

**CREATIVE AND NEW STRATEGIES RELATED TO
THE ADVICE OF COUNSEL DEFENSE:
USING THE LAWYER AS INVESTIGATOR**

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I. CREATIVE AND NEW STRATEGIES RELATED TO THE ADVICE OF COUNSEL DEFENSE: USING THE LAWYER AS INVESTIGATOR

- A. Many bad faith cases arise out of challenged coverage decisions.
- B. In the litigation, the carrier will have to defend its declination of coverage as well as demonstrate to the jury that its claims handling was “reasonable.”

Courts generally recognize that some fact gathering incident to providing legal advice can and must be done without making the attorney a witness. *Upjohn v. U.S.*, 449 U.S. 383; *Dunn v. State Farm Fire & Cas.*, 927 F.2d 869 (5th Cir. 1991); *Aetna v. Superior Court*, 153 Cal.App.3d 467 (1st Dist. 1984).

However, several courts have also held that where a lawyer acted primarily as an adjuster, the lawyer is unprotected from deposition or file discovery. *Mission National Ins. Co. v. Lilly*, 112 F.R.D. 160 (D. Minn. 1986); *Rounick v. Fireman’s Fund Ins. Co.*, 1996 WL 421903 (E.D. Pa. 1996); *Western National Bank of Denver v. Employees Ins. Of Wausau*, 109 F.R.D. 55 (D. Colo. 1985); *Reiss v. British Gen. Ins. Co.*, 9 F.R.D. 610 (S.D.N.Y. 1999). Factors that may weight in favor of compelling discovery include whether the attorney’s primary role was investigation with little or no legal advice involved, and whether counsel has relevant investigative knowledge not available elsewhere.

Some courts have gone further, actually eroding the privilege itself. *Boone v. Vanliner Ins. Co.*, 91 Ohio St. 3d 209, (communications between an insurance company and its coverage counsel “unworthy of protection” in any case where bad faith is merely alleged); *State Farm Mut. Auto Ins. Co. v. Lee*, 199 Ariz. 52, 13 P. 2d 1169 (2000) (legal opinion from outside counsel are “at issue” if the

insurer asserts it acted in good faith consistent with its understanding of the law even without asserting the “advice of counsel” defense).

For an excellent and thorough discussion of the attorney-client privilege in coverage disputes, see *Aylward, Protecting the Privilege Report of the DRI Task Force*, Dec. 2001.

- C. In complicated coverage cases, carriers should consider using the lawyer as the factual investigator (adjustor) as well as its legal advisor.
1. For example, assume that a large bank makes a fidelity claim against its insurer based upon the fact that the bank has been defrauded of millions of dollars.
 2. The carrier, preliminary to denying coverage, does an extensive factual investigation on the “dishonest acts” issue.
 3. Instead of using its own staff, carrier hires a well-known lawyer who is an expert in the field of fidelity coverage; lawyer conducts extensive investigation, including the taking of numerous witness statements, using private investigators, analyzing thousands of documents, etc.
 4. Lawyer’s “factual investigation” file is huge and extremely well-documented.

5. Lawyer's file is strictly divided between "factual investigative material" and his/her "legal opinion" or "legal analysis" section of the reports that the lawyer sends to the carrier.
 6. The factual investigation material will ultimately be discoverable in the bad faith/coverage litigation, but not the legal analysis or the lawyer's opinion of the legal effect of the factual investigation. This is traditional attorney-client communication and/or work-product privileged information.
- D. Ultimately, this lawyer may be deposed concerning his/her factual investigation – but perhaps not, since the factual investigation will be so extensive that it may speak for itself and the other side may decide not to depose the lawyer at all.
1. But if lawyer is deposed and does testify at trial, can make significant impact (favorable) on jury.
- E. Another plus in this approach is that carrier may be too understaffed to conduct the thorough and complete investigation that the lawyer conducted.
1. After all, lawyer is being paid by the hour and will do a complete investigation, whereas carrier may not have this ability.
 2. Also, the more complete the investigation, the easier it is for the carrier to avoid bad faith (i.e., carrier was "reasonable" in its investigation and spent a lot of money in doing a thorough investigation, which is what the carrier is supposed to do).

- F.** Therefore, in the bad faith litigation, one lawyer will be the “coverage” lawyer; the carrier can have a separate lawyer who will be the “bad faith” lawyer, to defend the company’s claims handling process. Ethical rules allow disqualification of a lawyer from acting as counsel in a trial “in which the lawyer is likely to be a necessary witness....” ABA Model Rule 3.7.
- G.** Also note that the extensive factual investigation can establish the “genuine issue” defense on coverage and damages issues that has been amazingly successful for insurers in the last decade.

