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Common Interest Doctrine And The Tripartite Relationship: Insurer Use Of Privileged/Protected Defense Material To Attack The Policyholder In The Coverage Case

By Martin C. Pentz and Michael Hoven[1]

I. Introduction

The relationship between an insurer, the policyholder, and the policyholder's defense counsel (appointed or independent) creates unique problems in applying the law of attorney-client privilege and the work product doctrine. An issue policyholders frequently face in coverage litigation concerns the status of opinion work product, and related privileged communications, authored by their defense attorney in the underlying litigation. That attorney, of course, commonly will have prepared evaluations of the strength of the case, or of the strength of particular claims or claims against particular parties. The insurer may have requested this material, or its equivalent, perhaps as a condition of paying for the defense of the case, citing its legitimate interest in evaluating the case for possible settlement or trial. When the case is resolved, there may be uncertainty regarding how much of the settlement or award should be allocated to claims that are covered and how much should be allocated to claims that fall outside the coverage.

In the event of a dispute on this issue and resulting coverage litigation, the policyholder, represented by new counsel, may wish to take a position about the relative strength of the claims that differs from that reflected in defense counsel's work product. The insurer may wish to use that work product as an admission of the policyholder and to argue to judge or jury that even the policyholder's own attorney agreed with the insurer's evaluation of the case. The mental impressions of underlying defense counsel are surely highly protected opinion work product, and may have been expressed in attorney-client communications; can the insurer nonetheless use them in litigation against the policyholder?

Insurers make two arguments to support such use. First, they argue that policyholders, by contesting the coverage decision, have put "at issue" their attorney's mental impressions. But policyholders need not, and often do not, rely on defense counsel's opinions in the coverage case, such that "at issue" precedents will be inapposite. Insofar as the coverage case involves a dispute over the reasonableness of defense counsel's fees, the issue is whether the attorney's work, and the fees charged therefor, were reasonable, not the content of the lawyer's advice or mental impressions. For that purpose, the policyholder can produce the bills from the underlying litigation (perhaps slightly redacted), and the insurer will be positioned to mount a defense.

Second, insurers argue that they had a common interest with the policyholder in containing the exposure posed by the underlying litigation, and so have a right to the otherwise privileged or protected materials generated during that litigation. Insurers are on more solid ground here; there is a zone of common interest, even when there is concurrently adversity (or potential adversity) concerning coverage. But even here, why is it necessary to allow the insurer to use evaluative work product of defense counsel in the underlying case to attack the policyholder in coverage litigation?

This paper focuses on the application of the common interest doctrine in coverage litigation. First, it presents the conflicting and not entirely satisfactory range of approaches that courts have taken to the issue. A recent opinion of the First Circuit, *Vicor Corporation v. Vigilant Insurance Company*, 674 F.3d 1 (1st Cir. 2012), is given special treatment because it illustrates the fundamental problem

[1] Marty Pentz is a partner, and chairs the Insurance Recovery Practice Group, at Foley Hoag LLP. Michael Hoven is a litigation associate at Foley Hoag. The views expressed in this article are those of the authors, and do not necessarily reflect views of Foley Hoag or its clients.

and the difficulty courts have had in resolving it. Second, the authors present a proposed modification of the existing doctrine to prevent the use, in coverage litigation, of materials disclosed pursuant to a common interest in the underlying litigation. The proposal derives from a recognition of the special character of privilege and work product in the tripartite relationship, and borrows from established principles of privilege law that, in some contexts, permit a partial or "selective" waiver of privilege or work product protection while maintaining privilege/protection for the same documents in other contexts or for other privileged/protected documents on the same subject.

II. The Current State of the Law

The common interest doctrine protects parties from waiving privilege or work product protection when they share privileged communications or work product materials with other parties who have a shared interest. *See generally* Edna Selan Epstein, *The Attorney-Client Privilege and the Work-Product Doctrine* 274-97 (5th ed. 2007). The shared interest must be a legal interest to avoid waiver of privilege, whereas a shared business interest is generally sufficient to protect work product materials. *Id.* at 1038. In the context of coverage litigation, insurers have argued that the common interest doctrine gives them the right to see the policyholder's privileged or work product material from the underlying litigation. While such material would generally be protected from disclosure to other parties, insurers argue that there was a common interest in the underlying litigation such that they were entitled to the material, without any waiver of privilege.

