litigation that the company waived any privileges or protections attaching to defense counsel’s files by disclosing them to a potentially adverse entity.

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6 See CGL Policy, Section I.2.a. (“expected/intended” exclusion).
Wenopayah Insurance will hear none of it. Repeatedly invoking both the cooperation clause and the consent-to-settlement clause in CleanChem’s policy, it insists on access to all the information it has requested. It follows up with another tart letter warning that CleanChem’s failure to cooperate, or to secure the insurer’s written consent to any settlement, will result in new, independent grounds for denying coverage – not only for any settlement or judgment, but also for defense costs.

CleanChem and its counsel now face tough choices. CleanChem wants to provide whatever information about Ms. Fence’s bills is necessary to start the defense reimbursement payments flowing from its insurer. It would also be willing to provide most of counsel’s interview notes, because most witnesses have said the stack fire was truly accidental and would support the case for coverage under the policy. Two witnesses, however, were more equivocal on this subject, and Ms. Fence and Ms. House are not eager to release their interview notes. Ms. Fence’s settlement evaluation, similarly, is a two-edged sword. It persuasively demonstrates the potential for high compensatory damages and thus would objectively show the reasonableness of the settlement range currently under discussion; but it also contains candid comments about the evidence that could support punitive damages. Ms. Fence personally would like to produce her meticulous trial outline, to disprove the insurer’s unfair charge that she is unprepared. But at the end of the day, the prospect of any of this material from counsel’s file ever getting into the hands of I.M. Green (and perhaps from him to his many friends in the press and in the plaintiffs’ bar) is a daunting prospect to all on the CleanChem side.

This is the kind of problem that many policyholders and their defense counsel face under standard liability policies, when an insurer has asserted a potentially coverage-defeating reservation of rights. There is, unfortunately, no one-size-fits-all solution to the problem. The next section surveys relevant statutes and case law in order to identify some of the considerations that may affect CleanChem’s and its counsel’s response.

III. The Law of Cooperation and Waiver

Where an insurer has a duty to defend but acts under a reservation of rights that introduces an actual or potential conflict between its interests and those of the policyholder, most states that have addressed the issue afford the policyholder some form of a right to independent defense counsel.

Providing independent counsel prevents the risk that counsel hired and controlled by

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7 See CGL Policy, Sections IV.2.c.(3) and 2.d.
the insurer might provide a less than zealous defense for the policyholder against underlying claims that, if successful, would relieve the insurer of its coverage obligations: for example, in the CleanChem hypothetical, the underlying plaintiff’s punitive damages claim alleging that CleanChem willfully or recklessly caused the harm at issue. Even where the issue is not regulated by statute, case law provides the policyholder with a right to independent counsel, and in some complex cases that inherently involve issues of knowledge or intent, the insurer may simply assume that the policyholder will retain its own defense counsel.

While the retention of independent counsel may protect a policyholder from conflicting loyalties in the conduct of its defense, it also presents the problematic questions faced by counsel in our hypothetical. In seeking guidance from the law for answers to these questions, counsel should analyze the matter from two different perspectives: first, that of potential coverage litigation between policyholder and insurer; and second, that of litigation with underlying claimants. That is, in our hypothetical case, would Wenopayah Insurance be able to compel CleanChem to produce otherwise protected confidential materials from its defense counsel’s files through discovery in coverage litigation? Alternatively, if CleanChem voluntarily shared such materials with Wenopayah, would I.M. Green be able to compel their production in the underlying environmental litigation, on the alleged ground that their privilege protection had been waived?

A. The Rock: Cooperation and Disclosure Obligations

Standard general liability policies provide that the policyholder must “[c]ooperate with [the insurer] in the investigation or settlement of the claim or defense against the [underlying


Particularly on the West Coast, the independent counsel required because an insurer has asserted a sufficient conflict is often called “Cumis counsel,” after the California Court of Appeal’s landmark decision in San Diego Navy Fed. Credit Union v. Cumis Insurance Society, Inc., 162 Cal. App. 3d 358 (1984) – even though the Cumis decision has been largely superseded by statute, Cal. Civ. Code § 2860(d) (discussed below). For a discussion of privilege issues related to Cumis counsel, see Wendy L. Feng and Geoffrey Painter, Cumis Privilege and the Risk of Waiver: A Policyholder’s Perspective, 19 THE FRAC. LITIGATOR 21 (July 2008).
lawsuit].” Such cooperation typically involves providing the insurer with regular updates on the underlying litigation. But as in our hypothetical, some insurers use this cooperation language as a basis for requesting privileged materials from an independent defense counsel’s files. In addition, in connection with settlements, a “voluntary payments” clause provides that “[n]o insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent.” Insurers may be inclined to withhold such consent until they have reviewed defense counsel’s settlement evaluations and perhaps considerably more information from counsel’s files.

Where the insurer is acting under a reservation of rights, the policyholder may not wish to disclose such materials to the insurer, particularly if it appears the insurer is fishing for evidence to support a defense in a future coverage case against the policyholder. In coverage litigation, an insurer will routinely argue that it has the right to discover defense counsel’s privileged files. Such an argument is usually based on a) the above cooperation language in the policy, b) the “common interest” doctrine, and c) the “at issue” doctrine.