II. THE HOLLYWOOD APPROACH; SCRIPTING THE CASE WELL IN ADVANCE OF LITIGATION

- A.** Often times, the carrier will know when a potential claim is about to arise and how serious it is, monetarily and politically.
- B.** Carrier should consider the advantages of quick reaction to a problem and the opportunity to “script” the ultimate defense of the claim well in advance of its presentation.
- C.** For example, carrier could consider hiring a highly qualified lawyer who makes an exceptionally good and persuasive presentation to the public and before a jury.

 - 1. Such an attorney can become involved at the early stages of the case, and can be a spokesman to the press and to the public concerning the claim.
 - 2. Such a lawyer would probably not ultimately be the lawyer handling the case once litigation is filed.
 - 3. Instead, this lawyer would be the one giving “advice” to the carrier, and the carrier may choose to use this lawyer in connection with the “advice of counsel” defense.
- D.** This is a lawyer who will present well before the jury; the jury will realize that the lawyer has been involved from the onset of the claim, knows a great deal about the claim, and the lawyer will be in a position to “tell the story” of the claim and the factual and legal ramifications and recommendations that he provided.

- E. Most importantly, the carrier has planned the entire endeavor well in advance and thereby will be better able to control the defense and the presentation, enhancing its chances of success.

III. THE ADVICE OF COUNSEL DEFENSE: USING THE UNDERLYING DEFENSE COUNSEL (IN A THIRD PARTY CASE) EFFECTIVELY

- A. Some bad faith cases arise out of third party underlying cases.
 - 1. For example, the verdict in the third party liability case in the underlying action may be in excess of the limits, triggering a bad faith case against the carrier.

- B. In such situations, the attorney representing the company in the bad faith case should consider carefully the use of defense counsel in the underlying action as a witness in the bad faith case. Good faith reliance on advice of counsel can negate bad faith. *State Farm Mut. Auto. Ins. Co. v. Sup. Ct.* (1991) 228 Cal.App.3d 721; *Merritt v. Reserve Ins. Co.* (1973) 34 Ca.App.3d 858. It may also eliminate punitive damages. *Melovich Builders, Inc. v. Sup. Ct.* (1984) 160 Cal.App.3d 131; *Fox v. Ac-ed* (1957) 49 Cal.2d 381.

- C. A big advantage in utilizing this technique is that defense counsel in the underlying action can “tell the full story” and get away with testimony and presentations that would otherwise not be allowed.
 - 1. This lawyer was present for most of the underlying case; conducted discovery; took the depositions; observed the witnesses; conducted the settlement negotiations; will be able to comment on the attitude and statements of opposing counsel in the underlying action; can comment (in the bad faith trial) on the demeanor of the witnesses in depositions (believable or not believable; liars or truth tellers)

2. This lawyer can testify as to his/her evaluation of the underlying case and why he or she felt that the case was worth under the policy limits and that he or she so advised the carrier (establishing both reasonableness on the part of the carrier in relying upon the lawyers advice).
 3. Having one person tell the full story avoids the “disjointed” presentation of a defense, with multiple witnesses testifying on separate and often unconnected aspects of the case.
 4. If the jury likes the defense lawyer and is persuaded by his full rendition of the underlying story, the carrier’s position is enhanced.
 5. Note that the lawyer will probably be able to get away with much hearsay testimony that would otherwise not be admissible: all of this will relate to what the lawyer felt the underling case was worth, the central issue, and often experts or other witnesses are allowed to rely upon “hearsay” which affected their opinion.
- D. There are four elements to the advice of counsel defense: (1) the 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. James C. Nielsen, *Advice of Counsel in Insurance Bad Faith Litigation: A Substantive Framework for Pleadings, Discovery and Proof*, 25 TORT & INS.L.J. 533, 43 (1990); see *Melovich Builders, Inc. v. Superior Court*, 160 Cal.App.3d

931, 936-37 (Ct. App. 1984). *Bertero v. National Gen. Corp.* (1974) 13 Cal.3d 43.

