

February 2016

The Battle to Define the Scope of Attorney-Client Privilege in the Context of Insurance Company Bad Faith: A Judicial War Zone


Steven Plitt

James E. Rogers College of Law, University of Arizona; Current successor author to the nationally acclaimed insurance treatise COUCH ON INSURANCE 3D

Joshua D. Rogers

Kunz, Plitt, Hyland & Demlong; Associate successor author to COUCH ON INSURANCE 3D.

Follow this and additional works at: https://scholars.unh.edu/unh_lr

 Part of the [Insurance Law Commons](#), and the [Legal Ethics and Professional Responsibility Commons](#)

Repository Citation

Steven Plitt & Joshua D. Rogers, *The Battle to Define the Scope of Attorney-Client Privilege in the Context of Insurance Company Bad Faith: A Judicial War Zone*, 14 U.N.H. L. REV. 105 (2016), available at http://scholars.unh.edu/unh_lr/vol14/iss1/4

This Article is brought to you for free and open access by the University of New Hampshire – School of Law at University of New Hampshire Scholars' Repository. It has been accepted for inclusion in The University of New Hampshire Law Review by an authorized editor of University of New Hampshire Scholars' Repository. For more information, please contact ellen.phillips@law.unh.edu.

The Battle to Define the Scope of Attorney-Client Privilege in the Context of Insurance Company Bad Faith: A Judicial War Zone

STEVEN PLITT* AND JOSHUA D. ROGERS**

CONTENTS

INTRODUCTION.....	105
I. ATTORNEY-CLIENT PRIVILEGE AND INSURER BAD FAITH.....	107
A. General Overview of the Privilege.....	107
B. Waiver of Attorney-Client Privilege Generally	110
C. Waiver Through Direct Assertion of the Advice-Of-Counsel Defense in Bad Faith Cases	114
II. THE BATTLE FOR IMPLIED WAIVER	128
A. Expansion of Implied Waiver	128
B. Stemming the Tide of Implied Waiver: The Intermediate Court Battle in Arizona.....	136
C. Defining the Battle Lines.....	158
III. CONCLUSION	160

INTRODUCTION

The attorney-client privilege is the “oldest of the privileges for confidential communications known to the common law.”¹ The privilege is “[d]eeply rooted in public policy,”² and plays a “vital role” in the administration of justice.³ As such, the privilege is “traditionally deemed

* Steven Plitt is an Adjunct Assistant Professor of Law at the James E. Rogers College of Law, University of Arizona where he teaches insurance law. He was a former Adjunct Law Professor at the Sandra Day O’Connor College of Law, Arizona State University where he taught the insurance law curriculum. He is the current successor author to the nationally acclaimed insurance treatise *COUCH ON INSURANCE 3D* where he and his team of associate authors are rewriting and revising the treatise series. He is an author of several insurance law treatises. He is a nationally recognized expert on insurance law.

** Joshua D. Rogers is a Partner at Kunz Plitt Hyland & Demlong. He is an associate successor author to *COUCH ON INSURANCE 3D*. He received his J.D., *cum laude*, from Pepperdine University School of Law in 2001. Mr. Rogers focuses his practice upon the litigation of complex insurance coverage cases.

¹ *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981) (citing 8 J. WIGMORE, *EVIDENCE* § 2290 (McNaughton rev. 1961)).

² *Pampered Chef v. Alexanian*, 737 F. Supp. 2d 958, 963 (N.D. Ill. 2010) (citing *In re Ford Motor Co.*, 110 F.3d 954, 966 (3d Cir. 1997)).

³ *Id.* (quoting *Am. Nat’l Bank & Trust Co. of Chi. v. Equitable Life Assur. Soc’y of the U.S.*, 406 F.3d 867, 878 (7th Cir. 2005)).

worthy of maximum legal protection”⁴ and “it remains one of the most carefully guarded privileges and is not readily to be whittled down.”⁵

The privilege has come under assault in the insurance bad faith context in recent decades resulting in a “whittling down” of the privilege for insurance companies as a target party. Over the past couple of decades, various courts have rendered significant decisions regarding implied waiver of the privilege in the insurance bad faith context. These courts have seemingly set a minimal threshold for waiver that is the functional equivalent of a *per se* waiver rule, a rule which is inconsistent with the strength of the protection normally provided the attorney-client privilege in other contexts involving non-target parties.

In contrast, Arizona, one of the jurisdictions which previously appeared to create such a *per se* rule, may be, with recent intermediate court decisions, redefining the battle for the scope of the attorney-client privilege in the insurance bad faith context. The Arizona decisions on this issue serve as a case study regarding the analytic gymnastics courts have engaged in to create implied waiver in the insurance bad faith context. However, these decisions may also set the stage for the judicial combatants. Will the battle result in a return to the more conservative protections of the privilege provided in other contexts or will it end with a broad *per se* implied waiver in the insurance context?

In Part I of this article, the attorney-client privilege is discussed generally, as well as specifically, in the context of insurer bad faith. In Part I.A, a general overview of the attorney-client privilege is presented. In Part I.B, express and implied waiver of the attorney-client privilege are discussed. The courts have disagreed on the general contours of the test to be applied in determining whether an implied waiver of the attorney-client privilege has occurred, and what should be the precise formulation for that determination. The courts have also disagreed as to when a client may be deemed to have injected privileged attorney-client communications into a case, causing an implied waiver. There are three general approaches to determine whether a litigant has impliedly waived the attorney-client privilege. Each of these approaches is discussed. In Part I.C, the article discusses general principles regarding insurance bad faith and how the direct assertion of the advice-of-counsel defense results in waiver of the attorney-client privilege in that context. The nature and scope of the advice-of-counsel defense is explored.

In Part II, the battle over the changing boundaries of waiver by implication is examined by comparing the case authority supporting expansion versus the development of three published decisions from the courts of Arizona. The discussion starts in Part II.A, where the expansion of

⁴ BNP Paribas v. Wynne, 967 So. 2d 1065, 1067 (Fla. Dist. Ct. App. 2007) (quoting Am. Tobacco Co. v. State, 697 So. 2d 1249, 1252 (Fla. Dist. Ct. App. 1997)).

⁵ *Id.* (citing Swidler & Berlin v. United States, 524 U.S. 399, 403 (1998)).

waiver by implication is discussed. Part II.B examines a decision from the Arizona Supreme Court which followed the trend of substantial expansion of the waiver-by-implication rule and then examines two subsequent decisions from the Arizona Court of Appeals which have applied the Arizona Supreme Court precedent to reach two very different and arguably contradictory results. The first of these appellate decisions arguably takes the expansion of implied waiver to the next level—a *per se* rule triggering automatic waiver as a result of defending a bad faith case on a subjective belief of acting in good faith. The second appellate decision, however, takes a step back from the ledge and seeks to limit the prior ruling to its facts rather than creating a *per se* rule in those circumstances. Part II.C seeks to synthesize and define the battle in Arizona over the scope of implied waiver, discussing the chilling effect continued expansion of implied waiver can have upon the advice that insurance companies seek from counsel and how the recent decision from Arizona may serve as a warm front to thaw the chill that has been in the air for the last two decades.

I. ATTORNEY-CLIENT PRIVILEGE AND INSURER BAD FAITH

A. General Overview of the Privilege

The attorney-client privilege protects communications between the attorney and the client.⁶ The purpose of the attorney-client privilege “is to

⁶ *Upjohn Co.*, 449 U.S. at 389. The traditional elements of the attorney-client privilege that identify communications that may be protected from disclosure and discovery are:

the asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the bar or a court, or his or her subordinate, and (b) in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client, (b) without the presence of strangers, (c) for the purpose of securing primarily either (i) an opinion of law or (ii) legal services or (iii) assistance in some legal proceeding, and (d) not for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client.

In re Grand Jury Investigation, 599 F.2d 1224, 1233 (3d Cir. 1979) (citing *United States v. United Shoe Mach. Corp.*, 89 F. Supp. 357, 358–59 (D. Mass. 1950)). The attorney-client privilege has been extended to third-party agents of a client or its counsel under certain circumstances. See, e.g., *United States v. Kovel*, 296 F.2d 918, 922 (2d Cir. 1961). Under *Kovel*, “voluntarily disclosing the information contained in the [privileged] documents to nonparties waives the attorney-client privilege, unless such disclosure was ‘necessary, or at least highly useful, for the effective consultation between the client and the lawyer which the privilege is designed to permit.’” *Strougo v. BEA Assocs.*, 199 F.R.D. 515, 522 (S.D.N.Y. 2001) (quoting *Kovel*, 296 F.2d at 922). Based on these principles, courts following *Kovel* have applied a two-step analysis in evaluating whether the attorney-client privilege should be

encourage full and frank communication between attorneys and their clients.⁷ Whether the attorney-client privilege attaches depends on the nature of the communication.⁸

There are two broad justifications which underlie the privilege. The first justification is that the privilege promotes disclosure of all relevant information by the client to enable the attorney to effectively represent the client or to give adequate legal advice.⁹ Without the privilege, it is presumed that many clients would not communicate all relevant information to the attorney if adverse parties could use it against them in subsequent litigation. The second justification is that an attorney must be able to openly

extended to third-party agents. This analysis focuses upon: (1) Whether the inclusion of the third-party agent in the otherwise privileged communications occurs under circumstances reflecting the parties' reasonable expectation that the confidentiality of the communications will be maintained, and (2) whether disclosure of the otherwise privileged communications to the third-party agent is necessary in order for the client to obtain appropriately informed legal advice. *See generally* United States v. Ackert, 169 F.3d 136, 139–40 (2d Cir. 1999); Constr. Indus. Servs. Corp. v. Hanover Ins. Co., 206 F.R.D. 43, 47–48 (S.D.N.Y. 2001); *In re Pfohl Bros. Landfill Litig.*, 175 F.R.D. 13, 23–24 (W.D.N.Y. 1997); *People v. Osorio*, 549 N.E.2d 1183, 1185–86 (N.Y. 1989); *Doe v. Poe*, 664 N.Y.S.2d 120, 122 (1997). In extending the scope of the privilege, implicitly or explicitly, the courts have found that the disclosure of the otherwise privileged communications to the third-party agent to be “necessary” to the client’s ability to seek and receive effective legal advice from counsel, are found that the third-party agent was essentially fulfilling a role functionally equivalent to that of an integral employee of the client. *See, e.g.*, Fed. Trade Comm’n v. GlaxoSmithKline, 294 F.3d 141, 147–48 (D.C. Cir. 2002); *In re Bieter Co.*, 16 F.3d 929, 937–38 (8th Cir. 1994); *In re Copper Mkt. Antitrust Litig.*, 200 F.R.D. 213, 215, 219 (S.D.N.Y. 2001).

⁷ *Upjohn*, 449 U.S. at 389.

⁸ The nature of the communication must be examined. Where the attorney is hired to perform claims adjusting or to act in a capacity other than as a lawyer, the communications may not be privileged. *Mission Nat’l Ins. Co. v. Lilly*, 112 F.R.D. 160, 163 (D. Minn. 1986) (holding that ordinary business of a party is outside the scope of attorney-client privilege); *Hercules, Inc. v. Exxon Corp.*, 434 F. Supp. 136, 147 (D. Del. 1977) (stating that advice of counsel rendered on non-legal matters is not within scope of attorney-client privilege); *Aetna Cas. & Sur. Co. v. Superior Court*, 200 Cal. Rptr. 471, 476 (1984). Some courts look to the “dominant purpose” of the communication to determine whether the attorney-client privilege exists for communications between the insurance company and the attorney. *See, e.g.*, *Travelers Ins. Co. v. Superior Court*, 191 Cal. Rptr. 871 (1983). The dominant purpose of the transaction must be to transmit information in the course of the attorney’s professional employment. *Id.* at 879. In *Lanasa v. State*, 71 A. 1058, 1064 (Md. 1909), the test utilized for “legal advice” was whether the communications relate to professional advice and to the subject matter about which such advice is sought. “The relevant question is not whether [the attorney] was retained to conduct an investigation . . . but rather, whether this investigation was ‘related to the rendition of legal services.’” *In re Allen*, 106 F.3d 582, 604 (4th Cir. 1997) (internal quotation marks omitted) (holding that a determination of whether the investigation is privileged will focus on whether the issues are routine or whether they are complex issues of law, which intrinsically require sophisticated legal appraisals). Therefore, the parties must intend the communication to be confidential. *In re Underwriters at Lloyd’s*, 666 F.2d 55, 57 (4th Cir. 1981).

⁹ *Upjohn*, 449 U.S. at 389 (citing *Trammel v. United States*, 445 U.S. 40, 51 (1980)).

communicate legal advice and strategies to the client in order to adequately represent him or her, and that the attorney would not engage in such communications if adverse litigants could discover them in subsequent litigation.¹⁰ Because “sound legal advice or advocacy serves public ends,”¹¹ the privilege is necessary to promote full and unrestricted communication within the attorney-client relationship.

¹⁰ *Id.*

¹¹ *Id.* Despite the beneficial nature of the attorney-client privilege, some courts have adopted a strict interpretation to limit its scope. See, e.g., *Cameron v. Gen. Motors Corp.*, 158 F.R.D. 581, 586 (D.S.C. 1994), *vacated in part on other grounds sub nom. In re Gen. Motors Corp.*, Case No. 94-2435, 1995 WL 940063 (4th Cir. Feb. 17, 1995). In *Cameron*, a non-insurance case, the district court recognized the limited nature of the attorney-client privilege and the strict construction and limitations governing its application: “Because the attorney-client privilege is an exception from the otherwise liberal construction of discovery rules, its use is not favored by federal courts. Therefore, assertions of attorney-client privilege are ‘to be strictly confined within the narrowest possible limits consistent with the logic of its principal.’” *Cameron*, 158 F.R.D. at 586 (internal quotations omitted); see also *NLRB v. Harvey*, 349 F.2d 900, 906 (4th Cir. 1965); *In re Grand Jury Investigation*, 599 F.2d 1224, 1235 (3d Cir. 1979); *United States v. Tedder*, 801 F.2d 1437, 1441 (4th Cir. 1986); *In re Grand Jury Proceedings Under Seal*, 947 F.2d 1188, 1190 (4th Cir. 1991) (“[T]he [attorney-client] privilege must be strictly construed.”).

Evidentiary privileges are an exception to the general rule that relevant evidence is admissible. Privileges forbid the admission of otherwise relevant evidence when certain interests the privileges are thought to protect are regarded as more important than the interests served by the resolution of litigation based on full disclosure of all relevant facts. However, the privilege forbidding the discovery of admission of evidence relating to communications between attorney and client is intended to insure that a client remains free from apprehension that consultations with a legal advisor will be disclosed. See *Hunt v. Blackburn*, 128 U.S. 464, 470 (1888). The attorney-client privilege encourages the client to reveal to the lawyer confidences necessary for the lawyer to provide advice and representation. See E. W. CLEARY, *McCORMICK ON EVIDENCE* § 87, at 314 (3d ed. 1984). Because the privilege serves the interests of justice, courts have observed that it is worthy of maximum protection. *Haines v. Liggett Grp., Inc.*, 975 F.2d 81, 90 (3d Cir. 1992). Courts and commentators have supported the privilege:

As long as our society recognizes that advice as to matters relating to the law should be given by persons trained in the law that is, by lawyers anything that materially interferes with that relationship must be restricted or eliminated, and anything that fosters the success of that relationship must be retained and strengthened. The relationship and the continued existence of the giving of legal advice by persons accurately and effectively trained in the law is of greater societal value, it is submitted, than the admissibility of a given piece of evidence in a particular lawsuit. Contrary to the implied assertions of the evidence authorities, the heavens will not fall if all relevant and competent evidence cannot be admitted.

State ex rel. Great Am. Ins. Co. v. Smith, 574 S.W.2d 379, 383 (Mo. 1978) (quoting Robert Allen Sedler & Joseph J. Simeone, *Privileges in the Law of Evidence: The Realities of Attorney-Client Confidences*, 24 OHIO ST. L.J. 1, 3 (1963)).

Courts must work to apply the privilege in ways that are predictable and certain in order to serve the interests of justice by encouraging consultation with counsel free from the apprehension of disclosure. “An uncertain privilege—or one which purports to be certain, but results in widely varying applications by the courts—is little better than no privilege.”¹² Thus, uncertainty regarding the scope of the attorney-client privilege may have an adverse impact. If uncertainty remains, attorneys and their clients will be forced to assume that private communications will be subject to discovery, essentially eliminating the privilege.¹³

B. Waiver of Attorney-Client Privilege Generally

Express waivers of the attorney-client privilege are easy to identify and are therefore not discussed herein. Whether an implied waiver has occurred, however, is a vexing issue. Courts disagree about the general contours of the test to be applied to determine whether an implied waiver of the attorney-client privilege has occurred. Courts also dispute at what point a client may be deemed to have injected privileged communications with his or her attorney into the case, thus causing an implied waiver. There are three general approaches courts have used to determine whether the attorney-client privilege has been impliedly waived by a litigant:¹⁴ (1) the Automatic Waiver Rule; (2) the Intermediate Test; and (3) the Restrictive Test.

Under the automatic waiver rule, the attorney-client privilege is waived upon an assertion of a civil claim or an affirmative defense “that raises as an issue a matter to which otherwise privileged material is present.”¹⁵ The

¹² *In re Von Bulow*, 828 F.2d 94, 100 (2d Cir. 1987).

¹³ *State Farm Mut. Auto. Ins. Co. v. Lee*, 13 P.3d 1169, 1187 (Ariz. 2000) (McGregor, J., dissenting).

¹⁴ *Frontier Ref., Inc. v. Gorman-Rupp Co.*, 136 F.3d 695, 699–700 (10th Cir. 1998). The court in *Zenith Radio Corp. v. United States* observed:

The first of these general approaches is the “automatic waiver” rule, which provides that a litigant automatically waives the privilege upon assertion of a claim, counter-claim, or affirmative defense that raises as an issue a matter to which otherwise privileged material is relevant. . . . The second set of generalized approaches provides that the privilege is waived only when the material to be discovered is both relevant to the issues raised in the case and either vital or necessary to the opposing party’s defense of the case. . . . Finally, several courts have recently concluded that a litigant waives the attorney-client privilege if, and only if, the litigant directly puts the attorney’s advice at issue in the litigation

764 F.2d 1577, 1579 (Fed. Cir. 1985).

¹⁵ *See Indep. Prods. Corp. v. Loew’s, Inc.*, 22 F.R.D. 266, 276–77 (S.D.N.Y. 1958) (originating “automatic waiver” rule); *see also Lyons v. Johnson*, 415 F.2d 540, 542 (9th Cir. 1969), (discussing *Independent Products* and automatic waiver rule); *Fed. Deposit Ins. Corp. v. Wise*, 139 F.R.D. 168, 170–71 (D. Colo. 1991) (same). The automatic waiver rule is typically used when directed at a plaintiff who initiates civil litigation. “As a voluntary

automatic waiver rule does not apply to defendants who have not initiated the lawsuit.¹⁶ However, this same consideration exists where a civil defendant raises an affirmative defense that is enmeshed in important evidence that will be unavailable to plaintiff if privilege prevails. This typically happens in the context when the insurance company raises the advice of counsel defense.¹⁷ The “automatic waiver” rule has been criticized because it minimizes the importance of the attorney-client privilege to the adversarial system.¹⁸

The intermediate approach balances the need for discovery with the importance of maintaining the attorney-client privilege.¹⁹ “Under this approach the privilege is waived only when the material to be discovered is both relevant to the issues raised in the case and either vital or necessary to the opposing party’s defense of the case.”²⁰ In *Hearn v. Rhay*,²¹ the court applied this approach. The court in *Hearn* analyzed various exceptions to the rules of privilege²² and distilled the factors common to recognized implied

litigant, the civil plaintiff has created the situation which requires him to choose between his silence and his lawsuit.” *Wehling v. Columbia Broad. Sys.*, 608 F.2d 1084, 1089 n.10 (5th Cir. 1979). Typically, a civil plaintiff “voluntarily” brings litigation only because there is no other effective means of protecting legal rights. See Marjorie S. White, Note, *Plaintiff as Deponent: Invoking the Fifth Amendment*, 48 U. CHI. L. REV. 158, 162 (1981) (challenging the voluntary-involuntary distinction); J.K. Richards, Note, *Toward a Rational Treatment of Plaintiffs Who Invoke the Privilege Against Self-Incrimination During Discovery*, 66 IOWA L. REV. 575, 594–601 (1981). Where the plaintiff has initiated the action and forced a defendant into court, the plaintiff cannot use privilege as both a sword and a shield. In *Lyons*, the court observed:

The scales of justice would hardly remain equal in these respects, if a party can assert a claim against another and then be able to block all discovery attempts against him by asserting [the attorney-client] privilege to any interrogation whatsoever upon his claim. If any prejudice is to come from such a situation, it must, as a matter of basic fairness in the purposes and concepts on which the right of litigation rests, be to the party asserting the claim and not to the one who has been subjected to its assertion. It is the former who has made the election to create an imbalance in the pans of the scales.

Lyons, 415 F.2d at 542.

¹⁶ *Indep. Prods. Corp.*, 22 F.R.D. at 27677.

¹⁷ See discussion *infra* Part I.C.

¹⁸ See *Greater Newburyport Clamshell Alliance v. Pub. Serv. Co.*, 838 F.2d 13, 19 (1st Cir. 1988) (criticizing “automatic waiver” rule); *Afro-Lecon, Inc. v. United States*, 820 F.2d 1198, 1205 (Fed. Cir. 1987) (same).

¹⁹ See *Black Panther Party v. Smith*, 661 F.2d 1243, 1266–69 (D.C. Cir. 1981) (balancing need for discovery with importance of privilege), *vacated without opinion*, 458 U.S. 1118 (1982).

²⁰ *Zenith Radio Corp. v. United States*, 764 F.2d 1577, 1579 (Fed. Cir. 1985).

²¹ 68 F.R.D. 574, 581–82 (E.D. Wash. 1975).

²² *Id.* at 580–82. Principally, the court reviewed the physician-patient privilege which is waived by a plaintiff-patient “by filing a [law]suit that places patient’s physical condition in controversy”; and the attorney-client privilege which is impliedly waived “where the attorney and client are themselves adverse parties in [litigation] arising out of the relationship.” *Id.* at

waiver situations: (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.