At least two states – Alaska and California – have passed so-called “Cumis statutes,” which regulate the right to independent counsel, but which also provide a statutory basis for limited discovery of defense counsel’s files by an insurer. Alaska Statutes section 21.89.100(e) provides:

If the insured selects independent counsel at the insurer's expense, the independent counsel and the insured shall consult with the insurer on all matters relating to the civil action and shall disclose to the insurer in a timely manner all information relevant to the civil action, except information that is privileged and relevant to disputed coverage. A claim of privilege is subject to review in the appropriate court. Information disclosed by the independent counsel or the insured does not waive another party's right to assert privilege.

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9 CGL Policy, Section IV.2.c.(3).

10 CGL Policy, Section IV.2.d. (emphasis added).

11 The “common interest” doctrine applies in its purest form where two parties “engage the same attorney to represent their respective interests, and each communicates separately with the attorney about some phase of common transaction.” Remington Arms Co. v. Liberty Mut. Ins. Co., 142 F.R.D. 408, 417 (D. Del. 1992) (quoting McCormick on Evidence § 91 (1984)). But the doctrine “preempts the attorney-client privilege only when it is evident from the nature of the representation that the client and attorney did not intend and could not expect that information imparted between them would remain confidential.” Dedham-Westwood Water Dist. v. Nat’l Union Fire Ins. Co. of Pittsburgh, No. Civ. A. 96-00044, 2000 Mass. Super. LEXIS 29 (Feb. 4, 2000).

The “common interest” doctrine has also been extended to apply “where the attorney, though neither retained by nor in direct communication with the insurer, acts for the mutual benefit of both the insured and the insurer.” Waste Mgmt., Inc. v. Int’l Surplus Lines Ins. Co., 144 Ill. 2d 178, 194 (1991). For a general discussion of the “common interest” doctrine and other authorities in the insurance context, see Barry R. Ostrager & Thomas R. Newman, HANDBOOK ON INSURANCE COVERAGE DISPUTES § 2.07(b) (15th ed. 2010) (“Ostrager Treatise”).

12 The “at issue” doctrine, which is related to general principles of waiver of the attorney-client privilege, “creates an implied waiver of the privilege only when the client tenders an issue involving the substance or content of a protected communication, not where the privileged communication simply represents one of several forms of indirect evidence in a particular case.” Rockwell Int’l Corp. v. Superior Court, 26 Cal. App. 4th 1255, 1268 (1994). Essentially, “[b]y taking an action that places privileged information ‘at issue’ the party may forfeit the privilege.” Remington Arms, 142 F.R.D. at 412. The Ostrager Treatise also discusses the “at issue” doctrine at § 2.07(b).

13 See n. 7, above.
Similarly, California Civil Code section 2860(d) states:

When independent counsel has been selected by the insured, it shall be the duty of that counsel and the insured to disclose to the insurer all information concerning the action except privileged materials relevant to coverage disputes, and timely to inform and consult with the insurer on all matters relating to the action. Any claim of privilege asserted is subject to in camera review in the appropriate law and motion department of the superior court. Any information disclosed by the insured or by independent counsel is not a waiver of the privilege as to any other party.14

While both statutes seek to encourage – even mandate – cooperation between policyholder and insurer where the policyholder is represented by independent counsel, they also recognize the tension created by their potentially conflicting interests. Both statutes attempt to strike a balance between cooperation and preservation of privilege. Ultimately, privilege prevails to this extent: both statutes make clear that a policyholder is not required to disclose privileged, coverage-relevant information to the insurer.15 Hence, in either Alaska or California, if Wenopayah Insurance seeks CleanChem’s defense counsel’s files in order to bolster its coverage defenses (rather than to assist in the underlying defense or evaluate settlement), then CleanChem and its counsel may assert this statutory language as a basis to withhold the files from discovery.16

In the absence of clear statutory language, the courts in several states have more broadly protected defense counsel’s privileged files from disclosure at the behest of insurers. For example, the Connecticut Supreme Court in Metropolitan Life Ins. Co. v. Aetna Cas. & Sur. Co., 249 Conn. 36, 60-63 (1999) rejected the cooperation clause, the “common interest” doctrine and the “at issue” doctrine as grounds for compulsory disclosure, finding that if an insurer had reserved its rights or denied coverage, it was not entitled to receive privileged communications from the policyholder or its independent defense counsel.

Similarly, in Eastern Air Lines, Inc. v. United States Aviation Underwriters, Inc., 716 So. 2d 340, 343-44 (Fla. App. 1998), a Florida court denied an insurer’s motion to compel discovery of communications between its policyholder and independent counsel, rejecting the insurer’s arguments based upon the cooperation clause and the “at issue” doctrine. The insurer had not agreed to coverage in the underlying litigation, which concerned environmental contamination.17

When Eastern sued for a declaration of coverage, the insurer sought discovery of communications

14 The territory of Guam has also recently adopted legislation governing the right to independent counsel, which closely follows the pattern of the California statute including the provision quoted above. See 22 Guam Code Ann. § 12111 (2009).