1. Insurer Sought Advice in Good Faith: The insurer must seek legal advice before making a decision on the claim, not merely to "rubber-stamp" a decision that has already been made. In addition, there may be an argument that the defense does not apply where a claim turns on a question of factual interpretation (e.g., a fraud claim), as opposed to legal advice.
2. Disclosure of all Pertinent Information: The insurer must show that it provided counsel with all pertinent information. *Douglas v. U.S.F.&G. Co.*, 127 A. 708, 710 (N.H. 1924). This is why it is good practice to provide counsel with a complete copy of the claims file and a certified copy of the policy.
3. Insurer Acts on the Advice in Good Faith: The insurer's reliance on the advice must be reasonable. Factors that may be considered is whether the insurer acted reasonably in choosing competent counsel; whether counsel provided a complete and well-reasoned opinion based on all the facts; and whether the insurer relied on the advice as the basis for its decision. *Allen v. Allstate Ins. Co.*, 656 F.2d 487 (9th Cir. 1981) (reliance on legal advice as to the percentage chance of an adverse judgment was "wishful thinking" not a good faith balancing of the insurer's interests against those of the insured); *Moore v. American United Life Ins. Co.* (1984) 150

Cal.App.3d 610 (defense not available where insurer knows or should know the advice is incorrect.

4. Competent Counsel: Courts will consider the attorney's reputation, experience and professional credentials in evaluating whether an insurer acted reasonably to retain competent counsel in the particular area of law. *Ferris v. Employers Mut. Cas. Co.*, 122 N.W. 2d 263 (Iowa 1963); *Olson v. Union Fire Ins. Co.*, 118 N. @ 2d 318, 321 (Neb. 1962). Thus, evidence of the attorney's experience in similar cases may be helpful to show the attorney was competent in the area.

- E. Interplay with the "Genuine Dispute" Doctrine: Many jurisdictions now recognize that an insurer does not act in bad faith so long as there was a "genuine dispute" as to coverage. *Chateau Chamberay* _____; *Guebara v. Allstate*. Assuming the insurer acted on the advice of counsel, even if the decision turns out to be wrong, the "genuine dispute" doctrine should provide an additional defense to bad faith.

- F. Considerations in whether to assert the advice of counsel defense.

1. Whether the defense will be successful under the facts of the particular case in view of the above requirements. Many courts have found that an insurer breached a duty to the insured for failure to settle even if the insurer followed the advice of counsel in rejecting a settlement offer below policy limits. [see me for citations fn 61]. In addition, whether an investigation is privileged may depend on whether the issues are fact-

based or routine, or whether they involve “complex issues of law, which intrinsically, required sophisticated legal appraisements.” *In re Allen*, 1096 F. 3d 582, 603 (4th Cir. 1997); *Schmidt v. California State Auto Ass’n.*, 127 F.R.D. 182, 184 (___ Nev. 1989). Query whether advice given in certain arson/fraud cases, which depend heavily on factual analysis, might not be protected.

2. Whether asserting the defense will be perceived as an admission of wrongdoing.
3. Whether the cost of proof is justified, especially in the third party context where an excess verdict will be viewed as de facto evidence that the legal advice given was unreasonable.
4. How a waiver of the attorney-client privilege will impact the case, since raising the defense operates as a waiver of the privilege as to communications relating to the advice. *Transamerica Title Ins. Co. v. Sup. Ct.* (1987) 188 Cal.App.3d 1047; *Handgards, Inc. v. Johnson & Johnson* (ND Cal. 1975) 413 F.Supp.926. Cf. no waiver where advice not asserted as defense. *Aetna Cas. & Sur. Co. v. Sup. Ct.* (1984) 153 Cal.App.3d 467. This also impacts the timing of raising the issue. Although it is not an affirmative defense, since raising the defense waives the privilege, the insured will be entitled to discovery of the attorney's files and testimony before trial. *Clem Co. Indus. v. Commercial Union Ins. Co.*, 665 F.Supp. 816, 830 (N.D. Cal. 1987).

- G.** Application to In-House Counsel: Although the fact that a corporate officer or director relied on the advice of counsel may help show that the insurer followed the business judgment rule, such reliance may not be enough to satisfy the standards of the business judgment rule, since an officer is expected to exercise his own good business judgment.
- H.** General comments on the Crime-Fraud Exception (for communications intended to advance a criminal or fraudulent enterprise). In Re Grand Jury Proceedings, 183 F.3d 71 (1st Cir. 1999; *Levin v. C.O.M.B. Co.*, 469 N.W.2d 512 (Minn.Ct.App. 1991) (mere allegation of wrongdoing does not warrant application of the exception; the claimant must make a *prima facie* showing the communication was in furtherance of a crime or fraud); accord, *Barr Co. v. Safeco Ins. Co. of America*, 1985 WL 2119 (N.D. ILL. July 1985).