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Protecting Confidential Communications under the Restatement, Law of Liability Insurance

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An issue that has bedeviled insurers and policyholders for years is the extent to which communications between an insured and counsel retained to defend a claim are protected from discovery in subsequent litigation over coverage between the insurer and the insured. While a broad spectrum of case law exists on this subject, the leading cases on each end of the spectrum are *Rockwell International Corporation v. Superior Court*, 26 Cal.App.4th 1255, 32 Cal. Rptr.2d 153 (1994), which protects attorney-client communications from discovery, and *Waste Management, Inc. v. International Surplus Lines Insurance Company*, 579 N.E.2d 322 (Ill. 1991), which gives insurers broad access to such communications.

Rockwell

In *Rockwell,* the policyholder sought coverage for environmental contamination claims from its liability insurers. Some of the insurers agreed to defend Rockwell under a reservation of rights, while others declined to defend Rockwell at all. In the ensuing coverage litigation, the insurers sought to discover a number of documents relating to the underlying action, some of which contained confidential communications between Rockwell and its counsel. Rockwell refused to turn those documents over, citing the attorney-client privilege. The insurers sought to compel production based on three arguments. First, they argued that "the cooperation clause in the insurance policies abrogated Rockwell's attorney-client privilege. Second, they argued that Rockwell's decision to sue its carriers placed its conduct "in issue" and thereby waived whatever privilege might otherwise have existed. And, finally, the carriers argued that their "common interest" made them a "joint client" with Rockwell so that Rockwell could not assert the privilege against them.

The California Court of Appeal rejected all three arguments. With regard to the cooperation clause, the court found that the parties did not intend for the cooperation clause to function as a waiver of privilege. The court found similar fault with the insurers' common interest doctrine argument, noting that the common interest doctrine, under which attorney-client communications are not privileged among the clients, only applies when counsel is retained to represent more than one client jointly. In Rockwell's case, the court found that its attorneys "were retained to represent Rockwell and only Rockwell." Finally, the court found that Rockwell had not put the disputed attorney-client communications at issue merely by bringing suit against the insurers.

Waste Management

In *Waste Management,* the Illinois Supreme Court reached diametrically opposite results on all three points addressed by the *Rockwell* court. The court construed the cooperation clause broadly to, in the courts words, "render any expectation of attorney-client privilege in coverage litigation unreasonable." The court further found that the communications sought were discoverable because they were "at issue" in the litigation between the policyholder and the insurer. Finally, the court held that the policyholder and the insurers shared a "common interest" —even though the insurers had neither retained defense counsel for the underlying action nor participated in the defense.

Restatement, Law of Liability Insurance

Restatement § 11 rejects the *Waste Management* court's approach and favors that of *Rockwell*, but does so in a manner that is unlikely to quell discovery battles in insurance coverage litigation. Section 11(2) provides that liability insurers are not entitled to privileged communications between policyholders and defense counsel only "if that information could be used to benefit the insurer at the expense of the insured." It is easy to see how protracted disputes could develop over whether information sought disadvantages the insured. One issue that will not have to be addressed is whether defense counsel is panel counsel selected by the insurer or independent counsel. The comments to § 13 make the rule applicable even when the attorney is hired by the insurer.

A related question is whether a policyholder's voluntary disclosure of privileged information to an insurer to assist the insurer in evaluating a claim for settlement should be deemed a waiver of the privilege allowing third-party claimants to gain access to the information, especially in states that do not recognize a common interest between an insurer defending under a reservation of rights and its policyholder. The case law on this issue is sparse, but Restatement § 11(1) takes a strong position against waiver in such circumstances.