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Insurer Ordered to Produce Communications With its Counsel Regarding Settlement of Bad Faith Claim, Which Led to Legal Malpractice Action Against Defense Counsel

July 31, 2014
Lawyers for the Profession® Alert

Imperial Fire & Cas. Ins. Co. v. Warman, U.S. Dist Ct., N.D.Okla., 2014 WL 3671327 (2014)

Brief Summary

In a legal malpractice action filed by an insurer against defense counsel it retained to defend an underlying auto accident case, which then led to a bad faith claim against the insurer which was settled, the district court ordered the insurer to produce all communications with its attorneys regarding the bad faith case, finding that the insurer placed such communications at issue by suing defense counsel for malpractice.

Complete Summary

An insurer (Imperial) filed a legal malpractice action against defendants arising out of the following: Imperial's insured, Benson, was at fault in an auto accident in which four people were killed and two others were seriously injured. Before any legal action was filed, Imperial hired an attorney and his firm ("defendants") who filed an interpleader action on Imperial's behalf. The policy limits ($50,000) were paid into court, and Imperial was dismissed. Subsequently, a personal injury action was filed against Benson. What the defendants were retained to do with regard to that action was in dispute and not explained in the decision. In any event, no answer was filed on Benson's behalf. Although a default was not entered, an agreed judgment was entered against Benson in the amount of $13.8 million. Benson also entered into an agreement with the judgment creditors whereby they would not execute against Benson, Benson would sue Imperial for breach of its duties of good faith and fair dealing (the bad faith action), and any money paid by Imperial would be distributed first in payment of Benson's attorney, then the net balance would be split 50/50 between Benson and the plaintiffs in the personal injury action.

Benson then commenced a bad faith action against Imperial. Imperial retained counsel other than the defendants to defend that action. Those same attorneys represented Imperial in the legal malpractice action. Imperial settled the bad faith action for an undisclosed amount. In the legal malpractice action, Imperial alleged that defendants' professional negligence was the cause of its damages

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and sought to recover from defendants the amount Imperial had to pay to settle the bad faith claim, and the attorneys' fees Imperial incurred defending that case.

Defendants sought an order compelling Imperial to produce all documents regarding communications about the bad faith lawsuit from the date the suit was filed through the date the claims were settled, including communications of any kind among Imperial's employees or representatives and Imperial and its various lawyers, claims handlers or insurers. Imperial noted that it "alleges that Defendants committed legal malpractice during the time period in which they were engaged as counsel for [Imperial] and/or Benson." Imperial further noted that it did not allege that defendants committed malpractice after withdrawal as counsel of record. As a result, all of the events that establish whether or not defendants committed legal malpractice occurred prior to the engagement of Imperial's current counsel. Imperial thus argued that communications between Imperial and its current counsel about the bad faith action were not relevant to the claims and defenses.

The district court summarized the parties' positions on the motion to compel as follows: Imperial alleges legal malpractice in defendants' handling of the auto accident case. Imperial ultimately settled a bad faith claim with its insured. Imperial claims the bad faith case was predicated on defendants' actions and claims defendants should have to pay Imperial the amount paid to settle the bad faith suit and the attorney fees Imperial incurred in defending that case. Defendants respond that they did not commit malpractice and that Imperial settled the case, at least in part, because of its own errors and because of errors committed in defending the bad faith suit. Further, defendants question the reasonableness of the decision to settle and the reasonableness of the amount of the settlement.

The parties agreed that in analyzing whether a waiver of the attorney-client privilege has occurred, it is appropriate to apply the three factor test set out in *Hearn v. Rhay*, 68 F.R.D. 574, 580 (E.D. Wash. 1975). To establish an implied waiver of the attorney-client privilege under the *Hearn* test requires the presence of three factors: 1) the assertion of the privilege is the result of some affirmative action taken by the asserting party; 2) through the affirmative act, the asserting party put the privileged information at issue; and 3) applying the privilege would deny the opposing party evidence that is vital to its defense. *Hearn*, 68 F.R.D. at 581. When these three factors exist, a court should find that the party asserting a privilege has impliedly waived the privilege through its own affirmative conduct.

Here, the court found all three factors existed, and the privilege was thus waived. First, Imperial's assertion of the attorney-client privilege was the result of Imperial's affirmative act of filing suit against defendants. Second, most of the information sought by defendants was at issue. In attempting to attribute the entire amount Imperial paid in settlement of the bad faith case to defendants' alleged negligence, Imperial directly placed in issue: Imperial's actions; the actions of its attorneys in defense of the bad faith suit; the reasonableness of the decision to settle the bad faith case, including Imperial's assessment of the risk of trial and the rationale for settling; and the reasonableness of the settlement amount. Third, the attorney-client communications were vital to the defense and not available from another source. As to the third factor, the court found it significant that the bad faith case was settled. The court found that complete information about Imperial's decision to settle the case and the decision to settle for the particular amount paid was not available from Imperial's employees and decision makers without obtaining attorney-client communications. The court thus held that defendants were entitled to discover all of the information at Imperial's disposal when it decided to settle, including all of the information about the case communicated to Imperial by its counsel. The waiver did not extend, however, to information in counsel's files that was not communicated to Imperial.

Significance of Opinion

This decision underscores the fact that a plaintiff's legal malpractice action against former counsel may place otherwise protected attorney-client communications with plaintiff's other lawyers "at issue" in the litigation, which waives the privilege. A waiver generally occurs where a party voluntarily injects either a factual or legal issue into the case, the truthful resolution of which requires an examination of the confidential communications.

For more information, please contact Terrence P. McAvoy.