15 See also Rockwell Int’l Corp. v. Superior Court, 26 Cal. App. 4th 1255, 1264 (1994).

16 Further support for policyholder counsel’s withholding of privileged information may also be found in a provision governing cooperation between insurer-provided counsel and policyholder-selected independent counsel: “[c]ounsel shall cooperate fully in the exchange of information that is consistent with each counsel’s ethical and legal obligation to the insured.” Cal. Civ. Code § 2860(d) (emphasis added); accord, Alaska Stat. §21.89.100(g); Guam Code Ann., § 12111(f). Arguably the exchange of privileged or sensitive information would be inconsistent with “counsel’s ethical and legal obligation to the insured.”

17 Eastern Airlines, 716 So.2d. at 341.
between Eastern and its counsel in the underlying action. The court found that “[u]nder Florida law, the cooperation clause does not eviscerate the attorney-client privilege.” The court also held that a policyholder does not put communications with its independent counsel “at issue” merely by filing suit against its insurer for a declaration of coverage. Hence, Eastern had not waived the attorney-client privilege as to its insurer, and the insurer was precluded from access to the policyholder’s communications with its independent counsel. Other courts have adopted reasoning similar to that in Metropolitan Life and Eastern Airlines.

Yet this reasoning has not been universally followed. At least one state, Illinois, has reached a diametrically opposite conclusion on all three issues addressed in the cases discussed above: the cooperation clause, the common interest doctrine, and the “at issue” doctrine. In Waste Management, Inc. v. International Surplus Lines Insurance Co., 144 Ill. 2d 178, 201 (1991), the Illinois Supreme Court held that the attorney-client privilege did not prevent the insurer from discovering the policyholder’s counsel’s files in the underlying litigation – even though the policyholder had independent defense counsel in that litigation, and even though the parties were actively at odds in a coverage action. In Waste Management, the court downplayed the attorney-client privilege, noting that “in Illinois, we adhere to a strong policy of encouraging disclosure, with an eye toward ascertaining that truth which is essential to the proper disposition of a lawsuit.”

Given that defense counsel’s actions in the underlying litigation formed “the basis of insurers’ declaratory judgment action and its defense to insured’s declaratory judgment action,” the court found that the communications sought were discoverable because they were “at issue”

18 Eastern Airlines, 716 So.2d at 341.
19 Eastern Airlines, 716 So.2d at 343.
20 Eastern Airlines, 716 So.2d at 343.
21 See, e.g., RML Corp. v. Assurance Co. of Am., No. CH02-127, 2002 Va. Cir. LEXIS 392, *18 (Oct. 25, 2002) (rejecting insurer’s common interest and “at issue” arguments); Dedham-Westwood Water Dist. v. Nat’l Union Fire Ins. Co. of Pittsburgh, No. Civ. A. 96-00044, 2000 Mass. Super. LEXIS 29, *15 (rejecting an insurer’s argument that the cooperation clause, common interest doctrine, and “at issue” doctrine entitled the insurer to discover communications between the policyholder and its independent counsel during the underlying litigation); State v. Hydrite Chem. Co., 220 Wis. 2d 51, 78-79 (1998) (finding no merit in an insurer’s arguments on “at issue,” cooperation clause, and common interest grounds in coverage action brought by insurer who did not participate in defense of underlying action); First Pac. Networks, Inc. v. Atl. Mut. Ins. Co., 163 F.R.D. 574 (N.D. Cal. 1995) (insurer’s reservation of rights eliminates common interest); North River Ins. Co. v. Columbia Cas. Co., No. 90 Civ. 2518, U.S. Dist. LEXIS 53 (S.D.N.Y. Jan. 5, 1995) (no common interest); Rockwell Int’l Corp. v. Superior Court, 26 Cal. App. 4th 1255, 1259 (1994) (finding the cooperation clause, the “at issue” doctrine, and the common interest doctrine inadequate bases to overcome the attorney-client privilege and permit discovery of documents related to the underlying litigation by the insurer); Owens-Corning Fiberglass Corp. v. Allstate Ins. Co., 660 N.E.2d 765, 769 (Ohio Ct. Com. Pl. 1993) (holding that there was no “common interest” between an insurer and policyholder where the insurer had neither defended nor indemnified the policyholder); NL Indus., Inc. v. Commercial Union Ins. Co., 144 F.R.D. 225, 231 (D.N.J. 1992) (“To permit insurers, however, unrestrained access to attorney-client communications and work product where those insurers refused to take part in litigation despite notice and opportunity to participate would distort the ‘common interest’ doctrine.”); In re Envtl. Ins. Declaratory Judgment Actions, 612 A.2d 1338, 1343 (N.J. Super. A.D. 1992) (holding that material created in underlying action at direction of defense counsel must be produced over work product objections subject to in-camera review, but attorney-client communications or work product containing mental impressions of attorney were privileged from discovery); Int’l Ins. Co. v. Newtown Mining Corp., 800 F. Supp. 1195 (S.D.N.Y. 1992) (insurer’s common desire for successful underlying defense is insufficient basis to establish common interest for privilege purposes); Eureka Inv. Corp. v. Chicago Title Ins. Co., 743 F.2d 932, 937 (D.C. Cir. 1984) (finding that attorney-client communications made after an insurer’s and policyholder’s interests had diverged were privileged, but not addressing the discoverability of communications made beforehand).