The statements of defense counsel in the underlying case, including those concerning the relative legal exposure among parties or claims, may constitute party admissions. *See, e.g.*, *Lightning Lube v. Witco Corp.*, 4 F.3d 1153, 1198 (3d Cir. 1993) (out-of-court statements by attorney are party admissions if "directly related to the management of the litigation" or authorized by the client). If the policyholder cannot assert privilege or work product protection against the insurer, it may argue that the legal opinions of its attorney should be excluded as impermissible opinion testimony or as unacceptably confusing to a jury, but this would not exclude all statements by its attorney and, of course, would not allow the policyholder to withhold the materials from discovery. *See Bensen v. Am. Ultramar*, 92 Civ. 4420, 1996 U.S. Dist. LEXIS 10647, at *41-43 (S.D.N.Y. July 26, 1996) (excluding admissions by attorneys under Rules of Evidence 701 and 403).

Cases in which an insurer has wholly accepted a defense or wholly denied coverage provide for clear applications of the common interest doctrine. If the assumption of coverage is unequivocal, there clearly is a common interest; if coverage is denied, there is no common interest. *But see Waste Mgmt., Inc. v. Int'l Surplus Lines Ins. Co.*, 144 Ill. 2d 178, 194 (1991) (finding common interest where coverage was denied). A more nuanced situation arises when the insurer has reserved rights as to indemnity.

Courts confronting this situation must determine whether a policyholder and an insurer have a common interest sufficient to warrant compelling the policyholder to turn over privileged or work product material. Courts have developed several approaches for determining the presence or scope of a common interest, which can be grouped into three categories depending on the primary focus of the court: (1) decisions that focus on the insurer's position concerning coverage; (2) decisions that focus on the nature of the representation in the underlying litigation; and (3) decisions that focus on the parties' respective interests (typically as reflected by their conduct). In addition, some courts apply the doctrine differently with respect to the work product doctrine.

A. The Insurer's Position as Dispositive

In keeping with the conventional focus on the coverage determination made by the insurer, some courts have found that the reservation of rights itself resolves the issue. A court may conclude that the reservation of rights precludes the identity of interests required. *First Pac. Networks v. Atl. Mut. Ins. Co.*, 163 F.R.D. 574, 579 (N.D. Cal. 1995) (reservation of rights creates conflict of interest); *Chi. of Alaska v. Emplrs. Reinsurance Corp.*, 844 P.2d 1113, 1116 (Alaska 1993) (defending under reservation of rights creates conflicts of interest).

This creates a clear, bright-line rule, but is the minority view. It also creates perhaps unnecessary obstacles to insurer use of defense counsel work product for purposes of making prudent settle-or-try defense decisions or in valuing the underlying case.

B. The Nature of the Representation

Instead of looking to the insurer, courts may focus on the lawyer: how is he or she chosen and paid, and who does he or she represent? This may be related to the insurer's decision to defend or reserve rights, since a reservation of rights gives the policyholder the right to have independent counsel in many jurisdictions. Nonetheless, the nature of the lawyer's representation can have significance independent of the insurer's decision, and may take into account decisions made by the policyholder.

Courts may treat the policyholder's decision to retain independent counsel as determinative. For example, a Virginia trial court held that while the insurer's decision to defend under a reservation of rights "alerted [the policyholder] to the *possibility* that their interests were adverse," it was the policyholder's election to have independent counsel that defeated application of the common interest doctrine. *RML Corp. v. Assurance Co. of Am.*, 60 Va. Cir. 269, 276 (Cir. Ct. 2002) (emphasis added); *see also In re Texas E. Transmission Corp. PCB Contamination Ins. Coverage Litig.*, MDL Docket No. 764, 1990 U.S. Dist. LEXIS 7912, *14 (E.D. Pa. June 27, 1990) (rejecting application of common interest doctrine because retention of independent counsel signaled that the scope of shared interest was uncertain).