The *Hearn* court instructed that when these three conditions are present, “a court should find that the party asserting a privilege has impliedly waived it through his own affirmative conduct.”²³ A court should begin this analysis with a presumption in favor of preserving the privilege.²⁴

580. The court also noted that in patent infringement lawsuits, a privilege waiver may occur “where a plaintiff put[s] the validity of the patent at issue.” See *Honeywell, Inc. v. Piper Aircraft Corp.*, 50 F.R.D. 117, 118 (M.D. Pa. 1970). In *Hearn*, the court found persuasive an analogy to “cases holding that a habeas corpus petitioner impliedly waives the attorney-client privilege by contesting the constitutionality of his state court conviction.” *Hearn*, 68 F.R.D. at 581. In the latter situation, other courts have permitted inquiry into the attorney-client relationship to determine whether a “deliberate bypass” of the right alleged to have been violated occurred. See, e.g., *Laughner v. United States*, 373 F.2d 326, 327 (5th Cir. 1967); *Henderson v. Heinze*, 349 F.2d 67, 70–71 (9th Cir. 1965). A defendant may also waive the privilege by asserting advice of counsel as an affirmative defense. See, e.g., *Hunt v. Blackburn*, 128 U.S. 464, 470 (1888) (holding that allegation that party was misled by counsel resulted in waiver); *Chevron Corp. v. Pennzoil Co.*, 974 F.2d 1156, 1162 (9th Cir. 1992) (holding that privilege was waived when party claimed that its tax position was reasonable because it was based on advice of counsel). A common denominator in these situations was that “the party asserting the privilege placed information protected by [the attorney-client privilege] in issue through some affirmative act for his own benefit, and to allow the privilege to protect against disclosure of such information would have been manifestly unfair to the opposing party.” *Hearn*, 68 F.R.D. at 581.

²³ *Id.* Significantly, the third prong of the *Hearn* test places the burden on the party seeking discovery to show that the information is relevant and material to the claim or defense. 68 F.R.D. at 582; see also 4 MOORE’S FEDERAL PRACTICE ¶ 26.60[6], at 26-218, 219 (1986). The burden is proportionate to the danger posed by the discovery to the type of privilege being asserted. Where a constitutional privilege is involved, for example, the First Amendment associational privilege, a heavy burden for disclosure exists primarily because of the “preferred position of First Amendment rights” in civil cases. *Black Panther Party v. Smith*, 661 F.2d 1243, 1268 (D.C. Cir. 1981), *judgment vacated without opinion sub nom. Moore v. Black Panther Party*, 458 U.S. 1118 (1982); see also *Zenith Radio Corp. v. United States*, 764 F.2d 1577, 1580 (Fed. Cir. 1985) (rejecting the automatic waiver rule to protect non-constitutional privileges). The Sixth Amendment provides a shield for the attorney-client privilege only in criminal proceedings. Upon the termination of these proceedings and initiation of a civil action putting the privilege at issue, that constitutional protection ends. The liberal federal policy favoring discovery is of substantially greater relative weight where the party invokes the privilege in a civil rather than a criminal case. *Indep. Prods. Corp. v. Loew’s, Inc.*, 22 F.R.D. 266, 278-79 (S.D.N.Y. 1958). One court has held that disclosure of information vital to a party’s case should be compelled “only after the litigant has shown that he has exhausted every reasonable source of information.” *Black Panther Party*, 661 F.2d at 1268. Furthermore, the party “must describe the information they hope to obtain and its importance to their case with a reasonable degree of specificity.” *Id.*

²⁴ However, under the *Hearn* test, in civil actions, fairness may require that the privilege holder surrender the privilege in so far as it will weaken, in a meaningful way, the opposing

The majority of jurisdictions follow the *Hearn* test.²⁵ The test is not without its critics, however. A significant minority of courts criticize the *Hearn* test because it focuses excessively on the asserted relevancy of the privileged communications while ignoring the reason why the privilege is recognized in the first place.²⁶ An example of this criticism is found in *Rhone-Poulenc Rorer, Inc. v. Home Indemnity Co.*²⁷ The court in *Rhone-Poulenc* observed that while the *Hearn* court “dress[ed] up [its] analysis with a check list of factors, [it] appear[s] to rest on a conclusion that the information sought is relevant and should in fairness be disclosed.”²⁸ Focusing on the important justifications behind the attorney-client privilege, the *Rhone-Poulenc* court expressed the criticism that the relationship between a client and his or her attorney will suffer because of the uncertainty regarding whether communications will remain confidential, leading to a greater risk that important confidential matters could require disclosure without any real predictability. “[B]ecause the definition of what may be relevant and discoverable from those consultations may depend on the facts and circumstances of as yet unfiled litigation, the client will have no sense of whether the communication may be relevant to some future issue, and will have no sense of certainty or assurance that the communication will remain confidential.”²⁹

The court in *Rhone-Poulenc* found that the advice of counsel was not placed in issue merely because it was relevant and that the advice given did not necessarily become an issue merely because the attorney’s advice might

party’s ability to defend. The privilege will give way where a party seeking to pierce the privilege can establish that the claim, and probable defenses thereto, are enmeshed in important, vital evidence that will be otherwise unavailable if the privilege prevails.

²⁵ *Frontier Ref., Inc. v. Gorman-Rupp Co.*, 136 F.3d 695, 699–700 (10th Cir. 1998); *Home Indem. Co. v. Lane Powell Moss & Miller*, 43 F.3d 1322, 1326 (9th Cir. 1995); *Pyramid Controls, Inc. v. Siemens Indus. Automations, Inc.*, 176 F.R.D. 269, 272 (N.D. Ill. 1997) (describing *Hearn* as “the seminal case on ‘at issue’ waiver”).

²⁶ *See Harter v. Univ. of Indianapolis*, 5 F. Supp. 2d 657, 664–65 & n.2 (S.D. Ind. 1998) (stating that “better-reasoned cases” hold that the act of filing a lawsuit where state of mind may be relevant does not waive privilege unless client specifically relies on advice of counsel; a contrary rule “effectively discourages a client from seeking legal advice by removing the assurance of confidentiality”); *Transamerica Title Ins. Co. v. Superior Court*, 233 Cal. Rptr. 825, 828–29 (1987) (stating that “[p]rivileged communications do not become discoverable simply because they are related to issues in the litigation” and upholding privilege even though insurer’s general state of mind was at issue in bad faith claim where insurer stipulated that it would not rely on advice of counsel defense). Other courts are more protective of the privilege and will not find waiver unless the client directly relies on advice of counsel. *See, e.g., Aranson v. Schroeder*, 671 A.2d 1023, 1030 (N.H. 1995) (holding that there is no waiver unless “the privilege holder injects the privileged material itself into the case”).

²⁷ 32 F.3d 851, 863 (3d Cir. 1994) (criticizing *Hearn* as of dubious validity).

²⁸ *Id.* at 864.

²⁹ *Id.*

affect the client's state of mind in a relevant matter.³⁰ The advice of counsel was only placed in issue where the client asserted a claim or defense, and attempted to prove that claim or defense by disclosing or describing an attorney-client communication.³¹

Under the restrictive approach, a litigant waives the attorney-client privilege if, and only if, the litigant directly puts the attorney's advice at issue in the litigation.³² For example, when a client files a malpractice action against his or her attorney, he or she may waive the privilege as to particular communications.³³ By placing the attorney's advice at issue, the client is waiving the privilege by requiring an examination of the facts and issues relating to that advice.³⁴ This may occur when the insurance company raises the advice of counsel defense to a bad faith lawsuit.

C. Waiver Through Direct Assertion Of The Advice-Of-Counsel Defense In Bad Faith Cases

1. A Brief Introduction to Bad Faith

As a concept, bad faith, like negligence, must be considered in a specific context because it has no definite independent meaning.³⁵ It is often

³⁰ *Id.* at 863.

³¹ *Id.*; see also *Pittston Co. v. Allianz Ins. Co.*, 143 F.R.D. 66, 71 (D.N.J. 1992); *N. River Ins. Co. v. Phila. Reinsurance Corp.*, 797 F. Supp. 363, 370 (D.N.J. 1992).

³² *Rhone-Poulenc*, 32 F.3d at 86364 (adopting restrictive test and criticizing more liberal views of waiver; purpose of privilege still applies when "state of mind" is at issue and single-minded focus on relevance "completely undermines the interest to be served"; no waiver where plaintiffs had not "injected the advice of counsel as an essential element of a claim"); see also *Pub. Serv. Co. of N.M. v. Lyons*, 10 P.3d 166, 173 (N.M. Ct. App. 2000) (rejecting the *Hearn* approach and adopting the *Rhone-Poulenc* test that there must be "an offensive or direct use of privileged information" before the attorney client privilege will be deemed to have been waived).

³³ *Rhone-Poulenc*, 32 F.3d at 863.

³⁴ *Id.* at 865.

³⁵ See James C. Nielsen, *Advice of Counsel in Insurance Bad Faith Litigation: A Substantive Framework for Pleading, Discovery and Proof*, 25 TORT & INS. L.J. 533, 534-35 (1990). Commentators have offered varying views of how many standards of bad faith exist. For an analysis of how commentators have offered various opinions on the standard to determine bad faith. See Lane Christine Boyarski, *The Best Place, Inc. v. Penn America Insurance Company.: Hawai'i Bad Faith Cause of Action for Insurer Misconduct*, 19 U. HAW. L. REV. 845, 853-54 (1997); see also Steven Plitt & Jordan R. Plitt, 1 PRACTICAL TOOLS FOR HANDLING INSURANCE CASES §§ 7:2-7:5 (Thomson Reuters 2011) (the authors discuss each state bad faith standard). For a description of the creation of the tort of insurance company bad faith, see Roger C. Henderson, *The Tort of Bad Faith in First-Party Insurance Transactions: Refining the Standard of Culpability and Reformulating the Remedies by Statute*, 26 U. MICH. J.L. REFORM 1, 22-26 (1992).

The court in *Wallbrook Insurance Co. v. Liberty Mutual Insurance Co.*, made the following insightful observation:

illustrated in a negative fashion by explaining what it is not. The tort of bad faith in Arizona has been described as a hybrid cause of action, sharing elements of both a negligence action and an intentional tort.³⁶ The tort is composed of two essential elements. The first element—whether the insurance company acted reasonably toward its insured—is based upon a simple, objective negligence standard.³⁷ The second element—whether the

Insurers are required to act with good faith in dealings with their insureds. The courts of this state recognize that the concept of good faith possesses “an intangible and abstract quality with no technical meaning.” One commentator sees the idea of good faith as having “no definite meaning of its own,” but is commonly illustrated in a negative fashion, “by explaining what it is not.” Coming to the same conclusion, another observer notes that good faith “is a phrase which has no general meaning or meanings of its own, but which serves to exclude many heterogeneous forms of bad faith . . . in a particular context the phrase takes on specific meaning, but usually this is only by way of contrast with the specific form of bad faith actually or hypothetically ruled out.” Looking to define bad faith is hardly less frustrating, for it too is recognized as an “amorphous concept” which “necessarily varies with the context” and thus has “no generally accepted ‘correct’ definition.” As may be gathered, the issue of whether good faith was exercised covers a broad range of territory. . . . [D]ecisions of the Court of Appeals have established that the litmus of good faith/bad faith is to be tested against the background of the totality of the circumstances in which the insurer’s disputed actions occurred.

7 Cal. Rptr. 2d 513, 518 (Ct. App. 1992). See Thomas A. Diamond & Howard Foss, *Proposed Standards for Evaluating When the Covenant of Good Faith and Fair Dealing Has Been Violated: A Framework for Resolving the Mystery*, 47 HASTINGS L.J. 585, 585–86 (1996).

³⁶ *Trus Joist Corp. v. Safeco Ins. Co. of Am.*, 735 P.2d 125, 134 (Ariz. Ct. App. 1986).

³⁷ Steven Plitt, ARIZONA LIABILITY INSURANCE LAW § 5.1 (State Bar of Arizona 1998). The concept of bad faith requires more than negligence to support judgment by the insurance company. *Rawlings v. Apodaca*, 726 P.2d 565, 576 (Ariz. 1986); *Centennial Ins. Co. v. Liberty Mut. Ins. Co.*, 404 N.E.2d 759, 762 (Ohio 1980). “It imports a dishonest purpose, moral obliquity, conscious wrongdoing, breach of a known duty through some ulterior motive or ill will partaking of the nature of fraud.” *Hoskins v. Aetna Life Ins. Co.*, 452 N.E.2d 1315, 1320 (Ohio 1983). The requirement of more than mere negligence is supported by the holdings in many published decisions. See, e.g., *Gen. Star Nat’l Ins. Co. v. Liberty Mut. Ins. Co.*, 960 F.2d 377, 380 (3rd Cir. 1992) (interpreting New York law); *White v. Cont’l Gen. Ins. Co.*, 831 F. Supp. 1545, 1555 (D. Wyo. 1993); *Turner Constr. Co. v. First Indem. of Am. Ins. Co.*, 829 F. Supp. 752, 762–64 (E.D. Pa. 1993); *Matt v. Liberty Mut. Ins. Co.*, 798 F. Supp. 429, 434 (W.D. Ky. 1991), *aff’d*, 968 F.2d 1215 (6th Cir. 1992) (interpreting Kentucky law); *Ins. Co. of N. Am. v. Citizensbank of Thomasville*, 491 So. 2d 880, 882 (Ala. 1986); *First Marine Ins. Co. v. Booth*, 876 S.W.2d 255, 257 (Ark. 1994); *Dolan v. Aid Ins. Co.*, 431 N.W.2d 790, 794 (Iowa 1988); *Wittmer v. Jones*, 864 S.W.2d 885, 890–92 (Ky. 1993); *Universal Life Ins. Co. v. Veasley*, 610 So. 2d 290, 295 (Miss. 1992); *Ganaway v. Shelter Mut. Ins. Co.*, 795 S.W.2d 554, 556 (Mo. Ct. App. 1990); see also *Mission Ins. Co. v. Aetna Life & Cas. Co.*, 687 F. Supp. 249, 253 (E.D. La. 1988) (requiring “something more than mere error of judgment” to show insurer bad faith). However, a minority of states apply a negligence standard. See, e.g., *Mock v. Mich. Millers Mut. Ins. Co.*, 5 Cal. Rptr. 2d 594, 607 (Ct. App. 1992); *Ind. Ins. Co. v. Plummer Power Mower & Tool Rental, Inc.*, 590 N.E.2d 1085, 1093 (Ind. Ct. App. 1992); *Hartford Cas. Ins. Co. v. N.H. Ins. Co.*, 628 N.E.2d 14, 17

insurance company acted knowingly³⁸—is a subjective determination. The introduction of this second element of knowledge is what elevates the cause of action to a quasi-intentional tort.

The first, negligence-based element of the tort acts as a threshold test for bad faith actions.³⁹ “Where the insurer acts reasonably, there can be no bad faith.”⁴⁰

Where an insurance company intentionally denies, fails to process, or refuses to pay a claim without a reasonable basis for such action, the tort of

(Mass. 1994); *Gelinas v. Metro. Prop. & Liab. Ins. Co.*, 551 A.2d 962, 966 (N.H. 1988); *Shamblin v. Nationwide Mut. Ins. Co.*, 396 S.E.2d 766, 776 (W. Va. 1990).

³⁸ It is the unreasonableness of the insurance company’s conduct that is the essence of the tort. See *Tomaselli v. Transamerica Ins. Co.*, 31 Cal. Rptr. 2d 433 (Ct. App. 1994); *Chester v. State Farm Ins. Co.*, 789 P.2d 534, 537 (Idaho Ct. App. 1990); *Alsobrook v. Nat’l Travelers Life Ins. Co.*, 852 P.2d 768, 770 (Okla. Ct. App. 1992). The focus is upon the actual knowledge of the insurance company that its conduct was unreasonable or whether the company should have known that it was acting unreasonably. See, e.g., *Galusha v. Farmers Ins. Exch.*, 844 F. Supp. 1401, 1404 (D. Colo. 1994); *Turner v. State Farm Fire & Cas. Cos.*, 614 So. 2d 1029, 1032 (Ala. 1993); *Ness v. W. Sec. Life Ins. Co.*, 851 P.2d 122, 125 (Ariz. Ct. App. 1992); *Brown v. Liberty Mut. Ins. Co.*, 513 N.W.2d 762, 763 (Iowa 1994); *Weatherly v. Blue Cross Blue Shield Ins. Co.*, 513 N.W.2d 347, 354 (Neb. Ct. App. 1994); *Transp. Ins. Co. v. Moriel*, 879 S.W.2d 10, 18 (Tex. 1994), *superseded by statute*, TEX. CIV. PRAC. & REM. CODE § 41.001(11), *as recognized in* *U-Haul Int’l, Inc. v. Waldrip*, 380 S.W.3d 118 (Tex. 2012).

³⁹ *Trus Joist*, 735 P.2d at 134.

⁴⁰ *Id.* The court in *Trus Joist Corp. v. Safeco Insurance Co. of America* gave an excellent exposition of this concept:

[D]id the insurance company act in a manner consistent with the way a reasonable insurer would be expected to act under the circumstances. This is the threshold test for all bad faith actions, whether first or third party. Where an insurer acts reasonably, there can be no bad faith. However, the converse of this proposition is not necessarily true: merely because an insurer acts unreasonably does not mean that it is guilty of bad faith. Negligent conduct which results solely from honest mistake, oversight or carelessness does not necessarily create bad faith liability even though it may be objectively unreasonable [citation omitted]. Some form of consciously unreasonable conduct is required.

Id. at 134. Thus, mere negligence or inadvertence is insufficient to establish the cause of action. *Rawlings v. Apodaca*, 726 P.2d 565, 576 (Ariz. 1986). The court in *Apodaca* observed:

Insurance companies, like other enterprises and all human beings, are far from perfect. Papers get lost, telephone messages misplaced and claims ignored because paper-work was misfiled or improperly processed. Such isolated mischances may result in a claim being unpaid or delayed. None of these mistakes will ordinarily constitute a breach of the implied covenant of good faith and fair dealing, even though the company may render itself liable for at least nominal damages for breach of contract in failing to pay the claim.

Id. at 573.

bad faith may arise.⁴¹ Insurance companies are permitted, however, to challenge claims that are “fairly debatable”⁴² or where a genuine dispute

⁴¹ *Noble v. Nat'l Am. Life Ins. Co.*, 624 P.2d 866, 867 (Ariz. 1981); *Anderson v. Cont'l Ins. Co.*, 271 N.W.2d 368 (Wis. 1978). The Arizona Supreme Court in *Zilisch v. State Farm Mutual Automobile Insurance Co.*, found that an insurance company may be liable for bad faith if its general claims handling practices are done in bad faith. 995 P.2d 276 (Ariz. 2000). The court in *Zilisch* held that certain practices of State Farm, including setting arbitrary goals for the reduction of claims paid and paying salaries and bonuses based on the amount paid out in claims, coupled with specific actions taken in plaintiff's case were sufficient to create a question for the jury regarding whether the company acted in bad faith. *Id.* at 280. Notably, in the *Zilisch* case, ten months after the initial demand to pay the claim, State Farm continued to decline to pay even though it had four doctors' reports supporting payment. *Id.* Further, after reviewing a fifth doctor's report, State Farm took four more months to pay and, during the additional four months, State Farm made several low offers to try to settle the claim. *Id.*

⁴² *Jordan v. Union Ins. Co.*, 771 F. Supp. 1031, 1033 (D.S.D. 1991) (stating that insurer is entitled to challenge fairly debatable claims); *Ward v. Firemann Ins. Co.*, 771 F. Supp. 1031, 1033 (D.S.D. 1991), *overruled by* *Transamerica Fin. Corp. v. Superior Court*, 761 P.2d 1019 (Ariz. 1988); *Dirks v. Farm Bureau Mut. Ins. Co.*, 465 N.W.2d 857, 861 (Iowa 1991). Numerous courts have articulated a “fairly debatable” standard in insurance bad faith cases. *See, e.g.*, *Davis v. Cotton States Mut. Ins. Co.*, 604 So. 2d 354, 358 (Ala. 1982); *Deese v. State Farm Mut. Auto. Ins. Co.*, 838 P.2d 1265, 1268 (Ariz. 1992); *Garnett v. Transamerica Ins. Servs.*, 800 P.2d 656, 666 (Idaho 1990); *Nassen v. Nat'l State Ins. Co.*, 494 N.W.2d 231, 236 (Iowa 1992), *cert. denied*, 507 U.S. 1031 (1993); *Pickett v. Lloyd's*, 621 A.2d 445, 453 (N.J. 1993); *Tokles & Son, Inc. v. Midwestern Indem. Co.*, 605 N.E.2d 936, 943 (Ohio 1992); *Bartlett v. John Hancock Mut. Life Ins. Co.*, 538 A.2d 997, 1000 (R.I. 1988); *In re Certification of Question of Law from the U.S. Dist. Court*, 399 N.W.2d 320, 324 (S.D. 1987); *Newhouse v. Citizens Sec. Mut. Ins. Co.*, 501 N.W.2d 1, 5–6 (Wis. 1993); *First Wyo. Bank, N.A. v. Cont'l Ins. Co.*, 860 P.2d 1094, 1101 (Wyo. 1993).

In *Zilisch v. State Farm Mut. Auto. Ins. Co.*, 995 P.2d 276 (Ariz. 2000), the Arizona Supreme Court vacated the Arizona Court of Appeals' decision—977 P.2d 134 (Ariz. Ct. Appl. 1998)—where the Court of Appeals held that as long as the amount the insurance company ultimately offers to its insured on an underinsured motorist claim is fairly debatable, “poor practice and bad motives [in the investigation process] do not enter into the inquiry [of whether bad faith has taken place].” 977 P.2d at 139. In rejecting the Court of Appeals analysis, the Arizona Supreme Court found that “fair debatability” as a “threshold question” was not outcome determinative of the bad faith inquiry. Recognizing that insurance companies may defend fairly debatable claims, the court found that an insurance company must exercise reasonable care and good faith when defending a fairly debatable claim. *Zilisch*, 995 P.2d at 279. The court further found that while fair debatability is a necessary condition to avoid a claim of bad faith, it was not always a sufficient condition to avoid bad faith. The appropriate inquiry was whether there was sufficient evidence from which reasonable jurors could conclude that in the investigation, evaluation, and processing of the claim, the insurer acted unreasonably and either knew or was conscious of the fact that its conduct was unreasonable. *Id.* at 279–80.

Courts have differed in defining and interpreting “fair debatability.” As an example, the Alabama Supreme Court in *National Savings Life Insurance Co. v. Dutton* found that where there is a genuine issue of law with respect to the insurance company's denial of a claim, which precluded a directed verdict for the insured, the insurance company was entitled to a directed verdict on the issue of bad faith. 419 So. 2d 1357 (Ala. 1982). However, the *Dutton* rule, which gave rise to the so-called directed verdict test of bad faith, has been rejected by

exists under the genuine dispute doctrine.⁴³ In determining “fair debatability, an examination of the circumstances surrounding the claim presentation

other courts. *See, e.g.*, *Bilden v. United Equitable Ins. Co.*, 921 F.2d 822, 829 (8th Cir. 1990) (interpreting North Dakota Law); *Linthicum v. Nationwide Life Ins. Co.*, 723 P.2d 703, 711–12 (Ariz. Ct. App. 1985), *aff’d in part and rev’d in part*, 723 P.2d 675 (Ariz. 1986).

