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Insurance Coverage Newsletter

FDCC Litigation Management College and the LMC Graduate Program

Author: Nick Farr

GWB is excited to make you aware of two upcoming programs sponsored by the Federation of Defense and Corporate Counsel (FDCC) - the Litigation Management College and the LMC Graduate Program. These highly regarded programs are scheduled to take place in Atlanta on June 4-8 at Emory. They are designed for claim and litigation management professionals with 5 -15 years of claims or litigation management experience. Both are immersion style programs which give participants the opportunity to work in small groups and gain valuable hands on experience. For example, the deposition prep and mock deposition sections provide the rare opportunity for attendees to face cross-examination and post-deposition evaluation in a non-judgmental friendly environment. These programs also are designed to prepare the participant for those situations that they will regularly face in their day to day work. Consider sending one or more of your claims professionals to the LMC or the LMC Graduate Program - it's not too late to register! Feel free to pass this information along to your colleagues. Below is information about the programs and the link to register.

HEAR SESSIONS From The Industry's Leading Minds!

CARL VAN

Carl Van is one of the most highly sought-after keynote speakers and presenters at claims conferences in the U.S. and Canada. He will be presenting the Keynote Address on Time Management. exploring secrets to successful time management.

Above: Van, Keynote Speaker

MARTIN LATZ, ESQ

ABC's Good Morning America anchor George Stephanopoulos has called Marty Latz "one of the most accomplished and persuasive negotiators I know." Martin will speak to Gain the Edge of Negotiations and Negotiation Skills. These sessions will arm the attendees with negotiating strategies to help them succeed in all their negotiations.

Above: Latz, Esq.

Click here for more information found on the FDCC website and to register.

Other Insurance Coverage News

Contravest Inc., et al v. Mt. Hawley Insurance Company (Judge Norton)

Beginning with the South Carolina Supreme Court's decision in *Harleysville Group Ins. v. Heritage Communities, Inc.,* No. 2013-001281 (Jan. 11, 2017) addressing, primarily, insufficiencies in reservation of rights letters, 2017 has not been a particularly great year for insurers in South Carolina. Continuing that trend, a federal court in South Carolina recently held that an insurer's communications with its attorneys and reinsurers (as well as reserve information) are relevant, not protected by privilege, and discoverable in bad faith actions. Below is a summary of this significant decision.

Contravest Inc., et al. v. Mt. Hawley Insurance Company, C.A. No.9:15-cv-00304, United States District Court for the District of South Carolina (Judge David C. Norton)

Background

In *Contravest*, Federal District Judge David Norton addressed a discovery dispute in the context of bad faith litigation. Plaintiffs -- the underlying insured and the underlying plaintiff -- filed suit against Mt. Hawley Insurance Company ("Mt. Hawley") for declaratory judgment, bad faith, breach of contract, and unjust enrichment based on Mt. Hawley's refusal to provide benefits allegedly owed under certain excess insurance policies issued to Contravest Construction Company ("Contravest"). In the underlying litigation, the homeowners association sued Contravest for defective construction of a development known as Plantation Point in Beaufort County, South Carolina. Despite repeated demands from Contravest, Mt. Hawley refused to defend, indemnify or participate in the lawsuit. Contravest settled the underlying action and assigned its rights and claims against Mt. Hawley to the homeowners association.

In the bad faith action, Plaintiffs served their first set of requests for production, seeking Mt. Hawley's file on Contravest's claim for excess coverage in connection with the underlying action. Mt. Hawley produced the claim file in conjunction with a privilege log. In response to supplemental discovery requests seeking Mt. Hawley's files on *all* of Contravest's claims under the excess policies, Mt. Hawley produced the files, again in conjunction with corresponding privilege logs. Plaintiffs filed motions to compel the withheld material and sought additional document production. The magistrate judge issued a Report and Recommendation (R&R) and Mt. Hawley filed objections to the R&R. Thus, he matter was ripe for the court's review.

At-Issue Waiver in Bad Faith Litigation Generally - *City of Myrtle Beach* Approach

The court first addressed Mt. Hawley's assertion that numerous communications in the claim files are protected by the attorney-client privilege. The court discussed the premise of the attorney-client privilege, which protects against disclosure of confidential communications by a client to his attorney, while also discussing an insured's right to recover damages for an insurer's breach of the covenant of good faith and fair dealing if the refusal to pay benefits was in bad faith or unreasonable. The court acknowledged that while the attorney-client privilege may protect even relevant information from disclosure, not every communication that falls within the ordinary scope of the privilege is entitled to protection. The court noted that bad faith claims are uniquely threatened and prejudiced by the attorney-client privilege because they turn heavily on what the insurer knew at the time it denied coverage. In this regard, the court observed that the public policy protecting confidential information must be balanced against the public interest in the proper administration of justice.

In determining that the attorney communications in the claim files were discoverable, the magistrate relied on *City of Myrtle Beach v. United National Insurance Co.*, No.4:08-cv-1183, 2010 WL 3420044, at *5 (D.S.C. Aug. 27, 2010), where the court addressed application of the attorney-client privilege and determined that attorney-client communications were discoverable in a bad faith action. The *City of Myrtle Beach* decision emphasized South Carolina's requirement that the proponent of the privilege establish the absence of waiver. The *City of Myrtle Beach* court then held that "if a defendant [insurer] voluntarily injects an issue in the case, whether legal or factual, the insurer [voluntarily]

waives, explicitly or impliedly, the attorney-client privilege." In other words, when a defendant insurer, through its answer and affirmative defenses, asserts that it acted in good faith, it opens the door to a waiver of the attorney-client privilege.