22 Waste Management, 144 Ill.2d at 190.
in the litigation between the policyholder and the insurer. Next, the court found that the relevant cooperation clause imposed an exceptionally broad duty of cooperation on the policyholder, which in turn meant that the attorney-client privilege did not bar discovery of the communications in the underlying lawsuits. Finally, the court found that the policyholder and insurers shared a common interest in defeating or settling the underlying claims. This loosely defined community of interest was enough to defeat the policyholder’s claims of attorney-client privilege and permit discovery by insurers. Nor did the work product doctrine provide a shield: the court deemed that the materials sought were prepared for the benefit of the insurer and policyholder in the underlying action, not in anticipation of the coverage litigation.

As the court observed in Allianz Ins. Co. v. Guidant Corp., 373 Ill. App. 3d 652 (2007), “almost every foreign jurisdiction that has considered the holding of Waste Management has assailed the decision as unsound and improperly reasoned.” Courts in most other states, as previously discussed, have held that the work product doctrine and attorney-client privilege protect communications between a policyholder and its defense counsel from discovery by an adversely situated insurer. Hence, in our hypothetical, CleanChem’s contractual duty to cooperate would be construed as one of reasonable cooperation in most states: it does not require CleanChem or its counsel to jeopardize the protection attaching to confidential communications by disclosing them to Wenopayah Insurance.

That said, even where the broader reasoning of Waste Management has been rejected, courts may require disclosure of confidential defense-related documents to insurers on narrower grounds. For example, although the court in Rockwell Int’l Corp. v. Superior Court, 26 Cal. App. 4th 1255 (Cal. Ct. App. 1994) generally rejected the reasoning of Waste Management, it did note that “if the insured places an otherwise privileged communication ‘in issue’ during the course of the coverage litigation (e.g., by a demand for reimbursement of money paid to settle a third party

23 Waste Management, 144 Ill.2d at 190-91.
24 Waste Management, 144 Ill.2d at 193.
25 Waste Management, 144 Ill.2d at 194. It is difficult to square the Illinois Supreme Court’s determination that the policyholder and its insurer share a “common interest” in Waste Management with its recognition in other decisions that the insurer may have an actual conflict of interest that requires it to hire independent counsel for the policyholder. See, e.g., Maryland Casualty Co. v. Peppers, 355 N.E.2d 24, 30-31 (Ill. 1976).
26 Waste Management, 144 Ill.2d at 195.
27 Waste Management, 144 Ill.2d at 199-200.
29 Rockwell, 26 Cal. App. 4th at 1264.
claim), the trial court can consider whether and to what extent the *in issue* doctrine applies to that particular issue.\[^{30}\]

Thus, even in jurisdictions that generally protect independent defense counsel’s files from disclosure to insurers, policyholders should not expect absolute protection, particularly with respect to documents reflecting advice about an underlying settlement that the insurer will be asked to pay. If the parties or the litigation have some nexus to a state with explicit rules requiring disclosure – the arguably anomalous judge-made disclosure rule in Illinois and the limited statutory disclosure rules in California and other states with *Cumis* statutes – then underlying defense counsel must be even more mindful that her communications could be produced to a hostile insurer in future coverage litigation.

**B. The Hard Place: Waiver of Privilege as to Third Parties**

The previous section has focused on potential coverage litigation between our hypothetical policyholder CleanChem and Wenopayah Insurance, where CleanChem would presumptively resist discovery of its confidential defense files. In the real world of claims-handling – at least where the policyholder and its insurer have not reached an impasse over coverage – this often is not the case. CleanChem may wish to cooperate with Wenopayah Insurance in hopes that Wenopayah will agree to coverage, or to encourage Wenopayah to consent to a proposed settlement between CleanChem and the underlying plaintiff class represented by I.M. Green. CleanChem’s outside defense counsel, Ms. Fence, also needs to submit her bills, which may include privileged information or attorney work product, to Wenopayah for payment. In these situations, CleanChem and its counsel face a different question: how can they share confidential materials with Wenopayah Insurance without waiving privilege and opening the materials to discovery by I.M. Green in the underlying tort action?

On one hand, as already discussed, the very existence of independent counsel may provide protection against discovery of privileged materials by an insurer. That protection is based on the principle that where an insurer acts under a reservation of rights or denies coverage, the policyholder and insurer are potentially adverse. Yet that same reasoning – and, indeed, the need for independent counsel that confirms the adversity of interest – may also allow the underlying plaintiff or another third party to allege that the policyholder has waived privilege protection, because it *voluntarily* shared the materials with its insurer. That is, because CleanChem and Wenopayah Insurance lack a common interest, CleanChem risks waiving the attorney-client and/or work product privileges attached to materials that it chooses to turn over to Wenopayah Insurance; and this may allow Mr. Green to discover those materials and use them against CleanChem in the underlying tort action.

This is the true rock-and-a-hard-place situation. Unfortunately, case law addressing this situation is sparse. Policyholders and defense counsel are often muddling through uncharted territory when deciding whether to agree to disclose privileged communications or work product to an insurer.