⁴³ As with the fair debatability doctrine, the genuine dispute doctrine applies to both factual and legal disputes. *Chateau Chamberay Homeowners Assn. v. Associated Internet Ins. Co.*, 108 Cal. Rptr. 2d, 776, 785 (Ct. App. 2001); *Fontaine v. Provident Mut. Life Ins. Co.*, 10 Fed. App’x. 415, 418 (9th Cir. 2001); *see also* Leo John Jordan & Jennifer K. Kenchel, *Recent Developments in Property Insurance Law*, 37 TORT & INS. L.J. 675, 698–700 (2002); Douglas G. Houser, Ronald J. Clark & Linda M. Bolduan, *Good Faith as a Matter of Law—An Update on the Insurance Company’s “Right to be Wrong,”* 39 TORT & INS. L.J. 1045, 1065 (2004). However, whether the doctrine applies in cases with factual disputes should be decided on a case-by-case basis. *Chateau Chamberay*, 108 Cal. Rptr. 2d at 785; *Guebara v. Allstate Ins. Co.*, 237 F.3d 987, 994 (9th Cir. 2001); *see also* Houser, *supra*, at 1065. Notwithstanding this general rule, state and federal courts have identified various ways in which an insurer may demonstrate the existence of a genuine dispute. One way is for an insurer to show that “it relied on opinions from experts while evaluating the insured’s claim.” *Keshish v. Allstate Ins. Co.*, 959 F. Supp. 2d 1226, 1233 (C.D. Cal. 2013) (quoting *Maynard v. State Farm Mut. Auto. Ins. Co.*, 499 F. Supp. 2d 1154, 1160 (C.D. Cal. 2007)); *Chateau Chamberay*, 108 Cal. Rptr. 2d at 785. “[A] single, thorough report by an independent expert is sufficient, all other things being equal, to support application of the ‘genuine dispute’ doctrine.” *Keshish*, 959 F. Supp. 2d at 1236 (quoting *Adams v. Allstate Ins. Co.*, 187 F. Supp. 2d 1207, 1215 (C.D. Cal. 2002)) (genuine dispute existed where insurer relied on independent contractor’s estimate for smoke damage remediation in determining the amount owing under policy); *see also* Leo John Jordan, *Recent Developments in Property Insurance Law*, 38 TORT & INS. L.J. 657, 684 (2003).

Insurers can also demonstrate the existence of a genuine dispute in cases where “an arbitrator awards substantially lower damages than Plaintiff claims.” *Keshish*, 959 F. Supp. 2d at 1236 (citing *Maynard*, 499 F. Supp. 2d at 1160); *see also Chateau Chamberay*, 108 Cal. Rptr. 2d 776 (affirming summary judgment in favor of insurer on bad faith claim; insurer had reasonable and legitimate basis for questioning the claim, as demonstrated by the evidence presented and by the fact that an arbitrator found only 45% of the plaintiff’s claim was covered).

A genuine dispute may also exist where liability is uncertain based on controlling case law. *Opsal v. United Servs. Auto. Ass’n*, 10 Cal. Rptr. 2d 352, 357 (Ct. App. 1991); *Dalrymple v. United Servs. Auto. Ass’n*, 46 Cal. Rptr. 2d 845, 857 (Ct. App. 1995); *see also Franceschi v. Am. Motorists Ins. Co.*, 852 F.2d 1217 (9th Cir. 1988) (genuine issue as to coverage where term “medical treatment” as used in policy was ambiguous); *LG Infocomm U.S.A. v. Euler Am. Credit Indem. Co.*, 419 F. Supp. 2d 1248 (S.D. Cal. 2005) (the term “allowed” as used policy exclusion was ambiguous and insured had case law supporting its interpretation; genuine dispute doctrine applied to defeat insured’s bad faith claim).

An insurer must have conducted a full, fair and thorough investigation to rely on the genuine dispute doctrine. *Bosetti v. U.S. Life Ins. Co. in City of N.Y.*, 96 Cal. Rptr. 3d 744, 767 (Ct. App. 2009) (citing *Chateau Chamberay*, 108 Cal. Rptr. 2d at 785); *see also Gentry v. State Farm Mut. Auto. Ins. Co.*, 726 F. Supp. 2d at 1160, 1166–67 (E.D. Cal. 2010) (the genuine dispute rule “does not relieve an insurer from its obligation to thoroughly and fairly investigate, process and evaluate the insured’s claim.”); *Wilson v. 21st Century Ins. Co.*, 171 P.3d 1082, 1086–88 (Cal. 2007).

Notwithstanding the foregoing, “a ‘thorough’ investigation is not necessarily a perfect investigation; and the mere fact that in hindsight there may be other areas that could have been

should be made.⁴⁴ A claim is typically “fairly debatable” where there remain unanswered material questions involving law or fact that provide an explanation for the insurance company’s delay or refusal to pay a claim.⁴⁵ The presence of a legitimate coverage defense to a claim submission may preclude bad faith.⁴⁶ Claims may be denied on the basis of a “fairly

investigated does not always establish bad faith.” *Fontaine v. Provident Mut. Life Ins. Co.*, 10 Fed. App’x 415, 418 (quoting Hon. H. Walter Croskey, et al., CALIFORNIA PRACTICE GUIDE: INSURANCE LITIGATION § 12:866 (Rutter Group 1999)) (internal quotation marks omitted). To constitute bad faith, a failure to investigate “must rise to the level of unfair dealing.” *Harbison v. Am. Motorists Ins. Co.*, 636 F. Supp. 2d 1030, 1041 (E.D. Cal. 2009) (quoting *Shade Foods, Inc. v. Innovative Prods. Sales & Mktg., Inc.*, 93 Cal. Rptr. 2d 364, 386 (Ct. App. 2000)). “An unreasonable failure to investigate amounting to such unfair dealing may be found when an insurer fails to consider, or seek to discover, evidence relevant to the issues of liability and damages.” *Id.*

⁴⁴ *Forcucci v. U.S. Fid. & Guar. Co.*, 11 F.3d 1, 2 (1st Cir. 1993).

Courts have differed regarding the point in time that becomes relevant for purposes of assessing whether the insurance company had reasonable grounds for denying the claim. A significant number of courts have stated that they will only consider evidence available to the insurance company at the time of the denial. *See, e.g., Aetna Life Ins. Co. v. Lavoie*, 505 So. 2d 1050, 1053 (Ala. 1987). However, some courts inquire as to whether the insurance company had a fairly debatable reason for denying the claim based on the facts presented at trial. *See, e.g., Mass. Bay Ins. Co. v. Hall*, 395 S.E.2d 851, 857 (Ga. Ct. App. 1990). One commentator has opined that insurance companies should not be permitted to meet the standards by putting forth grounds recognized after the denial of a claim. *See Chris M. Kallianos, Survey, Bad Faith Refusal to Pay First-Party Insurance Claims: A Growing Recognition of Extra-Contract Damages*, 64 N.C. L. REV. 1421, 1435 (1986).

⁴⁵ *See Larson v. Allstate Ins. Co.*, 857 P.2d 263, 266 (Utah Ct. App. 1993) (stating that questions of law and fact can make a claim fairly debatable); *S & W Prop., Inc. v. Am. Motorists Ins. Co.*, 668 So.2d 529, 532 (Ala. 1995) (plaintiff must establish insurance company had no factual or legal defense to the claim); *Morgan v. Am. Family Mut. Ins. Co.*, 534 N.W.2d 92, 96 (Iowa 1995), *overruled by Hamm v. Allied Mut. Ins. Co.*, 612 N.W.2d 775 (Iowa 2000) (a claim may be fairly debatable as to a matter of fact or law); *Larsen*, 857 P.2d at 266 (fairly debatable claims may concern matters of fact or law). A few courts have found that whether a claim is fairly or reasonable debatable is a question of law. *See AMCO Mut. Ins. Co. v. Lamphere*, 541 N.W.2d 910, 914 (Iowa Ct. App. 1995); *Billings v. Union Bankers Ins. Co.*, 918 P.2d 461, 464 (Utah 1996); *Bushey v. Allstate Ins. Co.*, 670 A.2d 807, 810 (Vt. 1995). However, other courts have found that the determination as to whether a claim is fairly or reasonably debatable is a question of fact for the jury. *Watts v. Westland Farm Mut. Ins. Co.*, 895 P.2d 626, 630 (Mont. 1995).

⁴⁶ *First Dakota Nat’l Bank v. Saint Paul Fire & Marine Ins. Co.*, 2 F.3d 801, 811–12 (8th Cir. 1993); *Claborn v. Wash. Nat’l Ins. Co.*, 910 P.2d 1046, 1051 (Okla. 1996); *Matthews v. Home Ins. Co.*, 916 S.W.2d 666, 669–70 (Tex. App. 1996); *Roberts v. Allied Grp. Ins. Co.*, 901 P.2d 317, 319 (Wash. Ct. App. 1995). Similarly, the presence of an open legal question may foreclose bad faith liability. *See Aceves v. Allstate Ins. Co.*, 827 F. Supp. 1473, 1486 (S.D. Cal. 1993), *rev’d in part*, 68 F.3d 1160 (9th Cir. 1995); *Frost v. Liberty Mut. Ins. Co.*, 828 S.W.2d 915, 920 (Mo. Ct. App. 1992); *J.H. Fr. Refractories Co. v. Allstate Ins. Co.*, 626 A.2d 502, 510 (Pa. 1993). Where an insurance company learns of legal authority supporting the insured’s position and promptly changes its prior coverage decision, bad faith may be foreclosed. *See, e.g., Harrington v. Guar. Nat’l Ins. Co.*, 628 So. 2d 323 (Ala. 1993).

debatable” policy interpretation, even though that interpretation ultimately may be rejected by the courts.⁴⁷ Insurance companies may litigate issues of first impression⁴⁸ by filing a declaratory judgment action without being exposed to bad faith.⁴⁹ Arizona courts have adopted fair debatability as a qualified defense in bad faith cases.⁵⁰

The linchpin of the tort of bad faith is the “covenant of good faith and fair dealing,” which is implied by law and imputed into all insurance policies.⁵¹ The implied covenant of good faith and fair dealing is often expressed as a promise implied in “every contract that neither party will do anything which will injure the right of the other to receive the benefits of the agreement.”⁵² A primary benefit flowing from the insurance company’s

⁴⁷ See *Mills v. Regent Ins. Co.*, 449 N.W.2d 294, 297 (Wis. Ct. App. 1989), *review denied*, 451 N.W.2d 297 (Wis. 1990). Where open legal questions remain, an insurance company may be insulated from bad faith. See *Aceves*, 827 F. Supp. at 1484; *Frost*, 828 S.W.2d at 920; *J.H. Fr. Refractories Co.*, 626 A.2d at 510.

⁴⁸ See, e.g., *First Fin. Ins. Co. v. Rainey*, 401 S.E.2d 490, 491–92 (Ga. 1991); *Pressman v. Aetna Cas. & Sur. Co.*, 574 A.2d 757, 758–60 (R.I. 1990); *Armacost v. State Farm Mut. Auto. Ins. Co.*, 644 P.2d 403, 405–06 (Kan. 1982); *CUNA Mut. Ins. Soc’y v. Norman*, 375 S.E.2d 724, 725–27 (Va. 1989).

⁴⁹ *Wierck v. Grinnel Mut. Reinsurance Co.*, 456 N.W.2d 191, 194 (Iowa 1990); *Ballinger v. Sec. Conn. Life Ins. Co.*, 862 P.2d 68, 70 (Okla. 1993). An insurance company is not in bad faith for litigating an issue of first impression. If the insurer learns that the legal authority previously relied upon does not continue to support its coverage position, however, it may be required to change its position promptly and resolve the claim. See, e.g., *Harrington*, 628 So. 2d at 326–27.

⁵⁰ See, e.g., *Ward v. Fireman’s Fund Ins. Cos.*, 731 P.2d 106 (Ariz. Ct. App. 1986) *review denied*; *Knoell v. Metro Life Ins. Co.*, 163 F. Supp. 2d 1072, 1075 (D. Ariz. 2001). *But see Zilisch v. State Farm Mut. Auto. Ins. Co.*, 995 P.2d 276 (Ariz. 2000) (fair debatability may not always be sufficient condition to avoid bad faith liability).

⁵¹ *Kan. Bankers Sur. Co. v. Lynass*, 920 F.2d 546, 548 (8th Cir. 1990); *State Farm Mut. Auto. Ins. Co. v. Weiford*, 831 P.2d 1264, 1266 (Alaska 1992); *Walter v. Simmons*, 818 P.2d 214, 223 (Ariz. Ct. App. 1991); *Pemberton v. Farmers Ins. Exch.*, 858 P.2d 380, 382 (Nev. 1993); *Pavia v. State Farm Mut. Auto. Ins. Co.*, 626 N.E.2d 24, 27 (N.Y. 1993); *Austin Co. v. Royal Ins. Co.*, 842 S.W.2d 608, 610 (Tenn. Ct. App. 1992). The implied covenant of good faith and fair dealing can be traced back as far as the late nineteenth century. See *Germania Ins. Co. v. Rudwig*, 80 Ky. 223, 235 (1882); see also *Brassil v. Md. Cas. Co.*, 104 N.E. 622, 624 (N.Y. 1914); Neal A. Goldberg et al., *Can the Puzzle Be Solved: Are Punitive Damages Awardable in New York for First-Party Bad Faith?*, 44 SYRACUSE L. REV. 723, 727 (1993). The implied covenant of good faith and fair dealing is an outgrowth of society’s promotion of reliance on contracts, and fairness and reasonableness in contractual relationships, which has formed the public policy of a particular state. See *Koehrer v. Superior Court*, 226 Cal. Rptr. 820, 828 (Ct. App. 1986).

⁵² *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 200 (Cal. 1958); see also *Wagonseller v. Scottsdale Mem’l Hosp.*, 710 P.2d 1025, 1038 (Ariz. 1985).

A few courts have described the duties that an insurance company owes its insured as those of a fiduciary. See, e.g., *Frommoethelydo v. Fire Ins. Exch.*, 721 P.2d 41, 44 (Cal. 1986) (stating that because insurance companies hold themselves out as such, they are fiduciaries); *Benke v. Mukwonago-Vernon Mut. Ins. Co.*, 329 N.W.2d 243, 248 (Wis. Ct. App. 1982) (declaring that insurance companies have “a fiduciary duty to act on behalf of” their insureds

express agreement to protect its insured from covered calamities “is the insured’s expectation that his insurance company will not wrongfully deprive him of the very security for which he bargained or expose him to the catastrophe for which he sought protection.”⁵³

A breach of the covenant of good faith and fair dealing can occur notwithstanding the insurance company’s payment of full policy benefits due on a particular claim.⁵⁴ The focus of the inquiry is not whether a specific express provision of the insurance policy has been breached by the insurer but instead, whether the company’s conduct damaged “the very protection or security which the insured sought to gain by buying insurance.”⁵⁵ When

as if their own interests were at stake). Other courts, however, have characterized the relationship as confidential and have imposed quasi-fiduciary duties on the insurance company. Typically, courts have prescribed an obligation which describes the duty as “fiduciary in nature.” *See* Hassard, Bonnington, Roger & Huber v. Home Ins. Co., 740 F. Supp. 789, 792 (S.D. Cal. 1990) (“[T]he relationship between an insurer and an insured has many of the elements of a fiduciary relationship, but is not an actual fiduciary relationship.”); *Love v. Fire Ins. Exch.*, 271 Cal. Rptr. 246, 251–52 (Ct. App. 1990) (stating that an insurance company’s obligation is “akin to fiduciary-type responsibilities”); *Tynes v. Bankers Life Co.*, 730 P.2d 1115, 1125–26 (Mont. 1986). *But see* William T. Baker et al., *Is an Insurer a Fiduciary to Its Insureds?*, 25 TORT & INS. L.J. 1, 1–2 (1989) (arguing that insurance companies are not fiduciaries).

⁵³ *Rawlings v. Apodaca*, 726 P.2d 565, 571 (Ariz. 1986).

⁵⁴ The Arizona Supreme Court in *Rawlings* has observed:

Failure to perform the express covenant to pay the claim is not the *sine qua non* for an action for breach of the implied covenant of good faith and fair dealing. To characterize the cases otherwise, would, in effect, construe them to hold that any breach of the express covenant would give rise to the tort action for bad faith. We hold explicitly that such a result is not permitted. Not every breach of an express covenant in an insurance contract is a breach of the covenant of good faith and fair dealing.

726 P.2d at 573.

⁵⁵ *Id.* Compare Paul E. Glad et al., *Bad Faith Liability in the Absence of Coverage?*, 7 BAD FAITH L. REP. 1 (1991) (arguing that no bad faith liability can exist absent coverage except in extraordinary cases), with Stephan S. Ashley, *Bad Faith Liability in the Absence of Coverage: A Response*, 7 BAD FAITH L. REP. 6 (1991) (explaining that “the law does not preclude bad faith in the absence of coverage”). It is well-established under Arizona law that a bad faith claim has independent standing, irrespective of coverage. *Manterola v. Farmers Ins. Exch.*, 30 P.3d 639, 645 (Ariz. Ct. App. 2001); *Lloyd v. State Farm Mut. Auto. Ins. Co.*, 943 P.2d 729, 737 n.4 (Ariz. Ct. App. 1996) (an insurer, however, “can be held liable for bad faith even when it does not violate any express provision of the insurance contract . . . The covenant of good faith and fair dealing can be breached even if the policy does not provide coverage.”) An insurance company may be “found liable for bad faith despite the fact that, under the circumstances, the policy did not require it either to defend or indemnify” the insured. *Lloyd*, 943 P.2d at 737 n.4; *see also* *Taylor v. State Farm Mut. Auto. Ins. Co.*, 913 P.2d 1092, 1094 (Ariz. 1996) (“[I]nsurer may breach its duty of good faith without actually breaching express covenants in the contract.”); *Deese v. State Farm Mut. Auto. Ins. Co.*, 838 P.2d 1265, 1270 (Ariz. 1992) (breach of express covenant not a necessary prerequisite to action for bad faith);

conduct is found to be designed to deprive the policyholder of the benefits of the contract, bad faith may exist, notwithstanding mere technical compliance with the literal terms of the contract because the remedies available may be insufficient, undermining public policy.⁵⁶ Courts differ on whether a breach of the covenant can be sustained in the absence of specific coverage.⁵⁷

2. The Advice of Counsel Defense

An insurance company may defend itself against allegations of bad faith claim handling by providing evidence that it relied upon the advice of competent counsel.⁵⁸ The so-called advice-of-counsel⁵⁹ defense⁶⁰ provides

Rawlings, 726 P.2d at 579 (covenant of good faith and fair dealing may be breached even when insurer fully performs express covenants of contract).

⁵⁶ See, e.g., *St. Benedict's Dev. Co. v. St. Benedict's Hosp.*, 811 P.2d 194, 198–200 (Utah 1991). One court has observed that tort liability in this context requires more than the intent to breach the contract or the intent to deprive the policyholder of benefits. See, e.g., *Metro. Life Ins. Co. v. Noble Lowndes Int'l, Inc.*, 192 A.2d 83, 88 (N.Y. App. Div. 1993). Several jurisdictions have rejected tort-based remedies for breach of the implied covenant of good faith and fair dealing. These jurisdictions have allowed recovery of consequential economic damages for breach of contract by the insurance company. See, e.g., *Marquis v. Farm Family Mut. Ins. Co.*, 628 A.2d 644, 650–52 (Me. 1993); *Lawton v. Great Sw. Fire Ins. Co.*, 392 A.2d 576, 579–81 (N.H. 1978); see also *Olson v. Rugloski*, 277 N.W.2d 385, 387–88 (Minn. 1979). Other jurisdictions have substantially blurred the tort/contract distinction in the area of consequential damages. See, e.g., *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951, 957 (7th Cir.).

⁵⁷ Compare *Harbor Ins. Co. v. Urban Constr. Co.*, 990 F.2d 195, 202 (5th Cir. 1993) (holding that absence of coverage, alone, did not preclude recovery for breach of the implied covenant) with *McMillan Scripts N. P'ship v. Royal Ins. Co. of Am.*, 23 Cal. Rptr. 2d 243, 247 (Ct. App. 1993) (holding that where no loss covered by policy occurred, there was no breach of the implied covenant).

⁵⁸ The following states have adopted the advice of counsel defense: **Alabama**: *Chavers v. Nat'l Sec. Fire & Cas. Co.*, 405 So. 2d 1, 8 (Ala. 1981) (qualified defense) (“While advice of counsel, along with all the other relevant factors, may be considered by the trial judge in his determination whether the strongest tendencies of the evidence, if believed, make out a case for the jury on the ‘lawful basis for refusal’ issue, it is not necessarily an absolute defense.”); **Alaska**: *Lloyd's & Inst. of London Underwriting Cos. v. Fulton*, 2 P.3d 1199, 1206 (Alaska 2000) (admissible as evidence of reasonableness of the insurer's conduct); **Arizona**: *State Farm Mut. Auto. Ins. Co. v. Lee*, 13 P.3d 1169, 1175 (Ariz. 2000); **California**: *State Farm Mut. Auto. Ins. Co. v. Superior Court*, 279 Cal. Rptr. 116, 118 (Ct. App. 1991); **Colorado**: *Brandon v. Sterling Colo. Beef Co.*, 827 P.2d 559 (Colo. App. 1991); **Delaware**: *Tackett v. State Farm Fire & Cas. Ins. Co.*, 653 A.2d 254, 260 (Del. 1995); **District of Columbia**: *Wender v. United Services Auto. Ass'n*, 434 A.2d 1372, 1373–75 (D.C. 1981); **Florida**: *Cotton States Mut. Ins. Co. v. Trevethan*, 390 So. 2d 724, 728 (Fla. Dist. Ct. App. 1980) (holding that reliance on the advice of counsel is “evidence to be considered on the issue of bad faith” but it “does not insulate the insurer” from a bad faith judgment); **Indiana**: *Worth v. Tamarack Am.*, 47 F. Supp. 2d 1087 (S.D. Ind. 1999), *aff'd* 201 F.3d 377 (7th Cir. 2000) (affirming summary judgment for insurer sued for bad faith where, among other things, insurer retained outside counsel to render opinion); **Massachusetts**: *G.S. Enters., Inc. v. Falmouth Marine, Inc.*, 571 N.E.2d 1363 (Mass. 1991); **Minnesota**: *Christian Builders, Inc. v.*

that when an insurer's actions are in conformity with advice given by its counsel, the insurer's actions are made in good faith.⁶¹ Thus, state of mind,

Cincinnati Ins. Co., 501 F. Supp. 2d 1224, 1232 (D. Minn. 2007); *Stan Koch & Sons Trucking, Inc. v. Great W. Cas. Co.*, 2006 WL 2331181 (D. Minn. 2006), *aff'd*, 517 F.3d 1032 (8th Cir. 2008); **Montana**: *Palmer v. Farmers Ins. Exch.*, 861 P.2d 895, 907 (Mont. 1993); **Nebraska**: *Graske v. Auto-Owners Ins. Co.*, 647 F. Supp. 2d 1105 (D. Neb. 2009); **Nevada**: *Mann v. Glens Falls Ins. Co.*, 418 F. Supp. 237, 249 (D. Nev. 1974), *rev'd on other grounds*, 541 F.2d 819 (9th Cir. 1976); **New Hampshire**: *Dumas v. Hartford Accident & Indem. Co.*, 56 A.2d 57, 61–62 (N.H. 1948); **New York**: *Gordon v. Nationwide Mut. Ins. Co.*, 285 N.E.2d 849 (N.Y. 1972); *Decker v. Amalgamated Mut. Cas. Ins. Co.*, 324 N.E.2d 552 (N.Y. 1974); **North Dakota**: *Corwin Chrysler-Plymouth, Inc. v. Westchester Fire Ins. Co.*, 279 N.W.2d 638, 646 (N.D. 1979); **Oregon**: *Rose v. Rose*, 25 P.2d 1051 (Or. 1933); **Pennsylvania**: *McAndrew v. Donegal Mut. Ins. Co.*, 56 Pa. D. & C.4th 1 (2002); **Tennessee**: *Perry v. United State Fid. & Guar. Co.*, 359 S.W.2d 1, 6–7 (Tenn. Ct. App. 1962); **Vermont**: *Wash. Elec. Coop, Inc. v. Mass. Mun. Wholesale Elec. Co.*, 894 F. Supp. 777 (D. Vt. 1995) (defense recognized generally but not in the specific context of bad faith); **Virginia**: *CUNA Mut. Ins. Soc. v. Norman*, 375 S.E.2d 724 (Va. 1989) (is a factor to be considered in assessing reasonableness), otherwise generally recognized as a defense *see, e.g.*, *Chipouras v. AJ&L Corp.*, 290 S.E.2d 859 (Va. 1982); **West Virginia**: *State ex. rel. United States Fid. & Guar. Co. v. Canady*, 460 S.E.2d 677 (w. Va. 1995); **Wisconsin**: *Berk v. Milwaukee Auto. Ins. Co.*, 15 N.W.2d 834 (Wis. 1944).