Alternatively, courts may focus on who paid defense counsel in the underlying litigation rather than who chose defense counsel. In *Vicor Corporation v. Vigilant Insurance Company* (of which more later), the First Circuit held that because the insurers paid for counsel and part of the settlement, defense counsel was deemed to represent both the policyholder and the insurers, even though the insurers had defended under a reservation of rights and the policyholder chose its own counsel. 674 F.3d 1, 18-19 (1st Cir. 2012).[2] Because the attorney represented both the policyholder and insurer, the parties had a common interest that made at least some privileged and work product materials discoverable. *Id.* at 19. In contrast, a California appellate court rejected the argument that the insurer's payment of independent defense counsel sufficed to create a common interest between the insurer and the policyholder, even where the insurer also selected defense counsel. *Rockwell International Corp. v. Superior Court*, 26 Cal. App. 4th 1255, 1267 (1994). The court held that counsel was retained *for* the policyholder and represented the policyholder alone. *Id.*

C. Identity of Interests

Courts may try to assess whether there is an identity of interests between the policyholder and insurer without regard to formalities of representation. Courts following this approach can be further subdivided into two camps. In the first camp are courts that focus strictly on the interests within the underlying litigation. In the second camp are courts that consider the policyholder's and the insurer's interests more broadly, namely, by taking into account the potentially adverse positions on coverage even when the parties' interests are aligned within the formal bounds of the underlying litigation.

The Illinois Supreme Court in *Waste Management* – in a decision that appears to be unique on this issue – determined that the policyholder and the insurer had a common interest in avoiding liability in the underlying litigation that compelled the disclosure of privileged materials in the coverage litigation even though the policyholder's attorney did not represent and was not retained by the insurer. *Waste Mgmt., Inc. v. Int'l Surplus Lines Ins. Co.*, 144 Ill. 2d 178, 194 (1991). Various courts have disagreed with *Waste Management* on precisely this issue and held that where the insurer did not participate in the defense of the underlying litigation there is categorically no common interest. *See, e.g.*, *Bituminous Cas. Corp. v. Tonka Corp.*, 140 F.R.D. 381, 386-87 (D. Minn. 1992) (no common interest because policyholder's attorney never represented the insurer); *Remington Arms Co. v. Liberty Mut. Ins. Co.*, 142 F.R.D. 408, 418 (D. Del. 1992) (same).

More commonly, courts recognize that even the shared goal of avoiding or minimizing liability does not eliminate all potential adversity when an insurer defends under a reservation of rights. In those cases, courts look to the conduct of the parties to answer

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[2] The First Circuit applied Massachusetts law, but whether it correctly discerned that law is debatable. The Court cited two cases for the proposition that "Massachusetts law . . . considers an attorney retained by an insurer to represent the insured as the attorney for both": *Imperiali v. Pica*, 338 Mass. 494 (1959), and *Rhodes v. AIG Domestic Claims, Inc.*, No. 01-1360-BLS2, 2006 Mass. Super. LEXIS 19 (Mass. Super. Jan 27, 2006). *Rhodes*, in turn, cites *Imperiali* and *McCourt Co., Inc. v. FPC Properties, Inc.*, 386 Mass. 145 (1982). None of the cases addresses a situation in which a policyholder chose its own independent counsel following an insurer's reservation of rights. Indeed, *McCourt* concerned whether a law firm repeatedly retained by an insurer had that repeat customer as its *only* client, or whether the policyholders that it represented were also clients; the SJC held that both the insurer and the policyholder were clients. 386 Mass. at 146-47. *Imperiali*, in assessing whether an insured had complied with a policy's cooperation clause, noted that "an attorney undertaking the defence of the case covered by the policy is an attorney for both the insurer and the insured." 338 Mass. at 499. There too, however, the attorney's relation with the insurer was treated as a given. *See id*. at 495.

a background question of privilege law: was there a reasonable expectation that the documents sought would remain private? *See, e.g.*, *ALIT Ltd. v. Brooks Ins. Agency*, No. 10-2403, 2012 U.S. Dist. LEXIS 38144, *29 (D.N.J. Mar. 20, 2012); *Lectrolarm Custom Sys. v. Pelco Sales, Inc.*, 212 F.R.D. 567, 570 (E.D. Cal. 2002); *Northwood Nursing & Convalescent Home v. Cont'l Ins. Co.*, 161 F.R.D. 293, 297 (E.D. Pa. 1995).