Voluntary disclosure may constitute a waiver of both the attorney-client privilege and work product protection. Each requires a separate analysis for waiver. For example, in *Go Medical Industries PTY, Ltd. v. C.R. Bard, Inc.*, No. 3:95MC522(DJS), 1998 WL 1632525, *1 (D. Conn. Aug. 14, 1998), rev’d in part on other grounds, 250 F.3d 763 (Fed. Cir. 2000), one party in patent infringement litigation (C.R. Bard) sought documents that the other party (Go) had shared with its insurer.\(^1\) The court found that Go’s interests and its insurer’s interests were “insufficiently compatible for the common interest rule to apply,” and therefore that Go’s disclosure to its insurer waived the attorney-client privilege.\(^2\) Work product shared with the insurer fared better, however: “unlike the attorney-client privilege, the work product privilege is not automatically waived by any disclosure to third persons.” 1998 WL 1632525, *7 (internal quotations omitted). Because Go’s disclosure to its insurer “did not substantially increase the opportunity for C.R. Bard to obtain its work product,” it did not waive work product protection.\(^3\)

In *In re Pfizer, Inc. Securities Litigation*, No. 90 Civ. 1260(SS), U.S. Dist. LEXIS 18215 (S.D.N.Y. Dec. 22, 1993), similar reasoning resulted in a similar conclusion. The court found that disclosure of documents by Pfizer to its insurers waived the attorney-client privilege, noting a lack of evidence that Pfizer and its insurers “agreed to act as partners in a single unified litigation strategy.”\(^4\) However, the court held that to the extent the documents merited work product protection, “the disclosure of the documents to an insurance carrier will not operate as a waiver.” 1993 U.S. Dist. LEXIS 18215, *26.\(^5\)

Contrast those decisions with *In re Imperial Corp. of America*, 167 F.R.D. 447 (S.D. Cal. 1995). In *Imperial*, which involved an underlying derivative suit by shareholders, the insured directors retained their own defense counsel because the insurer had no affirmative duty to defend under the applicable directors and officers liability policy.\(^6\) Counsel for the policyholders sent letters to the insurer addressing the likelihood of success in the underlying defense, as well as a settlement demand by plaintiffs in that action.\(^7\) After learning of these letters during a deposition in the underlying case, the shareholder plaintiffs demanded their production.\(^8\) In spite of a “joint defense agreement” signed by both the policyholders and their insurer (which was deemed ineffective because the parties were potentially adverse in coverage litigation), the court found no attorney-client protection for the letters.\(^9\) The court further held that the policyholders’ defense counsel had waived work product protection in disclosing the letters to an insurer that had not

\(^{1}\) *Go Medical*, 1998 WL 1632525, *1.

\(^{2}\) *Go Medical*, 1998 WL 1632525, *3-*4; see also Linde Thomson Langworthy Kohn & Van Duke, P.C. v. Resolution Trust Corp., 5 F.3d 1508, 1514-15 (D.C. Cir. 2003) ("[I]f what is sought is not legal advice but insurance, no privilege can or should exist.").


\(^{6}\) In re Imperial Corp., 167 F.R.D. at 449-50. D&O policies typically provide only for insurer reimbursement of the insured’s defense costs, in contrast to the affirmative duty to defend under standard CGL policies. Presumably for this reason, the court did not rely on California Civil Code section 2860(d), discussed above, text at n. 13, in deciding the issue.

\(^{7}\) In re Imperial Corp., 167 F.R.D. at 450.

\(^{8}\) In re Imperial Corp., 167 F.R.D. at 450.

\(^{9}\) In re Imperial Corp., 167 F.R.D. at 452-53.
committed to coverage, because it knew “a future coverage action pitting the insured against the insurer [was] a distinct possibility.”

Nonetheless, the rulings are not uniform, even among courts in the same state. Another California federal court applied a more nuanced analysis to reject waiver, in Lectrolarm Custom Systems, Inc. v. Pelco Sales, Inc., 212 F.R.D. 567 (E.D. Cal. 2002). There the underlying plaintiff (Lectrolarm) sought discovery of documents sent by Pelco to its insurer, Fireman’s Fund, which was partially paying at least some of Pelco’s independent defense counsel expenses under a reservation of rights. The court acknowledged that because of “inherent tension between the carrier’s interest and the interests of the insured,” and because of their separate counsel, “communications between Pelco and [its insurer] are not privileged per se”, and that “[g]enerally, disclosure of otherwise privileged communication to a third party waives the attorney client privilege and/or the attorney work product privilege.”

Despite the parties’ potential adversity on coverage for the claim, however, the court held that the “common defense doctrine,” typically applied only to co-defendants in the same litigation, precluded a waiver. Looking at the particular communications at issue – those “relating to the claims and defenses in the underlying lawsuit” – the court found sufficient “commonality of interest” to preserve both attorney-client privilege and work product protection. In contrast to the Imperial court, therefore, the Lectrolarm court’s waiver analysis implicitly distinguished insurer-insured adversity on the coverage side of their relationship from their common interest with respect to the underlying defense. Accordingly, it barred the underlying plaintiff from discovering communications between the policyholder and its insurer that supported the latter interest.