⁵⁹ For competing views of the scope of advice of counsel and its appropriateness, compare Michael Sean Quinn, Symposium, *The Advice-of-Counsel Defense: A Response to Fischer*, 72 TEX. L. REV. 1487 (1994) with James M. Fischer, Symposium, *Should Advice of Counsel Constitute a Defense for Insurer Bad Faith?*, 72 TEX. L. REV. 1447 (1994). *See generally* Nielsen, *supra* note 35, at 542–44.

⁶⁰ The term “defense” is a misnomer. The advice of counsel is typically accepted as only some evidence that, if believed, may tend to negate the claim that an insurance company engaged in bad faith. Advice of counsel is less frequently accepted as an absolute defense to a claim of bad faith. *See* Annotation, *Reliance on, or Rejection of, Advice of Counsel as Factor Affecting Liability in Action Against Liability Insurer for Wrongful Refusal to Settle Claim*, 63 A.L.R. 3d 725, 730 (1975); *cf.* *Crowe v. Lucas*, 595 F.2d 985, 992 (5th Cir. 1979) (“Reliance on advice of counsel does not serve as an absolute defense to a civil rights action. Rather, it is among the calculus of facts that a jury is to consider on the issue of good faith.”).

⁶¹ Commentators have different views regarding the necessary elements that give rise to the advice-of-counsel defense. One commentator has delineated four necessary elements of the defense: “(1) [T]he insurer sought counsel’s advice in good faith; (2) the insurer disclosed all pertinent information to its attorney (3) the insurer acted on the advice in good faith; and (4) the attorney was competent in the particular area of law and disinterested in the matter.” Nielsen, *supra* note 35, at 534–35, 543. Professor Quinn has identified criteria associated with the hiring of counsel to analyze coverage questions: (1) reasonable judgment must be exercised by the insurer in selecting experienced and competent coverage counsel; (2) sufficient facts and information must be provided for coverage counsel to render an appropriate opinion; (3) coverage counsel reasonably appears to have researched, investigated, and analyzed the issues; (4) coverage counsel communicates the opinion in a reasonable way; that is, coverage counsel’s analysis shows that objective consideration has been given to the facts and issues, any alternatives, the law, how to present arguments, and so forth; (5) the insurer thoughtfully considered the coverage opinion; and (6) the insurer largely follows the advice of counsel. Coverage opinions “are epistolary, single-spaced, and long.” Michael Sean Quinn & Kimberly Steele, *Insurance Coverage Opinions*, 36 S. TEX. L. REV. 479, 484 (1995).

Although these proposed elements may be jointly sufficient to establish the absence of bad faith, fewer elements may be necessary:

For example, it is not necessary that the insurer seek counsel's advice in good faith. The insurer might seek counsel's advice in bad faith and come into a state of good faith by having been jolted by counsel's vivid, perceptive, and well-reasoned opinion letter. It also is not necessary that the insurer disclose all pertinent information to its attorney. The insurer may not have all of the pertinent information, and might commission the lawyer to complete the investigation. Moreover, if the opinion letter came to the correct conclusion, even though missing pertinent information, if the insurer acted on the letter appropriately, and if the failure to disclose all of the pertinent information was nothing more than negligent, the opinion letter should still immunize the insurer from bad faith.

Quinn, *supra*, at 494–95 (1995). However, courts may take a contrary view. In *Bertero v. Nat'l Gen. Corp.*, 529 P.2d 608 (Cal. 1974), the court observed:

[I]f the initiator acts in bad faith or withholds from counsel facts he knew or should have known would defeat a cause of action otherwise appearing from the information supplied, that [reliance on legal advice] defense fails. Similarly, counsel's advice must be sought in good faith and "not as a mere cloak to protect one against a suit for malicious prosecution."

Id. at 616 (quoting *Walker v. Jensen*, 212 P.2d 569, 572 (Cal. Ct. App. 1949)) (citations and ellipsis omitted); *see also* *Read Corp. v. Portec, Inc.*, 970 F.2d 816, 829 (Fed. Cir. 1992) ("That an opinion is 'incompetent' must be shown by objective evidence. For example, an attorney may not have looked into the necessary facts, and, thus, there would be no foundation for his opinion. A written opinion may be incompetent on its face by reason of its containing merely conclusory statements without discussion of facts or obviously presenting only a superficial or off-the-cuff analysis.") (citation omitted); *id.* at n.9 ("An honest opinion is more likely to speak of probabilities than certainties. A good test that the advice given is genuine and not merely self-serving is whether the asserted defenses are backed up with viable proof during trial which raised substantial questions.").

Reliance on the advice of counsel must be reasonable. *See, e.g.*, *Burns v. Okla. Farm Bureau Mut. Ins. Co.*, 11 P.3d 162 (Okla. 2000) (acknowledging that reliance on advice of counsel can be a defense provided that reliance was reasonable, and, because advice of counsel was against existing case law and statutes, holding that reliance was unreasonable). This requires, in part, that the insurance company provide counsel with sufficient factual and other available, relevant information necessary to offer an accurate opinion or advice. *See, e.g.*, *Ins. Co. of N. Am. v. Smith*, 375 S.E.2d 866, 868–70 (Ga. Ct. App. 1988) (holding that where insurance company does not provide its counsel with all facts or information necessary to offer an accurate opinion or advice, it cannot invoke the defense); *see also* *Bertero v. Nat'l Gen. Corp.*, 529 P.2d 608, 616–17 (Cal. 1974) ("[I]f the initiator acts in bad faith or withholds from counsel facts he knew or should have known would defeat a cause of action otherwise appearing from the information supplied, the [reliance on legal advice] defense fails. Similarly, counsel's advice must be sought in good faith and 'not as a mere cloak to protect one against a suit.'"). Where an insurance company knows or has reason to know that the advice of its counsel is incorrect, it will not be able to avoid bad faith liability exposure by claiming reliance. *See* *Allen v. Allstate Ins. Co.*, 656 F.2d 487, 489–90 (9th Cir. 1981) (holding that insurer's reliance on obviously poor strategic advice of defense counsel did not shield it from bad faith claim). The case law has not addressed the probabilistic relationship

an essential element that an aggrieved policyholder must demonstrate in establishing insurer bad faith, can be potentially nullified.⁶² Conversely, the

regarding the advice provided by counsel and a particular justification for denying coverage. Professor Quinn has discussed this dilemma:

[I]t is not likely that there will ever be helpful law on this point. It is fairly obvious, in this context, that if a lawyer advises an insurance company that a given argument on behalf of no coverage should succeed before a court in a perfectly rational world, and if there is a sixty percent chance that it will succeed in our world, then this should constitute enough probability to defeat any suggestion of bad faith. But there are complications. How the law treats assessments of probability may depend upon whether the uncertainty derives from fact, or whether it derives from law. Obviously, in an unsettled area of the law, low probabilities as to the legal aspects of the opinion do not necessarily mean that there is no reasonable basis for the carrier's action. Further, the factual aspects of the opinion may be complicated. An insurance carrier is expected to know what happened with a high degree of certainty in the absence of conflicting factual scenarios. Obviously, if there are materially conflicting factual scenarios, probability assessments are extremely difficult. Material and credible factual disputes may, in and of themselves, constitute a reasonable basis for denying the claim. The upshot of this discussion is that there is no obvious connection between the probability that an opinion is right, and whether the insurance carrier has a reasonable basis for denying a claim. There is some relationship, to be sure, but the relationship is complex.

Quinn, *supra*, at 497–98; *see also* Clemco Indus. v. Commercial Union Ins. Co., 665 F. Supp. 816, 827–28 (N.D. Cal. 1987) (holding that the insurance carrier had not acted in bad faith when it incorrectly relied upon the definition of “occurrence” which was used to form a manifestation trigger theory in the 1970s and 1980s but was currently outdated); Hartford Accident & Indem. Co. v. Aetna Cas. & Sur. Co., 792 P.2d 749 (Ariz. 1990) (reversing prior precedent and finding that insurance company should have anticipated a change in the law).

Finally, the advice must be timely. An insurance company cannot bootstrap an incorrect coverage decision by later consulting with counsel. *See, e.g.*, Employers Mut. Cas. Co. v. Tompkins, 490 So. 2d 897, 900–05 (Miss. 1986); *see also* Beacon Nat'l Ins. Co. v. Reynolds, 799 S.W.2d 390 (Tex. App. 1990). In *Beacon*, the insurance company wrongfully denied a claim which resulted in a state board of insurance complaint. 799 S.W.2d 390. Months after denying the claim, and only in response to the board's demand, the insurance company sought counsel. *Id.* at 397. The insurance company attempted to introduce its counsel's letter at trial as proof of its reasonable claim denial. *Id.* The trial court refused to permit the letter's introduction. The court in *Beacon* concluded that the insurance company could not have relied on its counsel's advice in good faith given the timing of the letter. *Id.*

⁶² Guy O. Kornblum, *The Current State of Bad Faith and Punitive Damage Litigation in the U.S.*, 23 TORT & INS. L.J. 812, 838–39 (1988). Many courts have articulated a “fairly debatable” standard for insurer bad faith. *See, e.g.*, Davis v. Cotton States Mut. Ins. Co., 604 So. 2d 354, 358 (Ala. 1992); Deese v. State Farm Mut. Auto. Ins. Co., 838 P.2d 1265, 1268 (Ariz. 1992); Garnett v. Transamerica Ins. Servs., 800 P.2d 656, 666 (Idaho 1990); Nassen v. Nat'l States Ins. Co., 494 N.W.2d 231, 236 (Iowa 1992); Pickett v. Lloyd's (A Syndicate of Underwriting Members), 621 A.2d 445, 453 (N.J. 1993); Tokles & Son, Inc. v. Midwestern Indem. Co., 605 N.E.2d 936, 943 (Ohio 1992); Bartlett v. John Hancock Mut. Life Ins. Co., 538 A.2d 997, 1000 (R.I. 1988); *In re* Certification of Question of Law from the United States

rejection of counsel's advice⁶³ or the failure to seek legal advice when prudent claim handling dictates doing so may be evidence of bad faith.⁶⁴

Whether the advice-of-counsel defense is available may depend upon a particular jurisdiction's legal standard regarding the tort of bad faith.⁶⁵ A definitive standard of bad faith is difficult to formulate because the elements of the test change as the context changes.⁶⁶ Where the insurer's state of mind is the focus of the bad faith claim of unreasonableness, the advice-of-counsel defense may be applicable.⁶⁷ In those jurisdictions, like Arizona,⁶⁸ where the

Dist. Court, 399 N.W.2d 320, 324 (S.D. 1987); *Newhouse v. Citizens Sec. Mut. Ins. Co.*, 501 N.W.2d 1, 5–6 (Wis. 1993); *First Wyo. Bank, N.A. v. Cont'l Ins. Co.*, 860 P.2d 1094, 1101 (Wyo. 1993). For a different permutation of the "fairly debatable" standard, see *Hans Construction Co. v. Phoenix Assurance Co.*, where the court, applying Mississippi law, held that the retention and use of an independent expert gave the insurance company "arguable reasons" for denying a claim. 995 F.2d 53 (5th Cir. 1993). Conflicting opinions of the insurer's counsel and the policyholder's counsel, after each has reviewed the facts and law, may legitimize the presence of a fairly debatable dispute.

⁶³ See, e.g., *Md. Cas. Co. v. Elmira Coal Co.*, 69 F.2d 616, 620 (8th Cir. 1934); *Am. Mut. Liab. Ins. Co. v. Cooper*, 61 F.2d 446, 448 (5th Cir. 1932); *Kinder v. W. Pioneer Ins. Co.*, 42 Cal. Rptr. 394, 398–99 (Ct. App. 1965); *Thompson v. Commercial Union Ins. Co. of N.Y.*, 250 So. 2d 259, 260 (Fla. 1971); *Cotton States Mut. Ins. Co. v. Trevethan*, 390 So. 2d 724, 728 (Fla. Dist. Ct. App.).

For a cynical discussion of insurer's reliance on advice of counsel, see *Lozier v. Auto Owner's Ins. Co.*, 951 F.2d 251, 255 (9th Cir. 1991) (interpreting Arizona law).

⁶⁴ See H. Walter Croskey, *Bad Faith in California: Its History, Development and Current Status*, 26 TORT & INS. L.J. 561, 579 (1991) (opining that insurers may be under duty to consult with counsel at least in matters involving the reasonableness of settlement demands). An interesting case is *Allen v. Allstate Insurance Co.*, holding that, under California law, a jury could find that the insurance company acted in bad faith when it relied on the litigation estimate provided by counsel rather than on the litigation estimate prepared by the district manager. 656 F.2d 487, 489–90 (9th Cir. 1981). The court characterized the attorney's opinion as "wishful." *Id.* at 489.

⁶⁵ See Plitt & Plitt, *supra* note 35, 7:3, 7:4, 7:5 (where authors discuss the various bad faith standards adopted by the courts).

⁶⁶ Nielsen, *supra* note 35. Commentators have offered varying views of how many standards of bad faith exist. For an analysis of how commentators have offered various opinions on the standard to determine bad faith, see Boyarski, *supra* note 35.

⁶⁷ The link between the advice of counsel defense and the insurance company's state of mind can be seen in non-insurance cases. As an example, in *Ortho Pharmaceutical Corp. v. Smith*, the advice of counsel was advanced in a patent infringement case to negate the element of willfulness. 959 F.2d 936, 944 (Fed. Cir. 1992). The court noted that "counsel's opinion must be thorough enough . . . to instill a belief in the infringer that the court might reasonably hold the patent is invalid, not infringed, or unenforceable." In *Read Corp. v. Portec, Inc.*, the court noted that the advice of counsel defense does not lie when the legal advice is not sufficient to instill in the client a basis for reasonable belief in the accuracy and soundness of the advice. 970 F.2d 816 (Fed. Cir. 1992). The court explained:

This . . . does not mean a client must itself be able to evaluate the legal competency of its attorney's advice to avoid a finding of willfulness. The client would not need the attorney's advice at all in that event. That an opinion is "incompetent" must be shown by objective evidence. For

tort requires proof of the insurance company's actual intent to harm, the advice-of-counsel defense may undermine and diminish the required mental state necessary to establish bad faith. It must be established that the company knew or should have known that its contact created an unreasonable risk of harm to the insured.⁶⁹ Where the alleged bad faith is based on the insurance company's conduct, the advice of counsel may become irrelevant because the insurance company's conduct should be evaluated against industry standards for claims handling and claims processing.⁷⁰

3. Advice of Counsel Waiver

The scope of the waiver that occurs when the advice-of-counsel defense is raised is unclear.⁷¹ Once the insurance company interposes the advice-of-

example, an attorney may not have looked into the necessary facts, and, thus, there would be no foundation for his opinion. A written opinion may be incompetent on its face by reason of its containing merely conclusory statements without discussion of facts or obviously presenting only a superficial or off-the-cuff analysis.

Id. at 829. The court also noted:

An opinion of counsel, of course, need not unequivocally state that the client will not be held liable for infringement. An honest opinion is more likely to speak of probabilities than certainties. A good test that the advice given is genuine and not merely self-serving is whether the asserted defenses are backed up with viable proof during trial which raises substantial questions.

Id. at 829 n.9.

⁶⁸ See, e.g., *Walter v. Simmons*, 818 P.2d 214 (Ariz. Ct. App. 1991); *Trus Joist Corp. v. Safeco Ins. Co. of Am.*, 735 P.2d 125 (Ariz. Ct. App. 1986).

⁶⁹ See, e.g., *Webb v. Int'l Indem. Co.*, 599 So. 2d 1144, 1146 (Ala. 1992); see also *Walbrook Ins. Co. v. Liberty Mut. Ins. Co.*, 7 Cal. Rptr. 2d 513, 517–18 (Ct. App. 1992) (explaining that establishing good faith involves an inquiry into motive, intent, and state of mind).

⁷⁰ See *Travelers Ins. Co. v. Savio*, 706 P.2d 1258, 1275 (Colo. 1985) (“Whether an insurer has acted reasonably in denying or delaying approval of a claim will be determined on an objective basis, requiring proof of the standards of conduct in the industry.”). But see *Silberg v. Cal. Life Ins. Co.*, 521 P.2d 1103, 1109 (Cal. 1974) (“The scope of the duty of an insurer to deal fairly with its insured is prescribed by law and cannot be delineated entirely by customs of the insurance industry.”).

⁷¹ See *Conkling v. Turner*, 883 F.2d 431, 434–35 (5th Cir. 1989); *Bowne of N.Y.C., Inc. v. AmBase Corp.*, 150 F.R.D. 465, 487–89 (S.D.N.Y. 1993); *SEC v. Forma*, 117 F.R.D. 516, 523 (S.D.N.Y. 1987); *Bd. of Trs. of the Leland Stanford Junior Univ. v. Coulter Corp.*, 118 F.R.D. 532, 533 (S.D. Fla. 1987); *Russell v. Curtin Matheson Scientific, Inc.*, 493 F. Supp. 456, 458 (S.D. Tex. 1980); *Pitney-Bowes, Inc. v. Mestre*, 86 F.R.D. 444, 446–47 (S.D. Fla. 1980); *Handgards, Inc. v. Johnson & Johnson*, 413 F. Supp. 926, 929 (N.D. Cal. 1976);

counsel defense regarding a particular claim, the correspondence between the attorney and the insurance company is placed at issue and becomes discoverable.⁷² A relevant query at this juncture becomes whether reliance on the advice of counsel acts as an implied waiver of other coverage opinions prepared for the same insurance company by the same attorney (or the same law firm).⁷³ Waiver of the attorney-client privilege for one communication may in some instances permanently waive the privilege for all related communications.⁷⁴

II. THE BATTLE FOR IMPLIED WAIVER

A. Expansion of Implied Waiver

Over the past two decades, the Supreme Courts of several states have rendered significant decisions regarding implied waiver in the insurance bad faith context. While utilizing previously recognized analytic approaches to the implied waiver question, these courts set a minimal threshold for waiver

Garfinkle v. Arcata Nat'l Corp., 64 F.R.D. 688, 689-90 (S.D.N.Y. 1974); Republic Ins. Co. v. Davis, 856 S.W.2d 158, 163 (Tex. 1993).

⁷² See, e.g., Ellison v. Gray, 702 P.2d 360, 363 (Okla. 1985).

⁷³ One commentator has discussed this slippery slope:

Insurers frequently limit the number of firms they engage to provide coverage opinions for good reasons. One of them is economic. Another is that insurance coverage is a niche practice, where reservoirs of learning and practical experience are extremely valuable. In legal situations where there are recurrent themes and problems, forms are used. Many coverage attorneys who have a large number of duty-to-defend coverage opinions to deliver, develop a standardized discourse upon the [state] law of the duty-to-defend. This befits a form, and routinely appears in formal opinion letters.

If the waiver of the attorney-client privilege for a coverage opinion might lead to the implied waiver of that privilege for other letters, this matter must be carefully considered. The route from the letter produced, to the letters not produced is quite simple. The policyholder might take the deposition of the lawyer who wrote the coverage opinion and ask him which sections of the letter were canned. If the lawyer identifies several, and is then induced to go on and say that he frequently relies upon forms, the policyholder might have the right to discover redacted versions of other letters on somewhat the same topic.

Quinn, *supra* note 61, at 496.

⁷⁴ See, e.g., Duplan Corp. v. Deering Milliken, Inc., 397 F. Supp. 1146, 1161-62 (D.S.C. 1974). *But see* Commonwealth v. Goldman, 480 N.E.2d 1023, 1027 (Mass. 1985) (holding that waiver will only apply to communications relating to same object); Transamerica Title Ins. Co. v. Superior Court, 233 Cal. Rptr. 825, 828 (Ct. App. 1987) (holding that disclosure of limited number of attorney-client privilege materials will not entitle opposing party to the materials relating to advice given).

that is the functional equivalent of a *per se* waiver rule. When presented with a question of implied waiver, courts are required to make an objective determination of when the privileged party's conduct reaches a certain level of disclosure, such that fairness necessitates that the privilege be waived irrespective of whether or not the privileged person intended such waiver. For example, in Delaware, the threshold for waiver involved the insurance company's statement that it had engaged in "routine claim handling." The Delaware Supreme Court examined *in camera* the insurance company's claim file, and, on its own initiative, found sufficient facts to conclude that waiver was required.⁷⁵

⁷⁵ In *Tackett v. State Farm Fire & Cas. Ins. Co.*, an insured sued State Farm for bad faith, claiming that the insurance company had wrongfully attempted to underpay, and then delayed payment of, an underinsured motorist claim following a company "get tough" policy. 653 A.2d 254, 256–57 (Del. 1995). The "get tough" policy was established to limit an expected increase in bodily injury claims. *Id.* State Farm took the position that it had "reasonable justification" for underpayment and delay. *Id.* at 258. When pressed for an explanation of this "reasonable justification," State Farm responded by stating in an answer to an interrogatory that the claims-handling process "show[ed] a reasonable and orderly pattern of claims handling which ultimately and in due course led to the payment of the policy coverage." *Id.* The insured then sought discovery of the basis of State Farm's position. *Id.* at 257. State Farm withheld certain documents, claiming that both attorney-client privilege and the work product doctrine applied. *Id.* After an *in camera* examination of the pertinent documents, the trial court ordered their disclosure. *Id.* The Delaware Supreme Court affirmed. In doing so, the court noted that "waiver of the attorney-client privilege may be implicit, even if contrary to a party's actual intent." *Id.* at 259. The court explained that considerations of fairness and consistency are perforce included in determining waiver. "A privileged person would seldom be found to waive, if his intention not to abandon could alone control the situation. There is always also the objective consideration that when his conduct touches a certain point of disclosure, fairness requires that his immunity shall cease whether he intended the result or not." *Id.*

The court noted that a party cannot compel an insurance company to surrender the protections of the attorney-client privilege simply by bringing a bad faith lawsuit. *Id.* (citing generally *Hoescht Celanese Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, 623 A.2d 1118, 1125 (Del. Super. Ct. 1992)). "Where, however, an insurer makes factual assertions in defense of a claim which incorporate[s], expressly or implicitly, the advice and judgment of its counsel, [it] cannot deny opposing party 'an opportunity to uncover the foundation for those assertions in order to contradict them.'" *Id.*

The court in *Tackett* concluded that the insured had met the exacting standards for a finding of implied waiver of the attorney-client privilege. *Id.* When State Farm was required to set forth the reasons to support its claim of reasonable justification for non-payment, it relied upon the affidavit of one of its claims superintendents who was responsible for handling the *Tackett* claim. *Id.* at 260. The affidavit cited in relevant part the following:

Based on my experience of ten years, this claim was handled routinely, without any undue delay, with no bad faith on the part of State Farm Mutual Automobile Insurance Company or its employees. Furthermore, no reason existed to handle this claim unlike any other claim that comes through this office, and based on my experience, State Farm handled this

claim as expediently as any other claims office in this local [sic] would have handled a similar claim.