In the R&R, the magistrate acknowledged that the *City of Myrtle Beach* approach seemingly makes it difficult for a defendant to avoid waiver, because any defendant insurer who opposes a bad faith claim is essentially compelled to assert its own good faith. Nonetheless, the magistrate concluded that, in an apparent recognition of the draconian nature of the per se waiver approach, the *City of Myrtle Beach* court attempted to curb this "virtual per se waiver of the privilege" by finding waiver was mandated only in matters where the plaintiff had presented a prima facie case of bad faith.

Prima Facie Test

Having concluded the *City of Myrtle Beach* approach was appropriate, the court then addressed whether the plaintiffs had made a sufficient prima facie showing of bad faith to warrant waiver of the attorney-client privilege. The R&R concluded that the plaintiffs presented evidence that once Mt. Hawley realized the underlying policies were nearing exhaustion, it essentially changed its coverage position in an effort to avoid coverage. [1]

Before addressing the merits of the prima facie issue, the court noted that although *City of Myrtle Beach* discussed at length the prima facie finding, it does not necessarily stand for the proposition that a prima facie showing is required before waiver of the attorney-client privilege. The court noted that the R&R, in concluding a prima facie showing is required before waiver, actually applied a more insurer-friendly standard than other courts that have interpreted *City of Myrtle Beach*.

In any event, the court concluded that the *City of Myrtle Beach* decision rejected the per se waiver approach. It then stated:

However, if *City of Myrtle Beach* is applied without a prima facie showing requirement, the defendant-insurer waives the attorney-client privilege the moment it contests the plaintiff's allegations of bad faith. For most cases, this has the same effect as a per se waiver. . . . If the *City of Myrtle Beach* court's rejection of the per se waiver rule has any meaning, that decision must be read to require a prima facie showing of bad faith before the at-issue waiver can be applied.

The court then considered what is required to demonstrate bad faith. The magistrate focused only on the bad faith element of a bad faith claim. Mt. Hawley argued the opposite, contending that a plaintiff must present a prima facie showing of every element of a bad faith claim. The court found reason in both approaches, but noted that if Mt. Hawley's reading of the prima facie requirement was correct, it would effectively convert a discovery dispute into a motion for summary judgment on the merits of the coverage issue. Ultimately, the court concluded that it did not need to decide the issue because Mt. Hawley waived the argument by failing to present it to the magistrate. The court then concluded there was no clear error in the magistrate's finding that Plaintiffs presented a prima facie showing of bad faith. In this regard, the court noted that Mt. Hawley's argument was largely based on its own evidence, not the evidence cited by the plaintiffs in support of their prima facie showing. The court concluded that a defendant's evidence is immaterial to the prima facie showing analysis. Having found that the plaintiffs made a prima facie showing of bad faith, the Court adopted the R&R and determined that attorney communications in the insurer's claim file were discoverable.

Reinsurance Information

The court next addressed Mt. Hawley's challenge to the magistrate's finding that its communication with its reinsurers were relevant and discoverable. The court adopted the reasoning outlined in the R&R, and held that communications with reinsurers were relevant to explain why Mt. Hawley allegedly changed coverage positions as timed passed and communications with reinsurers on other claims were relevant to the insurer's good faith to the extent that the insurer explained its reasoning for granting or denying portions of Plaintiffs' claims or otherwise described or explained its handling of Plaintiffs' claims. The

court explained that in light of Plaintiffs' allegations, it was useful to know how Mt. Hawley handled prior claims made under the same policies.

Loss Reserves

With regard to the loss reserve information, Mt. Hawley argued that such information was not discoverable because it (1) was not relevant to coverage or bad faith and (2) was protected by the work-product doctrine. The court disagreed. The court concluded that loss reserve information is relevant to the extent the information reveals Mt. Hawley's assessment of the validity of Contravest's claims for excess coverage. With respect to the work-product objections, the court found that despite Mt. Hawley's arguments that reserve information reflects the mental impressions of counsel, Mt. Hawley failed to show how such information was prepared in the anticipation of litigation which is necessary for protection under the work-product doctrine. As such, the court determined that Mt. Hawley failed to carry its burden of proof that the reserve information constitutes work-product.

In Camera Review

With respect to the magistrate's rulings, Mt. Hawley continuously argued that the magistrate erred in ruling prior to conducting an in camera review of the documents at issue. However, the court rejected this argument, noting that the burden of proof is on the defendant to prove that the material sought is not discoverable, and there is no requirement that the court must independently confirm the relevancy of each piece of discovery material.

Conclusion

This decision evidences further erosion of the attorney-client privilege and expansion of discovery in the context of bad faith litigation. While some solace can be taken in the court's refusal to apply a per se waiver of the attorney-client privilege, the prima facie requirement is not a particularly high hurdle to clear. Moving forward, insurers should anticipate that their attorney-client communications, reinsurer communications and reserve information are potentially discoverable in any bad faith action. With this in mind, insurers (and their coverage counsel) should operate under the assumption that their files will be viewed by a potential plaintiff in a bad faith action and document them accordingly.

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[1] By way of background, the coverage dispute in the litigation was whether "vertical" or "horizontal" exhaustion applies when determining whether excess coverage is available in the progressive injury context over multiple policy periods. Plaintiffs argued that exhaustion should be determined vertically, meaning that an excess policy is triggered when the underlying policies in effect during the excess insurer's time on the risk are exhausted. Mt. Hawley advocated horizontal exhaustion, requiring exhaustion of all primary coverage policies triggered, even if those policies were not in effect during an excess carrier's time on the risk.