The ostensibly differing outcomes in Imperial and Lectrolarm underscore the need for policyholders and their

40 In re Imperial Corp., 167 F.R.D. at 454-55; see also, e.g., Continental Cas. Co. v. St. Paul Surplus Lines Ins. Co., 265 F.R.D. 510, 523, 528 (E.D. Cal. 2010) (in contribution action by defending insurer against non-defending insurer, the latter was required to produce its communications with policyholder and underlying defense counsel; both attorney-client privilege and work product protection were waived due to lack of common interest).

41 Lectrolarm, 212 F.R.D. at 571-72.

42 In re Imperial Corp., 167 F.R.D. at 572. The court further explained:

This “common defense doctrine” also referred to as the “joint defense privilege” serves to “protect the confidentiality of communications passing from one party to the attorney for another party where a joint defense effort or strategy has been decided upon and undertaken by the parties and their respective counsel.” United States v. Schwimmer 892 F.2d 237, 243 (2d Cir. 1989). The doctrine only protects communications when they are part of an ongoing and joint effort to set up a common defense strategy. Eisenberg v. Gagnon, 766 F.2d 770, 787 (3d Cir. 1985), cert. denied, sub nom., Weinstein v. Eisenberg, 474 U.S. 946, 106 S. Ct. 342, 88 L.Ed.2d 290 (1985); see Schwimmer, 892 F.2d at 243 (explaining that “[o]nly those communications made in the course of an ongoing common enterprise and intended to further the enterprise are protected.”); Matter of Bevill, Bresler & Schulman, 805 F.2d 120, 125 (3rd Cir. 1986) (holding that the party seeking the benefit of the joint defense doctrine must show that (1) the communications were made in the course of a joint defense effort, (2) the statements were designed to further that effort, and (3) the privilege has not been waived). Where a “joint defense effort or strategy has been decided upon and undertaken by the parties and their respective counsel,” communications may be deemed privileged whether litigation has been commenced against both parties or not. Schwimmer, 892 F.2d at 244.

43 Lectrolarm, 212 F.R.D. at 572.

44 Lectrolarm, 212 F.R.D. at 573.
counsel to tread cautiously when considering voluntary disclosure of privileged materials to an insurer that has reserved rights. As discussed previously, the California Cumis statute, Civil Code section 2860(d), expressly clarifies that “[a]ny information disclosed by the insured or by independent counsel is not a waiver of the privilege as to any other party.” In *First Pacific Networks, Inc. v. Atlantic Mutual Insurance Company*, 163 F.R.D. 574 (N.D. Cal. 1995) the court relied on this provision to hold that a policyholder did not waive the attorney-client privilege for documents provided to its insurer. The court suggested, however, that absent the statute, waiver would have occurred, because no common interest existed between the policyholder and an insurer acting under a reservation of rights. Following the statute with seeming reluctance, the court characterized section 2860(d) as follows:

The extent of the insured's power to control disclosure of some privileged communications, without risking waiver, is most visible in the fact that California law seems to permit an insured to pick and choose which of the insured's otherwise privileged communications it will share with a carrier funding a defense under a reservation of rights — and to do such picking and choosing without waiving the right to prevent its carrier from having access to other privileged communications — even communications on the same subjects.

For somewhat different reasons, Illinois provides similarly strong protection against waiver of privilege as to third parties. As discussed above, under *Waste Management*, a policyholder and its insurer are deemed to share a common interest, even where the policyholder is represented by independent counsel. The flip side of that “common interest” coin is that communications between them fall within the protection of the attorney-client privilege with respect to underlying plaintiffs and other third parties. In its own anomalous way, therefore, Illinois law promotes (or mandates, depending upon one's point of view) policyholder-insurer cooperation, while allaying fears of opening privileged communications to discovery by third parties.

In summary, if California or Illinois law is controlling in the dispute between CleanChem and I.M. Green’s clients, then Ms. Fence and Ms. House (CleanChem’s defense counsel and in-house

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45 Alaska’s statutory counterpart is less clear: “Information disclosed by the independent counsel or the insured does not waive another party's right to assert privilege.” Alaska Stat. § 21.89.100(e).
46 *First Pacific Networks, Inc.*, 163 F.R.D. at 584.
48 *First Pacific Networks, Inc.*, 163 F.R.D. at 584. The protection afforded by Cal. Civ. Code § 2860(d) was recently underscored by negative implication, in *Continental Casualty Co. v. St. Paul Surplus Lines Insurance Co.*, 265 F.R.D. 510 (E.D. Cal. 2010). There another California federal court found a waiver where the policyholder sent privileged communications to an insurer that had no duty to provide a defense — and therefore did not fall within the scope of § 2860(d). See id. at 526-27 (E.D. Cal. 2010).
49 See, e.g., *United Nat’l Ins. Co. v. City of Paris*, No. 09-2300, 2011 U.S. Dist. LEXIS 46198, *2-*3 (C.D. Ill. Apr. 29, 2011) (noting that although *Waste Management* did not allow an insured to withhold materials from its insurer, the insured still retained attorney-client privilege and work-product protection as to other parties); *In re Quantum Chemical/Lummus Crest*, No. 90 C778, 1992 U.S. Dist. LEXIS 5448, *10-*12 (N.D. Ill. Mar. 27, 1992) (recognizing that an insured’s documents were attorney-client privileged as to third parties, even though the insured’s disclosure of documents to an insurer would not waive such privilege under the common interest doctrine); *Allianz Ins. Co. v. Guidant Corp.*, 373 Ill. App. 3d 652, 674-75 (2007) (recognizing a common interest between an insured and its insurer, and commenting that the insured’s documents would enjoy privileged status as to underlying plaintiffs even after the insured shared those documents with its insurer).
counsel, respectively) may take reasonable comfort that voluntary disclosure of confidential
defense-related materials to Wenopayah Insurance will not open their client to discovery and
claims of waiver by Mr. Green on behalf of the claimants in the underlying case. Yet, outside
such “more-or-less-safe haven” jurisdictions – given the potential damage that discovery of
privileged materials could have on CleanChem’s defense of the underlying litigation –
CleanChem and its counsel must choose their voluntary disclosures to Wenopayah Insurance with
extreme caution.