Id. at 258. Reviewing these facts the court in *Tackett* observed:

Once State Farm alleged particularized facts that implicitly relied upon communications with counsel contained in the Tackett's file, the first prong of the waiver analysis was satisfied—disclosure of otherwise protected facts relevant to a particular subject matter relied upon as a defense. . . . Here, once State Farm alleged a routine handling of the Tacketts' claim and suggested that any delay was attributable to inaction on the part of the insured, the Tacketts could challenge those allegations only with a full showing of the facts contained in the claim file. To rule otherwise would permit State Farm to gain the inference that, not only was the claim handled routinely, but the routine analysis of the claim supported the delay in payment. Fairness requires that assertions of fact be tested by disclosure. Without access to the complete file, the Tacketts would be unable to challenge State Farm's assertions and would be forced to accept as true its claim of routine handling.

Id. at 260. The *Tackett* court, therefore, recognized that “[a] party cannot force an insured to waive the protections of the attorney-client privilege merely by bringing a bad faith claim.” *Id.* at 259. The court also emphasized that the standard for waiver is “exacting” and warned that its holding “does not create a rule of *per se* waiver of the attorney-client privilege in insurance bad faith cases.” *Id.* at 259–60.

The court expressly rejected the notion that it was creating a rule of *per se* waiver of the attorney-client privilege in insurance bad faith cases. *Id.* The court observed, however, that where an insurance company “makes factual representations which implicitly rely upon legal advice as justification for non-payment of claims, the insurer cannot shield itself from disclosure of the complete advice of counsel relevant to the handling of the claim.” *Id.* At issue in *Tackett* was the advice State Farm received from its outside counsel, which was contained within the State Farm claim file. In its internal evaluation report, a State Farm claims representative had evaluated the Tacketts' settlement demand and supporting documentation, and concluded that the claim was valued at between \$45,000 and \$50,000. *Id.* State Farm established a \$50,000 reserve on the claim but “ordered an independent medical examination (IME) because of a suspicion that a prior accident contributed to Mrs. Tackett's condition.” *Id.* at 257. State Farm's outside counsel, however, reported that “the possible benefit of an independent medical examination is questionable.” *Id.* Outside counsel also advised the State Farm claims representative that “the arbitrator would probably find the [Tacketts'] claim had a value of \$50,000 or more even though it had some obvious disabilities.” *Id.* The doctor performing the IME “reported to State Farm that Mrs. Tackett does not have any impressive neurological signs,” but that the accident in question did trigger a prior back condition. *Id.* As a result of the IME findings, State Farm “authorized payment of \$30,000 with an initial offer of \$20,000.” *Id.* The settlement offer was rejected, and counsel for the insured repeated a prior demand for the policy limits. *Id.* Shortly thereafter, the file was transferred to a new claims superintendent. *Id.* The new claims superintendent concluded, after a full review of the claims file, that State Farm had undervalued the claim. Therefore, a written offer of policy limits was sent to the Tackett's attorney. *Id.* Although the court determined that State Farm had waived the attorney-client privilege, the finding of waiver did not automatically relinquish the protection provided by the work product doctrine. *Id.* at 260. Recognizing the landscape of this debate, the court rejected the contention that

In Ohio, as in Delaware, the court examined *in camera* the insurance company's claim file. If the court finds in its review any attorney-client privileged communications that show a lack of good faith, those communications are "wholly unworthy of the protections afforded by any claimed privilege." In Ohio, the mere filing of a bad faith case entitles a court to an *in camera* review of the insurance company's attorney-client privileged communications.⁷⁶

Federal Rule of Civil Procedure 26(b)(3) grants absolute immunity to opinion work product. Thus, the court declined to read the mandatory language of the rule as establishing an impenetrable barrier to discovery of opinion work product. *Id.* at 262.

⁷⁶ In a split decision, the Ohio Supreme Court in *Boone v. Vanliner Insurance Co.*, , declared that "in an action alleging bad faith denial of insurance coverage, the insured is entitled to discover claims file materials containing attorney-client communications related to the issue of coverage that were created prior to the denial of coverage." 744 N.E.2d 154, 158 (Ohio 2001).

In reaching its decision that claims file materials showing an insurance company's "lack of good faith in denying coverage are unworthy of protection," the court summarily dismissed the argument that its holding would discourage insurance companies from seeking legal advice. *Id.* at 157. The court rejected this argument "because it assumes that insurers will violate their duty to conduct a thorough investigation by failing, when necessary, to seek legal counsel regarding whether an insured's claim is covered under the policy of insurance, in order to avoid the insured later having access to such communications, through discovery." *Id.*

The court in *Boone* limited its holding to only attorney-client communications and work product documents created prior to the denial of coverage. *Id.* at 158. Although the lack of a good faith effort to settle involves continuing conduct throughout the entire claims process, "a lack of good faith in determining coverage involves conduct that occurs when assessment of coverage is being considered." *Id.*

Three Justices of the Ohio Supreme Court dissented in *Boone*. The dissent began its analysis by stating its allegiance to the public policy considerations underlying the attorney-client privilege; that is, the encouragement of "full and frank communication between attorneys and their clients" to promote "broader public interests in the observance of law and the administration of justice." *Id.* at 160. The dissent observed that there are already safeguards in place that prevent abuse of the attorney-client privilege. *Id.* Particularly, communications in furtherance of a crime or fraud are not deserving of protection. *Id.* By adopting its "unworthy of protection" rationale, however, the majority likened communications in furtherance of civil fraud with an insurance company's communications with its attorney before the denial of coverage, without recognizing that a conceptual difference exists between bad faith and civil fraud. *Id.*

[B]ad faith by an insurer is conceptually different from fraud. Bad faith denial of insurance coverage means merely that the insurer lacked a "reasonable justification" for denying a claim. In contrast, an actionable claim of fraud requires proof of a false statement made with intent to mislead. Proof of an insurer's bad faith in denying coverage does not require proof of any false or misleading statements; an insurer could, for example, act in bad faith by denying coverage without explanation. Because bad faith is not inherently similar to fraud, there is no reason why an allegation of bad faith should result in an exception to the attorney-client privilege akin to the crime-fraud exception.

Id. (citations omitted).

The dissent addressed what it perceived was the “startling” practical effect of the majority’s holding:

The majority’s holding is also startling for its practical effect. After today’s decision, an insured need only *allege* the insurer’s bad faith in the complaint in order to discover communications between the insurer and the insurer’s attorney. Not even an allegation of the crime-fraud exception’s applicability carries such an absolute entitlement to discovery of attorney-client communications. In order to overcome the attorney-client privilege based on the crime-fraud exception, a party must demonstrate “a factual basis for a showing of probable cause to believe that a crime or fraud has been committed and that the communications were in furtherance of the crime or fraud.” The rule created today requires no similar *prima facie* showing of bad faith before an insured is entitled to discover attorney-client communications of the insurer. The result of the majority’s decision is a categorical exception to the attorney-client privilege applicable in *any* case alleging a bad-faith denial of insurance coverage. This is a sweeping exception that a number of courts have refused to adopt.

Id. at 160–61 (citation omitted).

Finally, the dissent found that the majority’s holding that insurance company communications were unworthy of the attorney-client privilege was inconsistent with the purpose of the privilege. *Id.* at 161. The dissent stated:

[T]he privilege is designed to encourage open discussion between attorney and client, so as to promote the observance of the law and allow an attorney to adequately advise the client. With today’s decision, the majority declares that an insurer’s consultation with an attorney prior to a denial of coverage does not fall within this purpose. The rule laid down today *assumes that an insurer will always have some sinister intent to act in bad faith when it discusses a coverage decision with its attorney.* But the majority overlooks the fact that an insurance company may consult with legal counsel to obtain legal advice about a coverage decision. An insurance company’s retention of legal counsel to interpret the policy, investigate the details surrounding the damage, and to determine whether the insurance company is bound for all or some of the damage, is a classic example of a client seeking legal advice from an attorney. These types of communications further the purpose of the attorney-client privilege and should be protected in the same manner as a communication by any other client seeking legal advice from an attorney.

Id. (quotation and citation omitted). Insurance companies “should be free to seek legal advice in cases where coverage is unclear without fearing that the communications necessary to obtain that advice will later become available” to a dissatisfied insured. *Id.* (citing *Aetna Cas. & Sur. Co. v. S.F. Superior Court*, 200 Cal. Rptr. 471, 475 (Ct. App. 1984); *State ex rel. United States Fid. & Guar. Co. v. Mont.* Second Judicial Dist. Court, 783 P.2d 911, 916 (Mont. 1989)). The majority’s holding would have a chilling effect on an insurance company seeking legal advice. *Id.* The uninhibited flow of information between the insurance company and its attorney facilitates the accurate assessment of coverage. *Id.*

More recently, in *Cedell v. Farmers Insurance Co. of Washington*, the Supreme Court of Washington held that there is presumptively no attorney-client privilege in “first party insurance claims by insured’s claiming bad faith in the handling and processing of claims, other than UIM claims.”⁷⁷ In *Cedell*, Cedell submitted a claim to Farmers after his home burned down.⁷⁸ Farmers hired attorney Ryan Hall to provide coverage advice and also to investigate the claim.⁷⁹ Farmers delayed paying the claim, prompting Cedell to sue Farmers for bad faith.⁸⁰ In the course of discovery in the bad faith suit, Cedell sought to compel production of communications between Farmers and attorney Hall.⁸¹ Farmers objected on the ground of privilege, claiming that attorney Hall was retained to give legal advice on coverage issues.⁸²

The Washington Supreme Court rejected Farmers’ claim of privilege. With regard to discovery in bad faith cases generally, the court observed:

The insured needs access to the insurer’s file maintained for the insured in order to discover facts to support a claim of bad faith. Implicit in an insurance company’s handling of claim is litigation or the threat of litigation that involves the advice of counsel. To permit a blanket privilege in insurance bad faith claims because of the participation of lawyers hired or employed by insurers would unreasonably obstruct discovery of meritorious claims and conceal unwarranted practices.⁸³

Because of this need, the court held that the insured is entitled “to broad discovery, including, presumptively, the entire claims file.”⁸⁴ More specifically, the court stated that it “start[s] from the presumption that there is no attorney-client privilege relevant between the insured and the insurer in the claims adjusting process.”⁸⁵ The insurer may overcome the presumption of discoverability by showing that “its attorney was not engaged in the quasi-fiduciary tasks of investigating and evaluating or processing the claim, but was instead providing the insurer with counsel as to its own potential liability; for example, whether or not coverage exists under the law.”⁸⁶

⁷⁷ 295 P.3d 239, 246 (2013).

⁷⁸ *Id.* 241.

⁷⁹ *Id.* at 242.

⁸⁰ *Id.* at 241.

⁸¹ *Id.* at 243.

⁸² *Id.*

⁸³ *Cedell*, 296 P.3d at 244–45.

⁸⁴ *Id.* at 247.

⁸⁵ *Id.* at 698–99, 295 P.3d at 246.

⁸⁶ *Id.* at 246.

“Upon such a showing, the insurance company is entitled to the redaction of communications from counsel that reflected the mental impressions of the attorney to the insurance company, unless those mental impressions are directly at issue in their quasi-fiduciary responsibilities to their insured.”⁸⁷

It is significant to note that while *Cedell* stated that this presumption applied to “first party insurance claims by insured’s,” federal courts in Washington applying *Cedell* have held that the presumption applies in third-party bad faith cases as well.⁸⁸

In *Stewart Title Guaranty Co. v. Credit Suisse, Cayman Islands Branch*,⁸⁹ the United States District Court for the District of Idaho adopted the reasoning of *Cedell*. In *Stewart Title*, Credit Suisse was insured under a policy issued by Stewart Title.⁹⁰ Upon being sued, Credit Suisse tendered the defense of the litigation to Stewart Title, which it accepted.⁹¹ Stewart Title hired attorneys at the law firm of Fabian Clendenin to represent Credit Suisse and hired attorneys at the law firm of Faegre Benson to investigate the subject of the lawsuit and to provide advice on coverage.⁹² Credit Suisse thereafter sought to compel production of communications between Stewart Title and the attorneys at Faegre Benson.⁹³ Stewart Title objected, claiming that the communications were protected by the attorney-client privilege and the work product doctrine.⁹⁴

Following the reasoning of the Washington Supreme Court in *Cedell*, the court held that Faegre performed the same mixed role performed by the attorney in *Cedell*.⁹⁵ Specifically, at times, Faegre was providing coverage advice to Stewart Title, and at other times it was investigating claims alongside Credit Suisse’s counsel from Fabian Clendenin. When counsel are providing such mixed services, the Washington Supreme Court wisely counseled that “insurers may wish to set up and maintain separate files so as not to comingle different functions.”⁹⁶

While the court stated that there was no Idaho Supreme Court decision addressing the issues faced by *Cedell*, Idaho’s Joint Client exception to the

⁸⁷ *Id.*

⁸⁸ *Carolina Cas. Ins. Co. v. Omeros Corp.*, Case No. C12-287-RAJ, 2013 WL 1561963, at *3 (W.D. Wash. Apr. 12, 2013) (finding *Cedell* applicable to third-party insurance actions because “[t]he *Cedell* court grounded its ruling in the quasi-fiduciary duty of an insurer to its insured, along with the public policy interest in regulating the business of insurance”); *Everest Indem. Ins. Co. v. QBE Ins. Corp.*, 2:13-CV-00828-RSM, 2013 WL 5885277 (W.D. Wash. Oct. 31, 2013) (finding *Cedell* applicable to “third-party bad faith actions”).

⁸⁹ 2013 WL 1385264 (D. Idaho 2013).

⁹⁰ *Id.* at *1.

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Stewart*, 2013 WL 1385264 at *4.

⁹⁶ *Id.*

attorney/client privilege found in Idaho Rule of Evidence 502(d) indicated that Idaho would follow the same reasoning as was espoused by the Washington Supreme Court in *Cedell*.⁹⁷ Idaho Rule of Evidence 502(d) states that “there is no privilege under this Rule . . . [a]s to a communication relevant to a matter of common interest between or among two or more clients if the communication was made by any of them to a lawyer retained or consulted in common, when offered in an action between or among any of the clients.”⁹⁸ The court noted that while no published Idaho decision applies this exception in a bad faith action, “nearly identical language has been applied to bad faith actions by other authorities.”⁹⁹ In the present case, the court held that “Idaho’s Joint Client exception would most clearly apply to communications between Stewart Title and the attorneys at Fabian Clendenin, retained to represent Credit Suisse. And where Faegre attorneys worked alongside Fabian Clendenin attorneys to investigate lien claims, the Joint Client exception would also apply.”¹⁰⁰ Thus, the court held that “Idaho’s Joint Client exception aligns with the holding in *Cedell*, and demonstrates that if the Idaho Supreme Court were faced with the facts of this case, they would apply the holding in *Cedell* to resolve the case.”¹⁰¹

Applying *Cedell’s* analysis, the court held that Credit Suisse was presumptively entitled to Stewart Title’s entire claims file.¹⁰² The court stated that Stewart Title may “overcome this presumption by identifying—in camera—documents and/or communications where Faegre was not engaged in the quasi-fiduciary tasks of investigating and evaluating the claim.”¹⁰³ Upon such a showing, Stewart Title “is entitled to the redaction of communications from [Faegre] that reflected the mental impressions of [Faegre] to [Stewart Title], unless those mental impressions are directly at issue in their quasi-fiduciary responsibilities to [Credit Suisse].”¹⁰⁴ The court therefore ordered Stewart Title to review the thousands of pages of documents in the challenged documents and submit to the Court for an in camera review those documents at which time the court would determine,

⁹⁷ *Id.* at *5.

⁹⁸ *Id.*

⁹⁹ See 24 CHARLES ALAN WRIGHT AND KENNETH W. GRAHAM, FEDERAL PRACTICE AND PROCEDURE § 5505 (1986). This treatise reaches the conclusion that the Joint Clients exception was designed to specifically apply to first party bad faith actions between an insured and an insurer. *Id.* at p. 551.

¹⁰⁰ *Stewart Title*, 2013 WL 1385264 at *5.

¹⁰¹ *Id.*

¹⁰² *Id.* at *6.

¹⁰³ *Id.*

¹⁰⁴ *Id.*

under the standards in enunciated previously, which should be protected and which should be disclosed.¹⁰⁵

B. Stemming The Tide Of Implied Waiver: The Intermediate Court Battle in Arizona

The recent precedents discussed above represent a trend in the law regarding implied waiver that would have a chilling effect upon attorney-client communications in the insurance context. The Supreme Court in Arizona appeared to have been an early adopter of this trend in *State Farm Mutual Automobile Insurance Co. v. Lee*.¹⁰⁶ However, the Arizona Supreme Court's ruling on implied waiver in *Lee* was followed by two more recent and conflicting Intermediate Appellate decisions. Each of these decisions is discussed below in order to show how, in at least one jurisdiction, the tide toward a presumptive or *per se* waiver rule may be receding.

1. *State Farm v. Lee* (Supreme Court)

In *State Farm v. Lee*,¹⁰⁷ the Arizona Supreme Court explored the contours of the "at issue" implied waiver doctrine as it related to the attorney-client privilege.¹⁰⁸

¹⁰⁵ *Id.*

¹⁰⁶ 13 P.3d 1169 (Ariz. 2000).

¹⁰⁷ *Id.*

¹⁰⁸ Arizona law provides that information contained in communications between attorney and client in the context of the attorney client relationship are confidential if maintained in confidence. ARIZ. REV. STAT. § 12-2234 (2003). Generally, the Arizona courts "construe privilege statutes narrowly because they exclude relevant evidence and impede the fact-finder's search for the truth." *Blazek v. Superior Court*, 869 P.2d 509, 511 (Ariz. Ct. App. 1994); *see also Church of Jesus Christ of Latter-Day Saints v. Superior Court*, 764 P.2d 759, 764 (Ariz. Ct. App. 1988). This is consistent with the law of other jurisdictions. *See, e.g., United States v. Mierzwicki*, 500 F. Supp. 1331, 1334 (D. Md. 1980) ("Any examination of the attorney-client privilege should begin with the observation that privileges are not favored in the law and are seen as a hindrance to litigation."); *League v. Vanice*, 374 N.W.2d 849, 856 (Neb. 1985); *Cohen v. Jenkintown Cab Co.*, 357 A.2d 689, 693-94 (Pa. Super. Ct. 1976); MCCORMICK ON EVIDENCE § 77, at 156 (2d ed. 1972) (privilege serves only to "shut out the light").

Under Arizona law, the attorney-client privilege belongs to the client and serves "to encourage free exchange of information between the attorney and the client to promote the administration of justice." *State v. Holsinger*, 601 P.2d 1054, 1058 (Ariz. 1979). The privilege encourages clients to tell their lawyers the truth. "Unless the lawyer knows the truth, he or she cannot be of much assistance to the client." *Samaritan Found. v. Goodfarb*, 862 P.2d 870, 874 (Ariz. 1993). Thus, the privilege under Arizona law is "central to the delivery of legal services." *Id.* The privilege, however, may be waived either expressly or implicitly if the person that holds the privilege voluntarily discloses information within its purview. *Danielson v. Superior Court*, 754 P.2d 1145, 1148-49 (Ariz. Ct. App. 1986).

In *Lee*, a class representing approximately one thousand State Farm insureds brought suit against State Farm contesting the systematic denial of uninsured and underinsured motorist coverage stacking claims.¹⁰⁹ Between 1988 and 1995 State Farm rejected stacking¹¹⁰ claims in single loss situations. It was State Farm's practice to issue separate insurance policies covering each vehicle in a multiple vehicle household.¹¹¹ When losses occurred for which there were insufficient insurance funds to compensate the insured from the other tortfeasor's insurance policies, the State Farm class members presented underinsured motorist claims to State Farm for additional compensation.¹¹² State Farm rejected these claims based on the wording of A.R.S. § 20-259.01(H),¹¹³ which permitted insurance companies to use anti-stacking policy clauses to eliminate stacking.¹¹⁴ In 1995, however, the Arizona Supreme Court, in *State Farm Mutual Insurance Co. v. Lindsey*,¹¹⁵ determined that the anti-stacking language used by State Farm was legally insufficient to prevent stacking.¹¹⁶

¹⁰⁹ *Lee*, 13 P.3d at 1171.

¹¹⁰ There are two types of stacking in the automobile insurance context. Intra-policy stacking can occur when the stated per person policy limits are multiplied by the number of vehicles covered by the policy. Courts in other jurisdictions have permitted this type of stacking. *See, e.g.*, *Allstate Ins. Co. v. Randall*, 753 F.2d 441 (5th Cir. 1985) (applying Mississippi law); *Am. Ins. Co. v. Takahashi*, 575 P.2d 881 (Haw. 1978); *Chaffee v. U.S. Fid. & Guar. Co.*, 591 P.2d 1102, 1105 (Mont. 1979); *Allstate Ins. Co. v. Maglish*, 586 P.2d 313, 314–15 (Nev. 1978); *Am. States Ins. Co. v. Milton*, 573 P.2d 367, 368 (Wash. 1978). However, the Arizona courts do not permit this type of stacking. *See, e.g.*, *Hampton v. Allstate Ins. Co.*, 616 P.2d 78 (Ariz. Ct. App. 1980). The court in *Hampton* rejected the insured's argument that stacking should be permitted because a separate premium was charged for the coverage available on each vehicle. In responding to this argument, the court found that the individual premium charge was justified because of the additional risk associated with covering multiple vehicles. *Id.* at 80–81.