ALIT and *Lectrolarm* involved third parties who sought discovery of communications between policyholders and insurers in underlying litigation, and argued that there was *not* a common interest. Without a common interest, any privilege would be waived by the disclosure between the policyholder and insurer. In both cases, the court held that the substance of the materials exchanged between the parties indicated that they expected those materials to remain confidential. The policyholder and insurer in each case communicated freely and frequently about the underlying litigation, including evaluations of potential liability and potential damages. Both courts concluded that this indicated that the parties had expected the communications to remain private, so they were protected by the common interest doctrine.

In *Northwood Nursing*, an insurer agreed to defend one underlying action, denied coverage on other actions, and had, at the time of the court's decision, not made decisions on yet other cases. 161 F.R.D. at 297. The court held that there was a common interest where the insurer agreed to defend and was not a common interest where coverage was denied. *Id.* Where the insurer had not determined whether coverage applied, the court held that the policyholder had a reasonable expectation that its communications with its attorney would be protected from disclosure to the insurer. *Id.*

D. Work Product Doctrine

Most courts discussing common interest do not address any distinction between privilege and work product, or expressly state that the common interest doctrine "applies with equal force to claims of work product" as to claims of privilege. *E.g.*, *Metro Wastewater Reclamation Dist. v. Cont'l Cas. Co.*, 142 F.R.D. 471, 478 (D. Colo. 1992). There is, however, one way in which courts have distinguished work product material from attorney-client communications in this context. Material prepared in anticipation of the underlying litigation may be distinguished from material prepared in anticipation of the coverage litigation and left unprotected.

Making this distinction narrows the potential scope of work product protection by allowing an insurer access to work product in the underlying litigation, while shielding work product that was created during the coverage litigation. This approach was taken in *Waste Management*, which held that work product prepared for a lawsuit in which the parties shared a common interest was not protected in subsequent litigation in which the same parties were adverse. 144 Ill. 2d at 198.

The District of Minnesota adopted a contrary position on the protection of work product materials prepared in underlying litigation. *Bituminous Cas. Corp. v. Tonka Corp.*, 140 F.R.D. 381, 386-87 (D. Minn. 1992). In *Bituminous*, the court recognized that the documents the insurers sought were not prepared for the instant declaratory judgment action, but said that "[t]he inquiry this court must answer is whether the documents were in fact prepared in anticipation of some litigation." *Id.* at 387. The court concluded that the documents were prepared in anticipation of prior litigation and were protected from disclosure. *Id.* at 390.

III. The *Vicor* Example

The First Circuit's decision in *Vicor* illustrates the fundamental problem. In the underlying litigation, Vigilant provided a defense to Vicor subject to a reservation of rights. *Vicor Corp. v. Vigilant Ins. Co.*, 674 F.3d 1, 16 (1st Cir. 2012). Vicor chose its own counsel, who provided periodic reports to Vigilant in order to comply with Vigilant's billing "guidelines." *Id.* The case ultimately settled for $50 million. *Id.* The settlement did not allocate a dollar amount per claim, or allocate the settlement amount between covered and uncovered claims. *Id.* Vigilant determined that approximately $13 million of the settlement amount was for covered claims, leaving Vicor responsible for the remaining $37 million. *Id.*

Vicor then brought the coverage suit, arguing that all of the $50 million settlement was for covered claims. *Id.* at 17. Vigilant moved to compel the production of all documents related to the underlying litigation that had been withheld as privileged or work product. *Id.* In particular, Vigilant was concerned with a report by defense counsel in the underlying case that categorized the claimed damages. *Id.* The district court denied the motion. *Id.*