IV. Steering Between the Rock and the Hard Place: Strategies for Balancing
Reasonable Cooperation and Protection of Privilege

As the discussion above demonstrates, the law in most states remains unrefined and uncertain on
the question whether a policyholder can disclose defense counsel’s confidential materials to its
insurer without waiver. Where the issue has not been regulated by statute, most courts to date
have simply determined that the policyholder and the insurer did, or did not, have a common
interest – without considering that in this love-hate relationship, it is usually a bit of both.
Rulings such as that in Lectrolarm, 212 F.R.D. at 572, suggest that some courts are willing to
distinguish the friendly side of this relationship from its unfriendly side, and to protect the
confidential communications that support the former. Until this more nuanced approach becomes
the norm, however, uncertainty about the risk of waiver will continue to inhibit cooperation and
communication between policyholders and insurers that have reserved their rights, particularly in
jurisdictions where that reservation of rights is recognized to preclude a common interest.

Conversely, there may be less risk of waiver in jurisdictions such as California and Illinois, as
discussed above, but only because such jurisdictions require the policyholder and its defense
counsel to communicate some types of information more freely to insurers. The insurer may
ultimately have a right to review counsel’s confidential claim files; and if counsel has not been
careful, those files may carry the potential for embarrassment or worse. Otherwise stated, the
reduced risk of privilege waiver may carry an enhanced risk of prejudice with regard to insurance
coverage.

The disclosure questions that arise whenever an insurer has reserved its rights against its insured
have neither simple nor universal answers. Nonetheless, we offer here a few pointers – once
again, in the context of our hypothetical – that may provide some practical guidance to
policyholders’ in-house counsel and independent defense counsel, as they navigate the
treacherous straits between coverage preservation and privilege protection in this ambivalent
relationship.

A. Learn the traps, or bring in help.

The first step that the policyholder company’s supervising counsel (Ms. Ina House in our
hypothetical) and its underlying defense counsel (Ms. Bess D. Fence) must take is to inform
themselves as best they can about the rules governing cooperation and waiver under the law or
laws governing the case. Better, if CleanChem has retained outside coverage counsel to pursue
its insurance claim – call her Ida Sue Carrier, Esq. – this is a good time for Ms. House to make
sure that Ms. Fence and Ms. Carrier get well acquainted. They should feel comfortable
consulting each other whenever tough questions about disclosure and privilege arise. Almost
certainly such questions will arise, both in the pursuit of the coverage claim and in the defense of the underlying claim. Any documentation of these consultations between defense counsel and coverage counsel on issues of coverage preservation should be carefully segregated from defense counsel’s litigation files, to protect them against discovery in coverage litigation. Finally, defense counsel should normally bill this coverage-related work under a separate matter number that will not be submitted to (and reviewed by) the insurer.

**B. Remind timekeepers that third parties may review their time entries.**

It is well recognized that “[b]illing records and underlying documentation may…reveal the motive of the client in seeking representation, litigation strategy, or the specific nature of the services provided to the insured. This information generally is protected by the confidentiality rule or the attorney-client privilege or both.” ABA Comm. on Ethics and Prof’l Responsibility, Formal Op. 01-421 (2001). Nonetheless, Ms. Fence should understand that at least Wenopayah Insurance will likely see her defense bills, if CleanChem is to get the benefit of the defense coverage it bought from its insurer. And as discussed above, there is the outside risk in some jurisdictions that I.M. Green on behalf of the underlying claimants will ultimately discover her bills. Thus, timekeepers should practice the fine art of recording their time accurately, informatively – and with sufficient lawyerly generality that they will not reveal the specifics of strategy or sensitive matters to unfriendly eyes. Otherwise, Ms. Carrier, as the policyholder’s coverage counsel, is likely to spend many hours trying to protect the privilege by redacting the bills before disclosing them to Wenopayah Insurance; and then many more hours haggling with Wenopayah Insurance over her redactions.