Interpolicy stacking arises in multi-policy situations. "Other insurance" clauses are typically used by the insurance industry to eliminate the stacking of coverages in multiple-policy situations. The typical anti-stacking clause contains two essential provisions. First, the policy requires coverage to be prorated. Second, the policy establishes a total coverage limit available for the loss to which the prorated percentage applies. Unless the policy places a limit on the amount of the loss, stacking can occur. *See, e.g.*, *Barrett v. Farmers Ins. Grp.*, 220 Cal. Rptr. 135 (Ct. App. 1985); *Menke v. Country Mut. Ins. Co.*, 386 N.E.2d 1133 (Ill. App. Ct. 1979); *Bishop v. Washington*, 480 A.2d 1088 (Pa. Super. Ct. 1984).

¹¹¹ *Lee*, 13 P.3d at 1171.

¹¹² *Id.*

¹¹³ ARIZ. REV. STAT. § 20-259.01(H) (2003) (formerly ARIZ. REV. STAT. § 20-259.01(F)).

¹¹⁴ *Lee*, 13 P.3d at 1171.

¹¹⁵ 897 P.2d 631 (Ariz. 1995).

¹¹⁶ In *Lindsey*, the court held that the provisions of Ariz. Rev. Stat. § 20-259.01(F) (now, subsection (H)) are not self-executing because the wording of the statute is merely permissive. 897 P.2d at 633. To be effective, "[a]dditional policy language is needed to incorporate the limitation into a policy." *Id.*

The class member insureds argued that even before the court's decision in *Lindsey*, State Farm knew the anti-stacking clause was invalid.¹¹⁷ Therefore, State Farm acted in bad faith when, from 1988 to 1997, State Farm denied its insureds' requests to stack coverage.¹¹⁸ State Farm maintained that until *Lindsey* was decided, it had acted reasonably in interpreting A.R.S. § 20-259.01(H) in conjunction with its policy language in order to preclude stacking.¹¹⁹

During discovery State Farm acknowledged having received the advice of counsel regarding whether to pay or reject class member claims.¹²⁰ State Farm asserted the attorney-client privilege regarding the production of counsel's coverage analysis, but declared that it would not advance a good faith defense based on the advice of counsel.¹²¹ The trial court accepted State Farm's position that it would not advance an advice-of-counsel defense directly.¹²² Thus, State Farm could not rely upon the objective reasonableness of its decision to deny stacking.¹²³ State Farm did "assert that

The importance of having appropriate court "anti-stacking" language in the policy was demonstrated in *State Farm Mutual Automobile Ins. Co. v. Herron*, where the insurance company argued that stacking was prohibited under Arizona law generally: "[A]ppellee argues that the law of Arizona does not allow 'stacking' of uninsured motorist coverages and that appellant may not collect an additional \$35,000 under the provisions of his own policy because this would constitute 'stacking.'" 599 P.2d 768, 771 (Ariz. 1979). In rejecting this argument, the court stated: "We recognized the elementary principle of contract law that if one wishes to buy more coverage, he may do so and the extent of that coverage will depend on the terms of the contract." *Id.* The "other insurance" clause in *Herron* was an excess type and did not preclude stacking. Indeed, the court in *Herron* acknowledged that the case did not involve a stacking question. *Id.* at 772. The court gave effect to the excess clause. *Id.* at 771-72.

¹¹⁷ *Lee*, 13 P.3d at 1172.

¹¹⁸ *Id.*

¹¹⁹ *Id.* State Farm argued that its position rejecting stacking was not unreasonable because of the unsettled status of Arizona law. State Farm cited *Giannini v. State Farm Mut. Auto. Ins. Co.*, 837 P.2d 1203, 1206 (Ariz. Ct. App. 1992) (Division One holding that anti-stacking provision in State Farm's policy sufficient to invoke the statute and precluded stacking) and *State Farm Mut. Auto. Ins. Co. v. Lindsey*, 885 P.2d 144, 150 (Ariz. Ct. App. 1994) (Division One again holding that anti-stacking provision in State Farm's policies "plainly encompass[es] the statute's] limitation on stacking"). *But see* *State Farm Mut. Auto. Ins. Co. v. Berardi*, No. 2 CA-CV-93-0051 (Ariz. Ct. App. 1993) (Mem.) (Division Two holding that State Farm was required to permit stacking of policyholder's UM/UIM claims, resulting in State Farm allowing stacking for policyholders residing within Division Two's boundaries).

¹²⁰ *Lee*, 13 P.3d at 1172.

¹²¹ *Id.* (involving documents with communications between 15 different law firms.).

¹²² *Id.* at 1173.

¹²³ *Id.* Like most states, Arizona employs a two-pronged test for insurance bad faith that has an objective and subjective component. *See Haney v. ACE Am. Ins. Co.*, 2015 WL 58670, *3 (D. Ariz. Jan. 5, 2015). Specifically, the Arizona courts have held that "[t]here are two elements to the tort of bad faith: (1) that the insurer acted unreasonably toward its insured, and (2) that the insurer acted knowing that it was acting unreasonably or acted with such reckless disregard that such knowledge may be imputed to it." *Miel v. State Farm Mut. Auto. Ins. Co.*, 912 P.2d 1333, 1339 (Ariz. Ct. App. 1995) (citing *Trus Joist Corp. v. Safeco Ins. Co. of Am.*,

its claims managers held a subjective good-faith belief that their decision to deny stacking was reasonable under what they knew about the state of the law as it then existed.”¹²⁴ Because State Farm avowed to the trial court “that it would defend in part ‘on what its decision makers knew, thought and did,’” the trial court determined “that what State Farm knew included advice of counsel because that ‘was a part of the basis for’ the defense.”¹²⁵ The trial court held, therefore, “that State Farm impliedly waived the privilege when it *put at issue* the subjective *legal* knowledge of its managers after they sought and received legal advice.”¹²⁶

The Arizona Court of Appeals accepted jurisdiction and vacated the trial court’s discovery order.¹²⁷ The court of appeals held that State Farm had not impliedly waived the privilege or put its attorney-client communications at issue because it had only refuted plaintiff’s allegations, and had not injected privilege-related issues into the case.¹²⁸ As a threshold matter, the court adopted¹²⁹ the three-prong test for “at issue” implied waivers set forth in *Hearn v. Rhay*.¹³⁰

735 P.2d 125, 134 (Ariz. Ct. App. 1986)); *see also* *Acosta v. Phx. Indem. Ins. Co.*, 153 P.3d 401, 404 (Ariz. Ct. App. 2007). In addressing the objective inquiry, *i.e.*, did the insurer act unreasonably toward the insured, it has been held that “[u]nreasonable actions include failure to “immediately conduct an adequate investigation,” failure to “act promptly in paying a legitimate claim,” “forc[ing] an insured to go through needless adversarial hoops to achieve its rights under the policy,” “lowball[ing] claims,” and similar conduct. *Zilisch v. State Farm Mut. Auto. Ins. Co.*, 995 P.2d 276, 280 (Ariz. 2000). As for the subjective question of the insurer’s intent, “[t]he ‘intent’ required here is an ‘evil hand’—the intent to do the act. . . . [T]he insurer must intend the act or omission and must form that intent without reasonable or fairly debatable grounds. But an ‘evil mind’ is not required; the insurer need not intend to harm the insured.” *Rawlings v. Apodaca*, 726 P.2d 565, 576 (Ariz. 1986). Intent is established if the insurer lacked a “founded belief” that its conduct was permissible. *Id.* “The founded belief is absent when the insurer either knows that its position is groundless or when it fails to undertake an investigation adequate to determine whether its position is tenable.” *Id.*

¹²⁴ *Lee*, 13 P.3d at 1173

¹²⁵ *Id.*

¹²⁶ *Id.* (emphasis added).

¹²⁷ In discovery matters, Arizona trial judges have broad discretion and their decisions are reviewed only for abuse. *See Brown v. Superior Court*, 670 P.2d 725, 729 (Ariz. 1983).

¹²⁸ *Lee*, 13 P.3d at 1173.

¹²⁹ *Id.*

¹³⁰ 68 F.R.D. 574, 581 (E.D. Wash. 1975). *Hearn* involved a prisoner plaintiff’s claim that the government had violated his constitutional rights by confining him to a mental health unit without a hearing or review. *Id.* at 577. The government asserted the defense of qualified immunity, alleging that it acted in the good faith belief that its actions did not violate any clearly established constitutional right. *Id.* The government expressly disavowed reliance on advice of counsel. *Id.* at 581 n.5. Nonetheless, the *Hearn* court found that the assertion of the defense was an affirmative act that made the government’s communication with counsel relevant, and the denial of access to those communications would have been manifestly unfair to the plaintiff. *Id.* at 581–82.

The Arizona Supreme Court rejected the view that implied waiver will be found only when the party advances an express claim of reliance on advice of counsel.¹³¹ The court noted that if the client's intent not to abandon the privilege could alone control the situation, then waiver would seldom be found.¹³² Thus, the determination of whether implied waiver has occurred also includes an objective consideration: when one's conduct reaches a "certain point of disclosure," fairness demands that the privilege be waived regardless of the privileged person's intentions.¹³³ Turning to this inquiry, the court recognized that there was "a great deal of confusion" in this area, and then described various approaches used in other jurisdictions:

At least three approaches to the waiver [issue exists]: the first approach radically holds that, whenever a party seeks judicial relief, the party impliedly waives the privilege. A second approach would attempt to balance the need for disclosure against the need for protecting the confidentiality of the client's communications on the facts of the individual case. The third approach avoids the extremes of an over-inclusive automatic-waiver or an indeterminate, *ad hoc* balancing approach. Instead, it focuses on whether the client asserting the privilege has injected the issue into the litigation and whether the claim of privilege, if upheld, would deny the inquiring party access to proof needed fairly to resist the client's own evidence on that very issue.¹³⁴

Privilege is waived under the first two views "whenever a client's mental state was in issue."¹³⁵ The court observed that this approach was "dubious absent acceptance of the Benthamite principle that the privilege ought to be overthrown to facilitate the search for truth."¹³⁶ The court in *Lee* adopted the third, intermediate approach as being least restrictive.¹³⁷ By adopting this approach, the court rejected "the idea that the mere filing of a bad faith action, the denial of bad faith, or an affirmative claim of good faith" constitutes an implied waiver of the privilege.¹³⁸ Waiver will occur,

¹³¹ *Lee*, 13 P.3d at 1178.

¹³² *Id.* (citing 8 JOHN H. RIDGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2327, at 636 (J. McNaughton rev. ed. 1961)).

¹³³ *Id.* The court in *Lee* questioned where that "certain point" is reached in which fairness requires waiver. *Id.* at 1178-79.

¹³⁴ *Id.* at 1179 (citing RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 80 cmt. b (1998)).

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ *Lee*, 13 P.3d at 1179.

¹³⁸ *Id.*

however, if the privileged party has asserted a claim or defense, “such as the reasonableness of its evaluation of the law,” which would include, necessarily, the information received from its counsel.¹³⁹ At that point the privileged party has injected “the issue of advice of counsel into the litigation to the extent that recognition of the privilege would deny the opposing party access to proof without which it would be impossible for the fact finder to fairly determine the issue raised by the party.”¹⁴⁰

The court in *Lee* concluded that the “certain point” at which fairness requires waiver is reached is when “the party asserting the privilege claims its conduct was proper and permitted by law and based in whole or in part on its evaluation of the state of the law.”¹⁴¹ When this occurs, the privileged party’s “knowledge about the law is vital, and the advice of its counsel is highly relevant to the legal significance” of the privileged party’s conduct.¹⁴² In this situation, “the truth cannot be found absent exploration of the issue.”¹⁴³ A contrary finding would result in “unfairness not just to the party opposing assertion of the privilege but to the entire [judicial] system.”¹⁴⁴

Preemptively, the majority focused on Justice Martone’s dissenting opinion. The court agreed with the dissent that it was the plaintiffs who had “raised the subjective bad faith of State Farm’s employees,” but noted that the waiver of the privilege was not based on State Farm’s denial of that allegation.¹⁴⁵ Further, State Farm’s affirmative assertion of good faith did not waive the privilege.¹⁴⁶ The court then identified the basis for its decision:

It is, rather, State Farm’s affirmative assertion that its actions were reasonable because of its evaluation of the law, based on its interpretation of the policies, statutes, and case law, and because of what its personnel actually knew and did.

But what its personnel did, presumably among other things, was to consult counsel and obtain counsel’s views of the meaning of the policies, statutes, and case law. Having asserted that its actions were reasonable because of what it knew about the applicable law, State Farm has put in issue the information it obtained from counsel.¹⁴⁷

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ *Lee*, 13 P.3d at 1179.

¹⁴⁴ *Id.* at 1179 n.5.

¹⁴⁵ *Id.* at 1180.

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 1180–81.

Although State Farm did not specifically state that legal “advice was relevant to the legal significance of its conduct,”¹⁴⁸ an assertion that the insurance company relied upon advice of counsel would be the “functional equivalent to an express advice-of-counsel defense.”¹⁴⁹ The court noted that “most sophisticated litigants [would] know better than to dig that hole for themselves.”¹⁵⁰ The concept of implied waiver does not “require such a magical admission,” nor does it require the court to “accept as dispositive the client’s assertion that it did not rely on the advice it received.”¹⁵¹ The majority found that a contrary holding would make “a mockery of the law.”¹⁵² On the one hand, an insurance company could argue “that it acted reasonably because it made a legal evaluation from which it concluded that the law permitted it to act in a certain manner,”¹⁵³ while, on the other hand, it would allow that same insurance company “to withhold from its adversary and the factfinder information it received from counsel on that very subject.”¹⁵⁴ In that situation, the “sword and shield metaphor would truly apply.”¹⁵⁵

“By asserting the subjective evaluation and understanding of its personnel about the state of the law on stacking, State Farm has affirmatively injected the legal knowledge of its claims managers into the litigation and put the extent, and thus the sources, of this legal knowledge at issue.”¹⁵⁶ The insurance company will be precluded from testifying “that they investigated

¹⁴⁸ *Id.* at 1181.

¹⁴⁹ *Lee*, 13 P.3d at 1181.

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² *Id.* at 1182.

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ *Lee*, 13 P.3d at 1182.

¹⁵⁶ *Id.* The deposition of Gillespie, State Farm’s Tucson claims superintendent, demonstrated the unfairness of this aspect of the judicial system. The review of the deposition indicated that Gillespie had little or no legal knowledge except that which was supplied to him by State Farm’s counsel. *Id.* at 1179 n.5. When Gillespie was asked to describe the legal training that State Farm had given him to qualify him to make the evaluation in question, Gillespie indicated that he could not recall what training he had. *Id.* When asked whether there were any sources that opposing counsel could look to in order to determine what legal information would have been available to Gillespie apart from the advice he received from counsel, Gillespie indicated there were no other sources. *Id.* The court found that by asserting the subjective evaluation and understanding of its personnel about the state of the law on stacking, State Farm had affirmatively injected the legal knowledge of its claim managers into the litigation and put the extent, and thus the sources, of that legal knowledge at issue. *Id.* at 1182. The court found that State Farm’s claim managers could not testify that they investigated the state of the law and concluded that they were acting within the law but deny plaintiffs the ability to explore the basis for that belief and to determine whether it “might have known its actions did not conform to the law.” *Id.*

the state of the law and concluded [that they] believed they were acting within the law but deny Plaintiffs the ability to explore the basis for this belief and to determine whether [the insurance company] ‘might have known its actions did not conform to the law.’¹⁵⁷

The court, however, limited the scope of its ruling. As an example, the court noted that its holding did not mean that the “privilege was waived as to communications between the [insurance company] and its counsel on other subjects pertaining to” the legal question at issue.¹⁵⁸ In essence, “[p]laintiffs are not entitled to a fishing expedition through all of counsel’s communications . . . but only to discovery of those communications pertaining to the permissibility or deniability of [the law] under the policy language, the case law [relevant to that point], and the statutes as they existed at the time the claims were presented.”¹⁵⁹

Ultimately, the court held that the trial judge had not committed legal error or abused its discretion by permitting discovery of attorney-client privileged materials.¹⁶⁰ The court also approved the *Hearn* test,¹⁶¹ and adopted the test set forth in Restatement (Third) of the Law Governing Lawyers §80(1), which provides, in relevant part, that:

The attorney-client privilege is waived for any relevant communication if the client asserts as to a material issue in a proceeding that:

- (a) the client acted upon the advice of a lawyer or that the advice was otherwise relevant to the legal significance of the client’s conduct .¹⁶²

The notion “that the mere filing of a bad faith action, the denial of bad faith, or the affirmative claim of good faith may be found to constitute an implied waiver of the privilege” was rejected.¹⁶³ The court found that a party does not waive the attorney-client privilege:

[U]nless it has asserted some claim or defense, such as the reasonableness of its evaluation of the law, which

¹⁵⁷ *Lee*, 13 P.3d at 1182 (quoting *Cox v. Adm’r U.S. Steel & Carnegie*, 17 F.3d 1386, 1418 (11th Cir. 1994)).

¹⁵⁸ *Id.* at 1182 n.8.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* at 1184.

¹⁶¹ *Id.* at 1173.

¹⁶² *Id.* at 1179 (emphasis omitted) (quoting RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 80(1)).

¹⁶³ *Lee*, 13 P.3d at 1179.

necessarily includes the information received from counsel. In that situation, the party claiming the privilege has interjected the issue of advice of counsel into the litigation to the extent that recognition of the privilege would deny the opposing party access to proof without which it would be impossible for the fact finder to fairly determine the very issue raised by that party. We believe such a point is reached when, as in the present case, the party asserting the privilege claims its conduct was proper and permitted by law and based in whole or in part on its evaluation of the state of the law. In that situation, the party's knowledge about the law is vital, and the advice of counsel is highly relevant to the legal significance of the client's conduct. Add to that the fact that the truth cannot be found absent exploration of that issue and the conditions of RESTATEMENT §80 are met.¹⁶⁴

State Farm argued that it injected the subjective belief of its claims personnel into the litigation because the plaintiffs first had alleged State Farm not only misinterpreted the law but knew that it was doing so.¹⁶⁵ Thus, State Farm argued that the plaintiffs, and not State Farm, had injected the issue of subjective belief into the litigation.¹⁶⁶ After acknowledging that it would be difficult for State Farm to meet plaintiffs' allegation without affirmatively alleging that it had investigated and evaluated the law,¹⁶⁷ the court stated that State Farm "could [have done] so simply by denying that it knew it was acting unlawfully and relying on a defense of objective reasonableness."¹⁶⁸ Plaintiffs would then be forced to prove State Farm knew it was acting unlawfully.¹⁶⁹

Justice Martone vigorously dissented from the majority's holding. The Justice prefaced his dissent by acknowledging and agreeing with the majority that the Restatement and the *Hearn* tests "set forth the appropriate rule . . . when a client impliedly waives the attorney-client privilege by putting assistance or communication in issue."¹⁷⁰ Having made these concessions, the dissent observed that "the Restatement and *Hearn* [analyses] require the *privilege holder*, not the other party to the litigation, to

¹⁶⁴ *Id.* at 1179 (footnote omitted).

¹⁶⁵ *Id.* at 1182.

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

¹⁶⁸ *Id.*

¹⁶⁹ *Lee*, 13 P.3d at 1182.

¹⁷⁰ *Id.* at 1184 (Martone, J., dissenting).

affirmatively inject an issue [that] implicates privileged communications.”¹⁷¹ The dissent emphasized that the Restatement approach required that either of two conditions be met: “The client acted upon the advice of a lawyer or *that the advice was otherwise relevant to the legal significance of the client’s conduct.*”¹⁷² In that regard, “it [was] not enough ‘that the advice of counsel was otherwise relevant to the legal significance of the client’s conduct.’”¹⁷³ Instead, it is the client who “must assert that the advice was otherwise relevant to the legal significance of a client’s conduct.”¹⁷⁴

In Arizona, a bad faith claim requires “proof of both objective and subjective unreasonableness on the part of the insurer.”¹⁷⁵ The plaintiff, not the privilege holder insurance company, “puts at issue the subjective reasonableness of the defendant’s conduct.”¹⁷⁶ In fact, “the plaintiff must inject the issue of subjective unreasonableness into the litigation.”¹⁷⁷ This is so because under the *Noble/Zilisch*¹⁷⁸ test for bad faith in Arizona “the appropriate inquiry is whether there is sufficient evidence from which reasonable jurors could conclude that in the investigation, evaluation, and processing of the claim, the insurer acted unreasonably and *either knew or was conscious of the fact that its conduct was unreasonable.*”¹⁷⁹ The dissent criticized the majority because the majority ruling requires a bad faith defendant to choose between defending against both prongs of the *Noble/Zilisch* test, and thereby waiving the attorney-client privilege, or defending solely on the objective reasonableness of its decision.¹⁸⁰

The practical consequence of the majority’s ruling would be that “no bad faith defendant [could] properly defend the action without waiving the privilege.”¹⁸¹ In that regard, “the majority’s application of *Hearn* and the *Restatement* in the context of [the] bad faith case [before it,] completely subvert[ed] the critical elements of [each] test.”¹⁸²

The dissent observed that under the majority view, “a plaintiff may abrogate the defendant’s attorney-client privilege simply by raising a bad

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ *Id.*

¹⁷⁴ *Id.*

¹⁷⁵ *Lee*, 13 P.3d at 1185 (Martone, J., dissenting) (citing *Noble v. Nat’l Am. Life Ins. Co.*, 624 P.2d 866, 868 (Ariz. 1981)).

¹⁷⁶ *Id.*

¹⁷⁷ *Id.*

¹⁷⁸ *Id.* at 1185; *Noble*, 624 P.2d at 868, and *Zilisch v. State Farm Mut. Auto. Ins. Co.*, 995 P.2d 276, 280 (Ariz. 2000).

¹⁷⁹ *Lee*, 13 P.3d at 1185 (Martone, J., dissenting) (quoting *Zilisch*, 995 P.2d at 280) (emphasis in original).