On appeal, the First Circuit vacated the denial, relying on its view that Massachusetts holds that defense counsel represents both insurer and insured, and holding that the common interest between Vicor and Vigilant in the underlying litigation made at least some of the withheld materials discoverable. *Id*. at 19-20. The Court also found it noteworthy that underlying defense counsel for Vicor had shared evaluative work product with Vigilant on numerous occasions. *Id.* at 19. For the First Circuit, this meant that Vicor was trying to "have it both ways," and should not be permitted to benefit from the common interest doctrine by avoiding waiver in the underlying litigation and then assert the privilege in the coverage litigation. *Id.* The court further concluded that, even where work product was protected, Vigilant might have a substantial need for the documents that would overcome the protection. *Id.* at 20.

While the First Circuit thus vacated the district court's denial of Vigilant's motion to compel, its instructions on remand gave scant guidance as to which documents must be produced and which remained protected. Vicor would not be permitted "to shield *all* communications between it and underlying defense counsel," and "[d]ocuments produced while the insurers were providing a defense are *unlikely* to be protected." *Id.* at 19-20 (emphasis added). Yet neither were "all communications [between insurer and insured] . . . excepted from the applicable privileges," and the insurers were not "necessarily entitled to the entire defense file, as they claim." *Id.* at 20. The First Circuit therefore rejected the parties' arguments that all privileged or work product materials should be produced (the insurers' position) or that no privileged or work product materials should be produced (Vicor's opinion), without stating where the line dividing protection from production should be drawn.[3]

IV. A Modest Remedial Proposal

The application of the common interest doctrine in coverage litigation is, as we have seen, unpredictable and inconsistent. Even the First Circuit Court of Appeals, in a recent case applying what it took to be established state law, could say no more than that the common interest doctrine dictated that some (but not all) privileged and work product materials should be produced in the coverage litigation. The current state of the law puts defense counsel in an untenable position: to help their clients reach a favorable settlement requires providing the insurer with the most accurate assessment of the case possible – which may simultaneously provide the insurer with a potent weapon in the not unlikely event of coverage litigation.

Any solution to this problem must serve two goals. First, it must preserve the value of the common interest doctrine in the relationship between the insurer and the policyholder. The insurer should have access to the best information available in order to make settlement decisions, and the material shared between the insurer and the policyholder should not thereby become discoverable to the plaintiff in the underlying litigation. Second, it must alleviate the conflict faced by defense counsel, when helping their client now might mean hurting their client down the road.

Certain insurers have developed one possible solution by "splitting the file": assigning one claim handler to manage the policyholder's defense, and another to determine whether coverage applies. *See* Jay M. Levin, Lauren Angelucci, *Erecting an Ethical Wall Between Coverage and Defense by Splitting Claim Files* at 4-5, ABA Insurance Coverage Litigation Committee CLE Seminar (March 2015); Brent W. Huber and Angela P. Krahulick, *Bad Faith Coverage Litigation: The Insurer's Covenant of Good Faith and Fair Dealing*, 42 Tort Trial & Ins. Prac. L. J. 29, 47 (Fall 2006). This would permit defense counsel to share information with the insurer to advance the insured's defense without the risk that the same information would be used to deny or limit coverage. *Erecting an Ethical Wall* at 5-6.

Two problems prevent splitting the file from being a fully effective solution. First, it is not mandatory. At most, an insurer's decision not to split the file *may* be a factor that a factfinder could consider in evaluating whether an insurer handled a claim in good faith. *See Twin City Fire Ins. Co. v. City of Madison*, 309 F.3d 901, 909 (5th Cir. 2002); *but see Am. Capital Homes, Inc. v. Greenwich Ins. Co.*, No. C09-622-JCC, 2010 U.S. Dist. LEXIS 89403, at *14-15 (W.D. Wash. Aug. 30, 2010) ("no support" for the argument that assigning a single adjuster to defense and coverage issues constitutes bad faith). Second, the screen established by splitting the file may not effectively prevent information from crossing over between the insurance company personnel assigned to defense and coverage. The screen would have to encompass more than merely the front-line adjusters, and would have to ensure that the adjusters

[3] The issue appears not to have been pressed on remand, so we do not have the benefit of the district court's application of the common interest rulings of *Vicor*.

handling the defense were not aware of the potential coverage issues. *See Armstrong Cleaners, Inc. v. Erie Ins. Exch.*, 364 F. Supp. 2d 797, 817 (S.D. Ind. 2005).