**C. Remember that third parties may see settlement evaluations and sensitive client reports.**

Ms. Fence may have concluded in her own mind that proceeding to trial against I.M. Green’s clients would be a financial and public relations disaster for CleanChem. Her written settlement evaluation, however, should not turn into an advocacy piece for capitulation. It should stick to the objective facts, particularly those that relate to causation and the plaintiffs’ quantifiable damages. To the extent that CleanChem’s conduct or intent is unavoidably the focus of the case, Ms. Fence must remember that an insurer reviewing her settlement evaluation may actually be seeking support for a coverage defense based on its exclusion for damage “expected or intended from the standpoint of the insured”50 or some other knowledge-based defense. Worse, I.M. Green might demand these or similar documents in discovery, once it emerges that CleanChem shared them with an unfriendly insurer. Ms. Fence should draft her written evaluations for the eyes of the most hostile reader, and elaborate as necessary by phone or in person with Ms. House or other CleanChem managers. In general, Ms. Fence and Ms. House should keep in mind that where sensitive or highly nuanced issues need to be communicated, an old-fashioned conversation will usually be preferable to an exchange of emails.

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50 See CGL Policy, Section I.2.a.
D. Consider whether mediation between policyholder and insurer may enhance protection for privileged information against third parties.

Many states recognize some form of statutory “mediation privilege,” whereby communications in the course of mediation enjoy enhanced protection from disclosure to third parties.\textsuperscript{51} If the parties are otherwise disposed to seek a coverage resolution, initiating a formal mediation procedure within which the policyholder can more readily comply with requests for defense invoices or other sensitive information will ease the tension between cooperation and privilege protection. Of course, the mediation process cannot be a mere charade. The parties should pursue a mediated resolution in good faith and with all deliberate speed, to justify the cloak of confidentiality that the mediation statute may throw over their sensitive exchange of information. If the mediation is successful, then they will have benefited doubly from the process: in our hypothetical, CleanChem and Wenopayah Insurance will no longer be adverse, thus reducing the risk of privilege waiver against I.M. Green’s clients and other underlying claimants going forward.

E. Eliminate, or minimize, the adversity in the policyholder-insurer relationship.

Even without a mediated or negotiated resolution, the adversity of interest between policyholder and insurer may become moot in some circumstances, while in others it may not yet be ripe. All counsel, including the insurer’s, should be alert for ways to eliminate or minimize the differences between CleanChem and Wenopayah Insurance, and to memorialize that circumstance before exchanging confidential information. The most favorable situation arises when the basis for the Insurer’s reserved coverage defense has simply vanished. In our hypothetical, this might happen if Ms. Fence succeeded in dismissing I.M. Green’s punitive damages count on summary judgment. A Confidentiality/Non-Waiver Of Privilege Agreement between CleanChem and an excess insurer, for example, could acknowledge that the underlying claim does not currently reach the layer of the excess insurer’s coverage, and further state that there is no need for the insurer to raise – and that the insurer does not presently raise – any preliminary coverage defenses.

F. Craft an insurance communication protocol.

To improve their chances of avoiding a mutually detrimental waiver with respect to the underlying claimants, CleanChem and Wenopayah Insurance should consider entering into an agreement governing their exchange of information about the underlying litigation. Of course, as the \textit{Imperial} case demonstrates, a one-size-fits-all “joint defense agreement” between policyholder and insurer may prove ineffective against third parties.\textsuperscript{52} But by clarifying and documenting the parties’ interests and intentions, an information agreement could help a court to

\textsuperscript{52} See \textit{In re Imperial Corp.}, 167 F.R.D. at 455-56.
distinguish the friendly side of the policyholder-insurer relationship from its unfriendly side, so that it protects confidential communications supporting the former as the Lectrolarm court did.\footnote{53 See Lectrolarm, 212 F.R.D. at 573.}

Such agreements must be tailored to the specific circumstances, but should include the following features:

- **Define common interests, and confine disclosures to their support.** The agreement should memorialize how the parties’ interests are aligned: \textit{e.g.,} in preventing or minimizing the underlying liability. It should further clarify that confidential information is provided solely to further common interests.

- **Conversely, clarify that no disclosures relating to issues of adverse interest will be made.** Since the insurer's reservation or denial of coverage may be limited to particular issues, \textit{e.g.,} a punitive damages claim in the underlying complaint, the agreement should identify the boundaries of the parties’ adversity and state that no disclosures relating to those issues are expected. It also should identify where possible the circumstances under which the parties’ adversity may disappear, \textit{e.g.,} after dismissal of an underlying claim implicating the policyholder’s knowledge or intent.

- **Limit disclosure of protected material.** Summaries or other information alternatives will often suffice instead of actual protected documents. It is in both parties’ interest to minimize the waiver risk by limiting sensitive disclosures in the first instance; such disclosures should not be made or requested without good cause.

- **Document the expectation of privacy.** The agreement should provide for confidential treatment of privileged or protected information, confine its use to common interests, and memorialize the parties’ intent to preserve applicable privileges without waiver.

V. Conclusion

None of the solutions proposed above is fail-safe. Nevertheless, CleanChem needs to get its defense bills paid; Wenopayah Insurance needs to set its reserves; and both want to resolve the underlying litigation on the most favorable terms feasible. Some information must be exchanged to make all that happen. In the real world of ambivalence and uncertainty that accompanies a complex, rights-reserved insurance claim, imperfect solutions for policyholder-insurer communications are better than none.