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² *Id.*

faith claim on any matter regarding an interpretation of the law.”¹⁸³ The dissent further observed that “it may well be that an insurer would be willing to make a coverage decision without relying on the advice of its lawyers. But the prudent insurer will consult a lawyer and under today’s decision that advice always will be admissible in an action against [a claim in] bad faith.”¹⁸⁴ Justice McGregor, who dissented but wrote separately, delivered a eulogy for the attorney-client privilege because of the majority’s decision:

Today we make the scope of the attorney-client privilege uncertain, at best, and abrogate the privilege in many

¹⁸³ *Id.*

¹⁸⁴ *Id.* Justice McGregor’s dissent points to the slippery slope that was created by the majority’s opinion:

But today’s holding, which applies not only to plaintiffs’ bad faith claim, but also to the counts alleging fraud, will sweep even more broadly. If a defendant can waive the privilege simply by relying upon knowledge gained, in part, through advice of counsel to deny a plaintiff’s allegations, any plaintiff advancing a subjective claim will run the risk of waiving the privilege simply by filing an action. A plaintiff who advances a subjective claim seemingly will waive the privilege if, before asserting his claim, he consults with his lawyer and uses the knowledge obtained to reasonably evaluate his claim. Because many, perhaps most, potential litigants do not know the elements of claims they seek to assert before consulting a lawyer, and do not understand whether they possess sufficient basis to assert a claim, a plaintiff’s decision to proceed with an action necessarily relies upon the advice of counsel. For instance, these plaintiffs presumably consulted with their attorneys before bringing this action for bad faith, which involves the subjective element described by the majority. If so, their reliance on their subjective and alleged reasonable evaluation of the law—but an evaluation that necessarily incorporates what the litigant learned from its lawyer renders the communication discoverable and admissible. Can the defendant now discover otherwise privileged communications to determine whether the plaintiffs in fact had a basis for making their claim? Similarly, a plaintiff in a personal injury action who claims subjective damages for pain and suffering could be found to have waived the attorney-client privilege if the knowledge on which she bases her claim and right to bring it derive, at least in part, from communications with counsel. If bringing the claim does not itself waive the privilege, is an assertion from the defendant that the plaintiff lacked a good faith basis for bringing the claim sufficient to waive the privilege? And if the defendant’s assertion alone does not waive the privilege, surely, in the words of the majority opinion, the plaintiff’s denial of the argument that he lacked a good faith basis for his claims constitutes an attempt to establish his mental state by asserting that he acted after investigating the law and reaching a well-founded belief that the law permitted the action he took.

Lee, 13 P.2d at 1186-87 (McGregor, J., dissenting) (quotations, citations, brackets, and ellipses omitted).

instances, at worst. . . . To permit plaintiffs to discover communications that they quite probably do not need to establish their claim, we have placed in jeopardy countless attorney-client communications, which litigants rightfully anticipate would be confidential. We also have introduced needless uncertainty into the attorney-client relationship, and have discouraged persons from seeking needed legal advice, which they cannot assume will remain confidential.¹⁸⁵

2. *Mendoza v. McDonald's Corp.* (Court Of Appeals)

In *Mendoza v. McDonald's Corp.*,¹⁸⁶ a former employee of McDonald's brought an action against her former employer for breach of the covenant of good faith and fair dealing in administering her workers' compensation claim.¹⁸⁷ Mendoza had suffered an injury to her right arm as a result of tripping and falling while working at a McDonald's restaurant.¹⁸⁸ Mendoza was eventually referred to an orthopedic surgeon, Thomas E. Roesener, M.D., who placed Mendoza on a no-work status, and McDonald's accepted Mendoza's workers' compensation claim.¹⁸⁹ "As a self-insured employer, McDonald's [started to pay] Mendoza temporary total disability benefits."¹⁹⁰

Based upon the diagnosed injuries,¹⁹¹ Dr. Roesener scheduled Mendoza for carpal tunnel surgery and sought McDonald's approval.¹⁹² McDonald's refused to approve the surgery, misinterpreting a report prepared by another physician, Vito R. Del Deo, M.D., as indicating Mendoza's carpal tunnel syndrome was not work related.¹⁹³ McDonald's sent Mendoza a notice of claim status denying the carpal tunnel surgery as "not work related."¹⁹⁴

Despite its denial, McDonald's requested that an independent medical examination of Mendoza be conducted by Ronald B. Joseph, M.D.¹⁹⁵ Based

¹⁸⁵ *Id.* at 1187 (McGregor, J., dissenting) (internal citations omitted).

¹⁸⁶ 213 P.3d 288 (Ct. App. 2009).

¹⁸⁷ *Id.* at 291.

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

¹⁹¹ Dr. Roesener initially believed Mendoza had suffered a strained right elbow and mild damage to her ulnar nerve. *Id.* Subsequently, however, based on her pain and on nerve conduction studies performed by Vito R. Del Deo, M.D., Dr. Roesener concluded Mendoza had injured her median nerve in the accident and was suffering from carpal tunnel syndrome. *Id.* Dr. Roesener further concluded that Mendoza had injured her radial nerve. *Id.*

¹⁹² *Mendoza*, 213 P.3d at 291.

¹⁹³ *Id.*

¹⁹⁴ *Id.* at 292.

¹⁹⁵ *Id.*

on Dr. Joseph's examination,¹⁹⁶ McDonald's sent Mendoza a notice of claim status accepting Mendoza's claim for benefits.¹⁹⁷ However, due to the fact that Dr. Joseph had opined Mendoza could return to a light-duty status, McDonald's terminated her temporary total disability benefits.¹⁹⁸ Mendoza thereafter sent a protest letter to the Industrial Commission of Arizona ("ICA").¹⁹⁹ The ICA set a hearing on the issues and Mendoza and McDonald's each retained counsel to handle the proceeding.²⁰⁰

During the pendency of the ICA proceedings,²⁰¹ Mendoza sued McDonald's for breach of the implied covenant of good faith and fair dealing

¹⁹⁶ Dr. Joseph, like Dr. Roesener, diagnosed Mendoza as having work-related carpal tunnel syndrome and recommended at least four weeks of conservative, nonsurgical treatment. *Id.* Dr. Joseph opined Mendoza could return to light-duty work, although he did not specify any specific light-duty work restrictions. *Id.* Dr. Joseph recommended endoscopic carpal tunnel surgery if the conservative treatment was unsuccessful. *Id.* Dr. Joseph further "concluded Mendoza had injured the right radial nerve in the accident and suggested Mendoza might ultimately need radial nerve decompression." *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ *Mendoza*, 213 P.3d at 292. Relying on Dr. Roesener's continuing recommendation, Mendoza did not return to perform light-duty work offered by McDonald's. *Id.*

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ During the course of the ICA proceedings, McDonald's requested that a hand surgeon, Mitchel A. Lipton, M.D., examine Mendoza. *Id.* at 293. According to a claim file note prepared by Chargaulaf, "McDonald's ICA counsel had set this examination 'to support [the] denial.'" *Id.* After the exam, "Dr. Lipton reached a 'diagnostic impression' [that Mendoza] had probable right carpal tunnel syndrome, although he recommended against surgery." *Id.* However, "[h]e was unable to determine . . . whether Mendoza's carpal tunnel syndrome was related to the accident at McDonald's." *Id.* Following this examination, "McDonald's decided to accept Mendoza's carpal tunnel syndrome as being work related, but refused to authorize the surgery." *Id.* Thereafter, at McDonald's request, Dr. Joseph again "saw Mendoza for another independent medical examination." *Id.* Based on Dr. Joseph's second examination, McDonald's offered to authorize endoscopic surgery, a type of surgery that Dr. Roesener did not perform. *Id.* Mendoza subsequently "requested McDonald's approve the carpal tunnel surgery, either endoscopic or classical, and agree to treatment by any qualified surgeon," but McDonald's refused. *Id.*

The ICA hearing went forward, with the "ICA administrative law judge conclud[ing] [that] Mendoza had sustained an industrial injury," that "the carpal tunnel syndrome was causally related to that injury," and that "she was, therefore, entitled to the surgery as recommended by Dr. Roesener ('First ALJ Decision')." *Id.* at 294. "The administrative law judge found, however, Mendoza was not entitled to temporary total disability benefits . . . because McDonald's had light-duty work available to her." *Id.* "Mendoza appealed the temporary total disability ruling . . . and [the Arizona Court of Appeals] set it aside." *Id.* (citing *Mendoza v. Indus. Comm'n*, 1 CA-IC 99-0113 (Ariz. App. June 6, 2000) (mem. decision)). "Based on the First ALJ Decision, McDonald's approved Dr. Roesener's surgery." *Id.* "Although the surgery was deemed technically successful in decompressing the carpal tunnel," Dr. Roesener was unwilling to release Mendoza to return to work because she "continued to experience pain and other difficulties." *Id.* "McDonald's responded by seeking a second independent medical examination from Dr. Lipton." *Id.*

in the administration of her workers' compensation claim (the "Bad Faith Lawsuit").²⁰² As part of the Bad Faith Lawsuit, "McDonald's had voluntarily provided Mendoza portions of the file maintained by its claims adjusters," initially without redaction or claim of privilege.²⁰³ Subsequently, McDonald's began "redacting the adjusters' notes it [had] produced . . . (redacted material)," claiming the attorney-client privilege shielded it from discovery."²⁰⁴ Mendoza then "moved to compel McDonald's to produce the entire . . . claim file," taking the position that

Mendoza thereafter began to be treated by Leonard S. Bodell, M.D., a hand surgeon. *Id.* "Dr. Bodell attempted to treat Mendoza's condition nonsurgically and requested McDonald's approval to refer Mendoza to other health care providers to assess and assist in treating her pain problems." *Id.* "McDonald's refused to approve the requested referrals and instead scheduled Mendoza to be examined by yet another hand surgeon, Paul M. Guidera, M.D." *Id.* "Dr. Guidera concluded Mendoza was not medically stationary and diagnosed possible persistent radial tunnel syndrome, which he related to the industrial injury." *Id.* "Dr. Guidera also recommended, as had Dr. Bodell, that Mendoza be seen by other specialists to assess and treat her continuing pain problems." *Id.* Dr. Bodell thereafter "asked McDonald's to approve right radial tunnel syndrome surgery," which McDonald's again refused. *Id.* at 295. Dr. Guidera thereafter conducted a second and third independent medical examination of Mendoza. *Id.*

After the First ALJ Decision was set aside, "a different administrative law judge found Mendoza had been entitled to temporary total disability benefits from the date of the accident . . . until her condition became medically stationary ('Second ALJ Decision')." *Id.* "The administrative law judge also concluded McDonald's had committed bad faith under A.R.S. § 23-930 (Supp. 2008) by unreasonably delaying approval of the carpal tunnel surgery." *Id.*

"[A]t McDonald's request, Peter J. Campbell, M.D., another hand surgeon, conducted another independent medical examination of Mendoza." *Id.* "Dr. Campbell concluded Mendoza had right radial tunnel syndrome and would benefit from radial nerve decompression surgery." *Id.* "McDonald's thereafter authorized radial tunnel surgery . . . , which Dr. Bodell performed." *Id.* "Although the surgery was deemed successful, Mendoza continued to experience pain." *Id.* "Because of her ongoing pain and inability to work, she experienced persistent depression and asked McDonald's to authorize psychological evaluation and treatment," which McDonald's refused. *Id.*

Dr. Campbell thereafter examined Mendoza again and "concluded further therapy or surgical intervention would not improve Mendoza's subjective complaints of pain." *Id.* "Although Dr. Campbell found Mendoza could not tolerate significant heavy lifting with her right arm, he nevertheless concluded her condition was stable and she was able to return to work with a permanent restriction of lifting no more than ten pounds with her right arm." *Id.* "McDonald's then terminated Mendoza's temporary total disability benefits and continued to deny Mendoza's request for psychological care." *Id.* "Mendoza protested both the termination of her temporary total disability benefits and the denial of psychological care." *Id.* "An ICA administrative law judge . . . reinstated temporary total disability benefits, and awarded Mendoza the additional treatment she had requested, including psychological and pain management treatment ('Third ALJ Decision')." *Id.* at 295-96.

²⁰² *Id.* at 296. Mendoza had three bad faith lawsuits in total, and all three actions were eventually consolidated. *Id.*

²⁰³ *Id.* at 300.

²⁰⁴ *Mendoza*, 213 P.3d at 300.

“McDonald’s had impliedly waived the attorney-client privilege.”²⁰⁵ Relying on *Lee*, “McDonald’s denied it had impliedly waived the privilege, arguing it had never ‘put into issue’ the redacted material because it was not claiming its conduct in handling Mendoza’s claim was ‘subjectively reasonable based on its . . . subjective understanding of the law.’”²⁰⁶

Following argument on the motion to compel and the court conducting an *in camera* review of the file, the court found the attorney-client privilege had not been waived, holding:

[Mendoza] also argues that the attorney client privilege does not apply under *State Farm Mut. Auto. Ins. v. Lee*. This court declines to read that case as broadly as plaintiff urges. In this case, defendant has not claimed that there is no bad faith because it relied on the advice of counsel, nor has it claimed as a defense that it relied on a subjective evaluation of the law that incorporates what it learned from its attorneys.²⁰⁷

“At the conclusion of a three-week trial [in the Bad Faith Lawsuit], the jury found McDonald’s had acted in bad faith and awarded Mendoza . . . compensatory damages” but not punitive damages.²⁰⁸ “After the court entered judgment and denied Mendoza’s motion for new trial, Mendoza appealed [and] McDonald’s timely cross-appealed.”²⁰⁹

On appeal, Mendoza argued that the trial court erred by failing to order McDonald’s to produce the redacted material from the claim file because McDonald’s had impliedly waived the attorney-client privilege.²¹⁰ Mendoza additionally argued the trial “court’s ruling prejudiced her case by depriving her of relevant evidence that McDonald’s had acted with the necessary ‘evil mind’ to allow the jury to assess a punitive damages award.”²¹¹ The Arizona Court of Appeals agreed with both of Mendoza’s arguments on this issue.²¹²

In reaching this decision, the Court of Appeals observed that the decision in *Lee* “outlined the test for determining whether an insurer has impliedly waived the attorney-client privilege in a bad faith tort action.”²¹³ Applying the reasoning of *Lee*, Mendoza argued that “McDonald’s impliedly waived the privilege . . . because its ICA attorneys regularly influenced and directed

²⁰⁵ *Id.*

²⁰⁶ *Id.*

²⁰⁷ *Id.* (citation omitted).

²⁰⁸ *Id.* at 297.

²⁰⁹ *Id.*

²¹⁰ *Mendoza*, 213 P.3d at 300.

²¹¹ *Id.*

²¹² *Id.*

²¹³ *Id.*

McDonald's claims decisions and, by representing its actions were subjectively reasonable . . . while [concurrently] asserting the privilege, it was able to hide the real reasons for its decisions."²¹⁴ In response, McDonald's argued that "*Lee* and its treatment of implied waiver [was] inapplicable [to this case] because [McDonald's] did not defend its actions based on the reasonableness of its subjective evaluation of the law."²¹⁵ McDonald's instead argued that "it defended its actions [solely] by contending they were objectively reasonable."²¹⁶

The court in *Mendoza* agreed that McDonald's did not defend on the basis that "its subjective evaluation of the law was reasonable."²¹⁷ However, the court stated that "there is nothing in *Lee* to suggest an insurer will *only* be deemed to impliedly waive the privilege when it argues its actions were reasonable based on its subjective evaluation of the law."²¹⁸ Instead, the court observed:

At the heart of *Lee* is the recognition that, in the bad faith context, when an insurer raises a defense based on factual assertions that, either explicitly or implicitly, incorporates the advice or judgment of its counsel, it cannot deny an opposing party the opportunity to discover the foundation for those assertions in order to contest them.²¹⁹

Further, the court held that, contrary to the characterization made by McDonald's, the defense was not limited to the objective reasonableness of McDonald's conduct.²²⁰ Instead, McDonald's "affirmatively asserted its actions in investigating, evaluating, and paying *Mendoza*'s claim were subjectively reasonable and taken in good faith."²²¹

"Through the testimony of its bad faith expert witness, Robert Wisniewski, McDonald's presented evidence it had not used independent medical examinations to deny or delay benefits, despite adjuster notes that stated certain examinations were being scheduled to 'cut' benefits or support a previous denial of benefits."²²² Wisniewski testified that "references [made] in the notes to 'get this claim closed' or other similar wording constituted nothing more than 'jargon' [used by adjusters] for moving a

²¹⁴ *Id.* at 301.

²¹⁵ *Id.*

²¹⁶ *Mendoza*, 213 P.3d at 301.

²¹⁷ *Id.* at 302.

²¹⁸ *Id.*

²¹⁹ *Id.* (citing *Lee*, 13 P.3d at 1178).

²²⁰ *Id.*

²²¹ *Id.*

²²² *Mendoza*, 213 P.3d at 302.

claim from one stage to another.”²²³ He further testified that McDonald’s was not improperly attempting to close the claim by trying to find a doctor who would provide it with an examination supporting closure.²²⁴ Instead, Wisniewski also explained that “the reason [that the] adjusters had sent Mendoza to so many different doctors was [that] ‘they were trying to give her the benefit of the doubt,’ and were ‘trying to find out what [was] wrong with her and address it.’”²²⁵

Jennifer Chargauf, the McDonald’s employee who initially handled Mendoza’s claim gave similar testimony, stating that “she had never tried to deny . . . or delay [Mendoza’s claim] ‘with either the hope that [Mendoza] would give up or go away.’”²²⁶ Instead, “she had believed the findings of Drs. Del Deo, Joseph, and Lipton provided a reasonable basis for [denying the request for surgery].”²²⁷ She additionally testified that she and the other claim handlers had been “motivated by a desire to make sure that Mendoza received ‘the care that was most appropriate or at least [she] explored her options.’”²²⁸

The Arizona Court of Appeals observed that by using this evidence to depict the actions of its claims adjusters as being driven by a desire to act in Mendoza’s best interest, “McDonald’s affirmatively placed in issue the subjective motives of its adjusters in administering Mendoza’s claim.”²²⁹ The court therefore held that McDonald’s “defended [the] case based on the subjective reasonableness of its conduct,” not just objective reasonableness.²³⁰

With this understanding, the court then examined the evidence, which belied the portrayal of McDonald’s subjective motives in handling Mendoza’s claim.²³¹ The court observed that this evidence indicated that “McDonald’s forced Mendoza to ‘go through needless adversarial hoops to achieve’ her workers’ compensation benefits, . . . based on advice from and judgments made by its ICA counsel.”²³² Specifically, the factual evidence used to support this decision included:

²²³ *Id.*

²²⁴ *Id.*

²²⁵ *Id.*

²²⁶ *Id.*

²²⁷ *Id.*

²²⁸ *Mendoza*, 213 P.3d at 302-03.

²²⁹ *Id.* at 303.

²³⁰ *Id.*

²³¹ *Id.*

²³² *Id.* (citation omitted).

- (1) Chargaulaf testified that she scheduled an independent medical examination (“IME”) of Mendoza “based on the recommendation of its ICA attorney”.²³³
- (2) Chargaulaf testified that “it was possible the ICA attorney wanted to find a doctor who would disagree with [another doctor’s] conclusion [that] Mendoza’s carpal tunnel syndrome was work related and who would support the denial of benefits”.²³⁴
- (3) Chargaulaf testified that “despite her decision accepting Mendoza’s carpal tunnel syndrome as compensable . . . , on advice of counsel, McDonald’s then began to assert Mendoza’s carpal tunnel syndrome was not work related, . . . a position with which [the adjuster] did not agree and thought would be in bad faith”.²³⁵
- (4) In a claim note, Chargaulaf “confirmed she had spoken to one of McDonald’s ICA attorneys who informed her he would ‘set up another independent medical exam to support our denial. He will also forward us a list of good doctors in the state’”.²³⁶
- (5) Chargaulaf testified “that even though she had notified Mendoza in July 1998 McDonald’s would accept Mendoza’s carpal tunnel syndrome as compensable, she relied on counsel’s advice in delaying surgical authorization through the end of her involvement with the claim in December 1998”.²³⁷ and
- (6) A subsequent adjuster testified that “she had relied on the advice of one of McDonald’s ICA attorneys in . . . , scheduling an independent medical examination with Dr. Guidera ‘for closure’ and to ‘[g]et this claim closed.’”²³⁸

While the Court of Appeals did not need to determine whether McDonald’s subjective motives were as it represented or not, the court concluded that by electing to defend “on the subjective, not just objective, reasonableness of its adjusters’ actions, McDonald’s placed in issue their subjective beliefs and directly implicated the advice and judgment they had received from McDonald’s ICA counsel incorporated in those actions.”²³⁹

²³³ *Id.*

²³⁴ *Mendoza*, 213 P.3d at 303.

²³⁵ *Id.* (citations omitted).

²³⁶ *Id.*

²³⁷ *Id.*

²³⁸ *Id.*

²³⁹ *Id.*

Therefore, “the advice and judgment [McDonald’s] adjusters received from its ICA counsel [became] relevant to the case” and the privilege was impliedly waived.²⁴⁰

3. Everest Indemnity Insurance Company v. Rea (Court Of Appeals)

In *Everest Indemnity Insurance Company v. Rea*,²⁴¹ the Arizona Court of Appeals once again addressed the issue of implied waiver of the attorney-client privilege under *Lee*.²⁴² In the *Everest* case, Rudolfo Brothers Plastering and Western Agricultural Insurance Company (collectively “Rudolfo”) claimed that Everest committed bad faith in the underlying case by entering into a settlement agreement in favor of some insureds by which the liability coverage of an Owner Controlled Insurance Program (“OCIP”) policy was exhausted to the alleged detriment of other insureds such as Rudolfo Brothers Plastering.²⁴³ Everest took the position that “the decision to settle was made in good faith,” based on both objective reasonableness and Everest’s subjective beliefs concerning the relative merits of the various available courses of action.²⁴⁴ Everest acknowledged that during the process of making the decision to settle the underlying case, Everest communicated with counsel.²⁴⁵ Therefore, “the issue [was] whether Everest impliedly waived the attorney-client privilege regarding those communications by asserting its subjective belief in the good-faith nature of its actions and by consulting with counsel during that period of time.”²⁴⁶

The Court of Appeals observed that Rudolfo relied on the decision in *Mendoza*, “for the proposition that by choosing to defend itself based on the subjective reasonableness of its actions after consulting with counsel, Everest

²⁴⁰ *Mendoza*, 213 P.3d at 303. (citing *Lee*, 13 P.3d at 1178 (“Where an insurer makes factual assertions in defense of a claim which incorporate, expressly or implicitly, the advice and judgment of its counsel, it cannot deny an opposing party ‘an opportunity to uncover the foundation for those assertions in order to contradict them.’” (quoting *Tackett v. State Farm Fire & Cas. Ins. Co.*, 653 A.2d 254, 259 (Del. 1195) (citations and ellipsis omitted))); *Roehrs v. Minn. Life Ins. Co.*, 228 F.R.D. 642, 646–47 (D. Ariz. 2005) (three adjusters testified in pretrial depositions they considered and relied upon legal opinions and legal investigation in denying coverage for insureds’ claims; because insurer could not ‘reasonably deny that what these employees knew at the time they denied the [insureds’] claims included information received from their lawyers’ and ‘[w]hat formed the subjective good faith beliefs and mental states of these three adjusters and the reasonableness of their decisions [was] critical in defense of the [insureds’] bad faith claim,’ insurer had placed attorney-client privileged material at issue and impliedly waived the privilege under *Lee*).”).

²⁴¹ 342 P.3d 417 (Ariz. Ct. App. 2015).