The authors propose a different solution: a doctrinal fix that would bring clarity to this murky area of law, and relieve defense counsel of the dilemma of whether helping their client by providing the insurer with an assessment necessary to evaluate settlement would simultaneously injure their client by providing the insurer with a weapon in potential coverage litigation. The law as it currently stands already provides that:

1. The policyholder and an insurer defending under a reservation of rights share a common legal interest that permits the policyholder to share privileged and work product material with the insurer without waiving the privilege or work product protection as to third parties.

Recognizing the unique nature of the tripartite relationship, and borrowing from Federal Rule of Evidence 502 and the doctrine of selective waiver, the authors propose the additional rule that:

2. Privileged or work product material regarding an underlying proceeding that is shared by a policyholder with an insurer pursuant to a common defense interest should not, in any coverage case concerning that proceeding, either (i) be offered in evidence or otherwise used by the insurer, or (ii) furnish a basis for discovery of privileged or work product information not previously disclosed.

This proposal recognizes the reality that, in the reservation of rights context, the policyholder and insurer are not parties who once shared a common interest and then had a falling out. Instead, the relationship always consisted of zones of common interest alongside zones of adverse interest. Any attempt to define the scope of common interest chronologically ignores this aspect of the tripartite relationship.

The proposal also fosters "full and frank communication" in coordinating the defense in the underlying litigation, thereby serving one of the fundamental purposes for the attorney-client privilege in the first place. *See Upjohn Co. v. United States*, 449 U.S. 383, 389-90 (1981). It also serves the particular goal of the common interest doctrine: to allow parties to share information without risking its disclosure to an adversary. The position taken by insurers in coverage litigation achieves the contrary goal: compelling policyholders to hand over information to their adversary. Indeed, the common interest doctrine itself arguably already calls for at least part of the remedy proposed here: if the disclosure to the insurer did not waive the privilege in the first place, then why should the insurer be permitted to deploy the material at issue in the coverage case, where doing so necessarily would involve a *further* disclosure to judge and/or jury? The policyholder's objection or motion to strike grounded in privilege should be sustained.

Existing doctrine regarding partial waiver of privilege (now embodied in Federal Rule of Evidence 502) and so-called "selective waiver" principles (where applicable) already embrace a pragmatic approach to limiting the impacts of disclosure of privileged or work product protected material. Rule 502 permits a party to disclose information in a federal proceeding, or to a federal agency, without necessarily waiving the privilege or protection applicable to other materials on the same subject. Similarly, the doctrine of selective waiver recognizes that disclosure of material to a government agency should not necessarily permit use of the same material against the disclosing party in subsequent litigation.

The touchstone of the analysis under Rule 502 or selective waiver is fairness. FRE 502(a)(3); *In re Grand Jury Proceedings John Doe Co. v. United States*, 350 F.3d 299, 302 (2d Cir. 2003). In the context of coverage litigation, fairness favors protecting the privileged and work product material created in the underlying litigation. Insurers would not be prevented from mounting an effective defense. They could still discover the underlying facts, and present testimony from retained experts. A leading commentator on privilege law has said that, where "underlying facts were provided" and "the adversary was free to do its own work and reach its own conclusions," it would be "punitive" not to allow selective waiver. Edna Selan Epstein, *The Attorney-Client Privilege and the Work-Product Doctrine* 1093 (5th ed. 2007). All that the present proposal would prevent insurers from doing is saying, in support of its arguments regarding allocation or reasonableness of defense costs, "Even your attorney who defended the case said so!"