²⁴² *Id.* at 418.

²⁴³ *Id.*

²⁴⁴ *Id.* at 418, 418 n.1.

²⁴⁵ *Id.* at 418.

²⁴⁶ *Id.*

has necessarily waived the attorney-client privilege.²⁴⁷ In other words, the position of Rudolfo, and the ruling of the trial court, was that *Mendoza* created a *per se* rule that defending a bad faith case based upon subjective reasonableness automatically waived the privilege.²⁴⁸ However, the Court of Appeals rejected this argument as over-reading *Mendoza* and being inconsistent with *Lee*.²⁴⁹ Indeed, the court observed that “*Lee* expressly held that the assertion of a subjective good faith defense coupled with consultation with counsel did not, without more, waive the attorney-client privilege.”²⁵⁰

The Court of Appeals observed that under *Lee*, “the attorney-client privilege is impliedly waived only when the litigant asserts a claim or defense that is *dependent* upon the advice or consultation of counsel.”²⁵¹ Specifically, in *Lee*, the insurer was held to have waived the attorney-client privilege “because its defense was based on its ‘investigation and evaluation’ of the law, which [was] inevitably depende[nt] [upon] and necessarily included the advice [the insurer] received from its lawyers.”²⁵² The Court of Appeals noted that because the coverage issue in *Lee* “turned on State Farm’s interpretation of recently-decided case law . . . , ‘the party’s knowledge about the law is vital, and the advice of counsel is highly relevant to the legal

²⁴⁷ *Everest Indemnity Ins. Co.*, 342 P.3d at 419.

²⁴⁸ *Id.* at 420 (Orozco, J., dissenting).

²⁴⁹ *Id.* at 419.

²⁵⁰ *Id.* “We assume client and counsel will confer in every case, trading information for advice. This does not waive the privilege. We assume most if not all actions taken will be based on counsel’s advice. This does not waive the privilege. Based on counsel’s advice, the client will always have subjective evaluations of its claims and defenses. This does not waive the privilege. All of this occurred in the present case, and none of it, separately or together, created an implied waiver.” *Id.* (quoting *Lee*, 13 P.3d at 1183).

²⁵¹ *Id.* The Court in *Lee* stated:

But the present case has one more factor—State Farm claims its actions were the result of its reasonable and good-faith belief that its conduct was permitted by law and its subjective belief based on its claims agents’ investigation into and *evaluation of the law*. It turns out that the investigation and evaluation included information and advice received from a number of lawyers. It is the last element, combined with the others, that impliedly waives the privilege. State Farm claims that its actions were prompted by what its employees knew and believed, not by what its lawyers told them. But a litigant cannot with one hand wield the sword—asserting as a defense that, as the law requires, it made a reasonable investigation into the state of the law and in good faith drew conclusions from that investigation—and with the other hand raise the shield—using the privilege to keep the jury from finding out what its employees actually did, learned in, and gained from that investigation.

Id. (quoting *Lee*, 13 P.3d at 1183) (emphasis added)).

²⁵² *Everest Indemnity Ins. Co.*, 342 P.3d at 419 (citing *Lee*, 13 P.3d at 1183).

significance of the client's conduct."²⁵³ As a result, the court explained that State Farm's actions were therefore "inextricably intertwined" with the advice it received from counsel and the Supreme Court held that State Farm had impliedly waived the attorney-client privilege.²⁵⁴

In order to waive the attorney-client privilege under *Lee*, the Court of Appeals stated that "a party must make an affirmative claim that its conduct was based on its understanding of the advice of counsel—it is not [enough] that the party consult with counsel and receive advice."²⁵⁵ In contrast, the Court of Appeals held that in the present case, "there has been no showing that Everest was in doubt as to any legal issue."²⁵⁶ Instead, Everest "made decisions during the course of litigation and, of necessity, involved lawyers in that litigation."²⁵⁷ "The decision Everest made to settle the case was not necessarily the product of legal advice, and Everest has not yet asserted—expressly or impliedly—that it was."²⁵⁸

Addressing *Mendoza*, the Court of Appeals observed that the employer "relied on the advice of counsel in scheduling independent medical examinations and determining whether to issue surgical authorization for an employee's worker's compensation claim."²⁵⁹ Indeed, the employer in that case "expressly admitted that it had relied substantially on the advice of . . . counsel in reaching its decisions."²⁶⁰ The Court of Appeals stated that "*Mendoza* found the attorney-client privilege was impliedly waived under *Lee*" because a claim that those decisions, "made based on the advice of counsel, . . . were made in subjective good faith necessarily depends upon the information the client had learned from [counsel]."²⁶¹

In *Everest*, the Court of Appeals held that "Everest's defense [fell] short of the *Lee* and *Mendoza* requirements for an implied waiver."²⁶² The court acknowledged that Everest: (1) was contending "that it acted with a subjective belief in the good-faith nature of its actions"; (2) admitted to consultation with counsel "before making the decision to enter into the settlement agreement"; and (3) admitted that its "counsel were involved in the settlement negotiations."²⁶³ The court held, however, that these facts

²⁵³ *Id.* (quoting *Lee*, 13 P.3d at 1179).

²⁵⁴ *Id.* (citing *Lee*, 13 P.3d at 1177).

²⁵⁵ *Id.* (citing *Lee*, 13 P.3d at 1177); see also *Twin City Fire Ins. Co. v. Burke*, 63 P.3d 282, 287 (2003) ("finding that no waiver of privilege occurred when party had not 'affirmatively injected any advice it received from counsel into the bad faith action'").

²⁵⁶ *Id.* at 420.

²⁵⁷ *Id.*

²⁵⁸ *Everest Indemnity Ins. Co.*, 342 P.3d at 420.

²⁵⁹ *Id.* (citing *Mendoza*, 213 P.3d at 303).

²⁶⁰ *Id.* (citing *Mendoza*, 213 P.3d at 303).

²⁶¹ *Id.* (citing *Mendoza*, 213 P.3d at 304).

²⁶² *Id.* at 420.

²⁶³ *Id.*

alone were “not enough to suggest that Everest’s subjective belief in the legality of its actions necessarily included or depended on the advice it received from counsel.”²⁶⁴ The Court of Appeals observed that Everest had not yet asserted as a defense that it depended on “advice of counsel in forming its subjective beliefs regarding the appropriate course of conduct” in reaching and entering into the settlement.²⁶⁵ The court further noted that Everest had “not yet seen the need to share the advice of its counsel with its own [bad faith] expert” and that Everest’s “expert simply cite[d] the *fact* of consultation as a procedural indication of good faith.”²⁶⁶ Therefore, the court held that “Everest ha[d] not yet placed the advice it received from counsel at issue” and vacated the trial court’s order regarding implied waiver of Everest’s attorney-client privilege.²⁶⁷

In the dissent, Judge Orozco agreed with the conclusion of the majority that the mere fact that an insurer asserts a “subjective good faith defense does not, by itself, waive the attorney-client privilege.”²⁶⁸ Consequently, she also agreed with the majority that *Mendoza* does not establish automatic waiver of privilege upon asserting subjective good faith but was instead a fact-based application of *Lee*.²⁶⁹ The dissent disagreed however that “Everest had not yet asserted a defense that it depended on the advice of counsel in forming its subjective beliefs[.]”²⁷⁰ Specifically, Judge Orozco held that two facts gave rise to the affirmative interjection of the advice of counsel: (1) “Everest has asserted in its initial disclosure statement and in response to interrogatories that it acted in good faith by reaching the settlement at issue”; and (2) Everest’s counsel participated in the settlement negotiations on Everest’s behalf.²⁷¹ Thus, the dissent viewed “[c]ounsel’s participation, along with Everest’s assertion of subjective good faith, is an affirmative interjection of counsel’s role in formulating and acting upon Everest’s subjective good faith in this litigation.”²⁷²

²⁶⁴ *Everest Indemnity Ins. Co.*, 342 P.3d at 420 (citing *Lee*, 13 P.3d at 1183).

²⁶⁵ *Id.* at 420.

²⁶⁶ *Id.*

²⁶⁷ *Id.*

²⁶⁸ *Id.* (Orozco, J., dissenting).

²⁶⁹ *Id.* (Orozco, J., dissenting).

²⁷⁰ *Everest Indemnity Ins. Co.*, 342 P.3d at 420 (Orozco, J., dissenting) (citations omitted).

²⁷¹ *Id.* at 420–21. (Judge Orozco, dissenting).

²⁷² *Id.* at 421 (citing *Empire West Title Agency, L.L.C. v. Talamante*, 323 P.3d 1148, 1150 (2014) (citing *Lee*, 13 P.3d at 1179) (noting that *Lee* requires “the party claiming the privilege must affirmatively interject the issue of advice of counsel into the litigation” (quotations omitted))).

C. Defining The Battle Lines

The battle being waged is clear. On one side, jurisdictions such as Ohio, Delaware, Washington and Idaho represent and stand behind the continued expansion of implied waiver of the attorney-client privilege in the context of insurance bad faith. In contrast, the intermediate court battle in Arizona may signal a turn in the tide relative to continued expansion. This change in Arizona stands in stark contrast to these other jurisdictions and serves as a case study of the significant implications of this battle.

Arizona, consistent with the majority of jurisdictions,²⁷³ employs a two-pronged test for insurance bad faith, which has an objective and subjective component.²⁷⁴ Specifically, the two elements of this test are: “(1) that the insurer acted unreasonably toward its insured, and (2) that the insurer acted knowing that it was acting unreasonably or acted with such reckless disregard that such knowledge may be imputed to it.”²⁷⁵ Consistent with this

²⁷³ See *Gen. Star Nat'l Ins. Co. v. Liberty Mut. Ins. Co.*, 960 F.2d 377, 380 (3rd Cir. 1992) (interpreting New York law); *Matt v. Liberty Mut. Ins. Co.*, 798 F. Supp. 429, 434 (W.D. Ky. 1991), *aff'd*, 968 F.2d 1215 (6th Cir. 1992) (interpreting Kentucky law); *Balzer v. Am. Family Ins. Co.*, 805 F. Supp. 2d 618, 624–25 (N.D. Ind. 2011) (“a successful bad faith claim is composed of an objective element (such as the lack of a reasonable basis to deny a claim) and a subjective element (such as the knowledge of the lack of a reasonable basis to deny a claim.)”); *White v. Cont'l Gen. Ins. Co.*, 831 F. Supp. 1545, 1555 (D. Wyo. 1993); *Turner Constr. Co. v. First Indem. of Am. Ins. Co.*, 829 F. Supp. 752, 762–64 (E.D. Pa. 1993); *First Marine Ins. Co. v. Booth*, 876 S.W.2d 255, 257 (Ark. 1994); *Wittmer v. Jones*, 864 S.W.2d 885, 890–92 (Ky. 1993); *Universal Life Ins. Co. v. Veasley*, 610 So. 2d 290, 295 (Miss. 1992); *Dolan v. AID Ins. Co.*, 431 N.W.2d 790, 794 (Iowa 1988); *Ins. Co. of N. Am. v. Citizensbank of Thomasville*, 491 So. 2d 880, 882 (Ala. 1986); *Ganaway v. Shelter Mut. Ins. Co.*, 795 S.W.2d 554, 556 (Mo. Ct. App. 1990); see also *Mission Ins. Co. v. Aetna Life & Cas. Co.*, 687 F. Supp. 249, 253 (E.D. La. 1988) (requiring “something more than mere error of judgment” to show insurer bad faith); *Galusha v. Farmers Ins. Exch.*, 844 F. Supp. 1401, 1404 (D. Colo. 1994); *Brown v. Liberty Mut. Ins. Co.*, 513 N.W.2d 762, 763 (Iowa 1994); *Transp. Ins. Co. v. Moriel*, 879 S.W.2d 10, 18 (Tex. 1994); *Turner v. State Farm Fire & Cas. Co.*, 614 So.2d 1029, 1032 (Ala. 1993); *Terletsky v. Prudential Property & Cas. Ins. Co.*, 649 A.2d 680, 688 (Pa. Super. Ct. 1994); *Weatherly v. Blue Cross Blue Shield Ins. Co.*, 513 N.W.2d 347, 354 (Neb. Ct. App. 1994); *Ness v. W. Sec. Life Ins. Co.*, 851 P.2d 122, 125 (Ariz. Ct. App. 1992). *But see* *Hartford Cas. Ins. Co. v. N.H. Ins. Co.*, 628 N.E.2d 14, 17 (Mass. 1994); *Shamblin v. Nationwide Mut. Ins. Co.*, 396 S.E.2d 766, 776 (W. Va. 1990); *Gelinas v. Metro. Prop. & Liab. Ins. Co.*, 551 A.2d 962, 966 (N.H. 1988); *Mock v. Mich. Millers Mut. Ins. Co.*, 5 Cal. Rptr. 2d 594, 607 (Ct. App. 1992); *Ind. Ins. Co. v. Plummer Power Mower & Tool Rental, Inc.*, 590 N.E.2d 1085, 1093 (Ind. Ct. App. 1992).

²⁷⁴ *Haney v. ACE American Ins. Co.*, 2015 WL 58670, *3 (D. Ariz. 2015).

²⁷⁵ *Nardelli v. Metro. Grp. Prop. & Cas. Ins. Co.*, 277 P.3d 789, 794–95 (Ariz. Ct. App. 2012) (“An insurer acts in bad faith when it unreasonably investigates, evaluates, or processes a claim (an ‘objective’ test), and either knows it is acting unreasonably or acts with such reckless disregard that such knowledge may be imputed to it (a ‘subjective’ test).”); *Miel v. State Farm Mut. Auto. Ins. Co.*, 912 P.2d 1333, 1339 (Ariz. Ct. App. 1995) (citing *Trus Joist Corp. v. Safeco Ins. Co. of Am.*, 735 P.2d 125, 134 (Ariz. Ct. App. 1986)); see also *Acosta v. Phoenix Indem. Ins. Co.*, 153 P.3d 401, 404 (Ariz. Ct. App. 2007).

fact, every claim for bad faith necessarily involves a plaintiff having to make an *objective* showing that the insurance company acted unreasonably and a *subjective* showing that the insurance company knew it was acting unreasonably.²⁷⁶ Consequently, offering a complete defense to a bad faith claim requires the insurance company to contest both the objective and subjective elements of a plaintiff's bad faith claim.

In accordance with this understanding, a *per se* rule of implied waiver where an insurance company defends on the subjective element of the claim would mean that in every bad faith case in which an insurance company consults an attorney, the insurance company—like ancient seafarers in Greek mythology—will be placed squarely between Scylla and Charybdis:²⁷⁷ the company must either waive its' right to defend against the subjective element of a bad faith claim or else waive the attorney-client privilege for communications with its' counsel. If the insurance company chooses the former, it loses its ability to present any defense as to half of the bad faith case. If, on the other hand, the latter is chosen, the insurance company loses the significant and closely-guarded protection of the attorney-client privilege. Either way the insurance carrier loses. This is a choice no other holder of the privilege is forced to make in any other context and is a choice an insurance company should not be forced to make either.

In fact, forcing an insurer to make this choice cuts against the heightened nature of proving bad faith. It is the subjective element of the bad faith claim—the insurer's subjective state of mind—which turns an ordinary breach of contract claim into the tort of bad faith. If the insurer gives up its defense on the subjective element of the claim, the plaintiff is effectively been granted the ability to prove bad faith merely by showing a breach of contract. On the other hand, if the insurer elects to defend on the subjective element and the plaintiff actually has to prove true bad faith, the plaintiff is automatically given the benefit of a waiver of the attorney client privilege. Therefore, a plaintiff either does not have to meet the heightened standard of bad faith all or, if they do have to meet this standard, they get an advantage no other plaintiff received in that they get an automatic waiver of the attorney-client privilege.

It is also a choice which severely undermines the public policy underlying the attorney-client privilege. It has been observed that “[t]he purpose of the attorney-client privilege is to encourage a client to confide in

²⁷⁶ *Trus Joist Corp. v. Safeco Ins. Co. of Am.*, 735 P.2d 125, 134 (Ariz. Ct. App. 1986).

²⁷⁷ “In *The Odyssey* by the Greek poet Homer, Odysseus was confronted at one point in his attempt to return home with having to navigate his ship between Scylla, a cliff-dwelling monster who snatched and devoured sailors from passing ships, and Charybdis, a whirlpool capable of dragging down the entire ship. Thus, Odysseus had the unenviable task of choosing between the loss of part of his ship's crew and the loss of the entire ship and crew.” *Smith v. English*, 586 So. 2d 583, 594 n.1 (La. Ct. App. 1991).

his or her attorney all the information necessary in order that the attorney may provide effective legal representation.”²⁷⁸ Indeed, “[t]he attorney-client privilege is the oldest of privileges for confidential communications and is rigorously guarded to encourage full and frank communications between attorneys and their clients and thereby promote broader public interests in the observance of law and the administration of justice.”²⁷⁹

A *per se* rule of implied waiver in this context would not only discourage full and frank communications between an insurance company and its counsel, it would actually discourage insurance companies from ever seeking the advice of counsel in coverage matters because of the risk that all such communications could be discoverable in a subsequent bad faith action. This is detrimental to both insurance companies and insureds alike. The wide-ranging impact of the battle therefore cannot be overstated.

III. CONCLUSION

An insurance company should not lose the protection of the attorney-client privilege simply because its litigation opponent raises an issue to which advice of counsel may be relevant. Implied waiver can only occur when the privilege holder affirmatively injects advice of counsel into the litigation. If the privilege holder does not use advice of counsel as a sword, there is no basis for stripping him or her of its shield. For this reason, courts throughout the country have consistently held that an insurer’s mere denial of a bad faith allegation is not sufficient to waive the attorney-client privilege.²⁸⁰

Even in those jurisdictions where a *Hearn*-type “issue” analysis is applied, more than a mere denial has been required to waive the privilege in the context of insurance bad faith. The Seventh Circuit Court of Appeals has determined that waiving “the attorney-client privilege by voluntarily injecting an issue in the case, a defendant must do more than merely deny a plaintiff’s allegations. The holder must inject a new factual or legal issue

²⁷⁸ *Granger v. Wisner*, 656 P.2d 1238, 1240 (Ariz. 1982).

²⁷⁹ *State v. Sucharew*, 66 P.3d 59, 64 (Ariz. Ct. App. 2003) (citing *State v. Towery*, 920 P.2d 290, 299 n.6 (Ariz. 1996)) (citation and quotations omitted).

²⁸⁰ See, e.g., *Chi. Meat Processors, Inc. v. Mid-Century Ins. Co.*, No. 1996 WL 172148, at *11–12, (N.D. Ill. Apr. 9, 1996) (rejecting argument that insurance company waived attorney-client privilege on grounds that insurance company did “not raise[] as an affirmative defense reliance on counsel in support of its defense to the [bad] faith claim,” but instead “simply denied [insured’s] allegations of bad faith [which] is insufficient to waive the privilege.”); *Barr Marine Prods. Co. v. Borg-Wamer Corp.*, 84 F.R.D. 631, 635 (E.D. Pa. 1979) (holding that privilege is not waived merely by defending a suit, but by “rais[ing] as a defense that which transpired between client and counsel, or reliance on advice of counsel, or questions counsel’s authority”).

into the case.”²⁸¹ Merely offering “a new form of evidence to counter an issue injected by the plaintiffs,” such as bad faith, does not waive the privilege.²⁸² The suggestion that an insurance company affirmatively argues its good faith ignores that good faith in the insurance context is merely the absence of bad faith.²⁸³ Indeed, as a technical matter, a “bad faith” claim is an allegation that the insurer has breached its implied covenant of good faith and fair dealing. Plaintiffs will typically raise an insurance company’s good faith, or lack thereof, in their complaint, and the insurance company should not be required to waive its privilege by denying those allegations.²⁸⁴

Insureds could simply induce an automatic waiver by accusing an insurance company of bad faith. A claim that an insurance company’s “state of mind” is at issue, would lead to a demand to examine privileged materials as a matter of “fairness,” on the theory that advice of counsel must have contributed to the insurer’s state of mind. The only way by which an insurance company could effectively avoid this result is by not defending on its “state of mind”—the subjective reasonableness of its actions—and limiting its defense to solely the objective element of the defense to bad faith.

In *Lee*, the Arizona Supreme Court held that fairness of the judicial process requires implied waiver whenever the insurance company “claims its conduct was proper and permitted by law and based in whole or in part on its evaluation of the state of the law.”²⁸⁵ A pointed dissent in *Lee* delivered a eulogy for attorney-client privilege in insurance bad faith cases, as a result of the majority’s decision.²⁸⁶ In essence, the dissent observed that a plaintiff may abrogate the insurance company’s attorney-client privilege simply by raising a bad faith claim on any matter regarding an interpretation of the law.²⁸⁷

The Arizona Court of Appeals in *Mendoza* arguably confirmed the fears of the dissent in *Lee* by interpreting and extending the decision in *Lee* in such a manner as to effectively institute a *per se* waiver where the insurer defends

²⁸¹ *Lorenz v. Valley Forge Ins. Co.*, 815 F.2d 1095, 1098 (7th Cir. 1987).

²⁸² *Id.* (reversing lower court’s holding that insurer had waived the privilege by arguing that it acted in good faith during settlement negotiations, where insurer had merely denied and refuted allegation of bad faith failure to settle).

²⁸³ *See Nielsen, supra* note 35, at 10.

²⁸⁴ *See Oil, Chem. & Atomic Workers Int’l Union v. Sinclair Oil Corp.*, 748 P.2d 283, 290 (Wyo. 1987) (holding that where plaintiffs in defamation action alleged that defendants acted with malice, defendants did not waive privilege by asserting their lack of knowledge as a defense: “When, as in this case, malice is an element of a liable action, the burden of pleading and proving that element rests on the plaintiff. Consequently, malice became an issue in this case when appellants filed their complaint.”) (citation omitted).

²⁸⁵ *Lee*, 13 P.3d at 1179.

²⁸⁶ *See Id.* at 1187 (McGregor, J., dissenting).

²⁸⁷ *See Id.* at 1185 (Martone, J., dissenting).

on the basis of subjective reasonableness.²⁸⁸ Now, the recent decision of the Arizona Court of Appeals in *Everest* appears to stem the tide to a certain degree. When viewed against decisions from court in Delaware, Ohio, Washington and Idaho, the development of the Arizona decisions in *Lee*, *Mendoza*, and *Everest* highlight the ongoing uncertainty that exists regarding the attorney-client relationship in insurance bad faith cases; these cases propagate uncertainty for insurance companies relative to seeking needed legal advice because they cannot assume the advice will remain confidential. However, the battle lines have been drawn.

The continued expansion of implied waiver would have a chilling effect upon the attorney-client relationship between insurance companies and their outside counsel. Certainly there is a chill in the air with the decision from Delaware, Ohio, Washington and Idaho. The question remains as to whether *Everest* is signaling that a thaw is coming to the winter that has been creeping into the insurance landscape across the country.

²⁸⁸ See *Mendoza*, 213 P.3d at 303–04.