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Navigating Your Way Through Reservations of Rights, Cooperation Clauses and Privilege

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Insurance companies often invoke a policy's cooperation clause to compel a policyholder to share privileged defense information even after the insurance company has reserved the right to deny coverage at a later date. At one extreme, the policyholder might withhold all defense information and risk, prompting the insurance company to issue a disclaimer of coverage for failure to cooperate. At the other end of the spectrum, a policyholder might lose the protection of litigation privileges by giving the insurance company unfettered access to defense information, potentially rendering the material discoverable by the policyholder's adversary in the underlying action. Policyholders can avoid these outcomes by taking proactive steps to preserve the privileged nature of defense materials shared with their primary or excess insurance companies.

Policyholders are familiar with insurance companies' practice of reserving rights to disclaim coverage early in the policyholder's defense of the underlying action. Despite their reservations of rights, insurance companies nevertheless often demand privileged defense materials from their policyholders and ground the demand in the policy's cooperation clause — a clause (common to commercial general liability policies) that purports to impose an undefined "duty to cooperate" on the policyholder. While the stated purpose is to gather information relevant to the defense of the underlying action, insurance companies frequently mine this material for information that could support a disclaimer of coverage and thus reduce or eliminate the insurance company's exposure to loss.

Enter the Excess Insurance Company

The situation is further complicated when a policyholder has both primary insurance and excess insurance that "follows form" to the primary insurance. Often, the primary insurance company bears the duty to defend and is closely involved in the defense of the underlying action from the start of the litigation.

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Excess insurance companies, meanwhile, may not enter the fray for months, often years, after the policyholder and primary insurance company have established a working relationship, be it amicable or contentious. Excess insurance companies that have seemingly been uninterested in the details of the underlying action may suddenly seek to become involved; and may even seek to appoint their own selection of co-counsel to appear in the case on the eve of trial. There is strong support for the proposition that insurance companies cannot intervene in the defense of an action late in the case. *See, e.g., Bassett Seamless Guttering, Inc. v. GutterGuard, LLC*, No. 05 Civ. 184, 2007 U.S. Dist. LEXIS 51002 (M.D.N.C. July 13, 2007) (two months before trial); *McWhorter v. Elsea, Inc.*, No. 00 Civ. 473, 2006 U.S. Dist. LEXIS 88273 (S.D. Ohio Dec. 6, 2006) (five months before trial).

Even if the excess insurance company successfully asserts a right to associate in the defense of an action, its role and, consequently, its access to privileged materials is limited. This majority position is reflected in § 26 of the American Law Institute's July 23, 2014, draft "Principles of the Law of Liability Insurance." As set forth in the proposed guidance, an excess insurance company that associates in the defense has "the right to receive from defense counsel and the insured, upon request, information that is reasonably necessary to assess the insured's potential liability and to determine whether the defense is being conducted in a manner that is commensurate with that potential liability, with the exception of confidential information that relates to an actual or potential coverage dispute[.]" *Id.* at § 26(a)(1). In its comments to § 26(1)(a), ALI explains that "the information that must be provided and the situations in which consultation is required are subject to a reasonableness rule that is context dependent." Factors in that context-specific analysis include the excess insurance company's prior level of engagement in the claim, the degree to which the policyholder has kept the excess insurance company apprised of the claim, and the soundness of defense counsel's strategy.

The Risk of Forfeiting Privilege

The tension between the policyholder's desire to comply with the cooperation clause, and fear of arming its insurance company is compounded by the risk that privilege could be lost in the process, and the plaintiff in the underlying action might thereby gain access to the information. Generally, disclosure of privileged information to parties outside the attorney-client relationship results in a waiver of that privilege. The risks are high: the disclosure of unfavorable defense materials not only may provide the insurance company with a basis to deny coverage, it also may arm the plaintiff with information that will hurt the policyholder at trial.

Many states seek to mitigate this risk through a doctrine called the "common interest privilege" (also called the "joint defense privilege" or "community of interest privilege"). Whether your state recognizes this doctrine should always play a role in deciding what information to disclose to your insurance company. The common interest privilege preserves the privileged nature of documents and information that are shared with those outside the confidential relationship, so long as the disclosure is made to further a common interest and in a manner that demonstrates an intent to maintain confidentiality.

Depending on the applicable state law, privileged defense material shared with a policyholder's insurance company to further a common interest — namely, minimizing the policyholder's liability — may be done without waiving the privilege or rendering the material subject to discovery by the plaintiff in the underlying action. Some states limit the common interest doctrine to cases in which one attorney represents both the policyholder

and the insurance company's interests. *See e.g., Remington Arms Co. v. Liberty Mut. Ins. Co.*, 142 F.R.D. 408, 417-18 (D. Del. 1992). And most jurisdictions have declined to recognize the common interest privilege as between a policyholder and its insurance company if the insurance company has disclaimed coverage. *See, e.g., Lafarge Corp. v. Hartford Cas. Ins. Co.*, 61 F.3d 389, 398 (5th Cir. 1995); *NL Industries, Inc. v. Commercial Union Insurance Co.,* 144 F.R.D. 225, 231 n. 10 (D.N.J. 1992). This renders the common interest privilege inapplicable in precisely those cases in which the insurance company probably will seek to use privileged information against the policyholder to avoid or reduce its coverage obligations.

Protect Yourself in Advance with a Confidentiality Agreement

A carefully drafted agreement between the policyholder and the insurance company can address these risks and not only preserve privilege, but also limit the scope of what will be shared with the insurance company. A "common interest and confidentiality agreement" can both demonstrate that the policyholder seeks to satisfy its duty to cooperate, and protect the policyholder from having to divulge harmful defense materials to the plaintiff in the underlying action.

Not much case law has developed regarding the right of a plaintiff to obtain access to privileged information that a defendant has shared with its insurance company under a confidentiality agreement. As other commentators have suggested, the key to a successful confidentiality agreement is to identify the parties' common interest and their adverse interests. *See, e.g.,* John Buchanan and Wendy Feng, *Protecting Privilege While Preserving Coverage,* available at http://bit.ly/1mt8az9 (Mar. 8, 2012). In appropriate circumstances, that which is common may be shared.

The interest common to both the insurance company and the policyholder is the reduction of the policyholder's ultimate liability to the plaintiff. The confidentiality agreement should clearly and unequivocally confirm that the only purpose of the agreement is for the policyholder to share privileged defense information with the insurance company in order to further the parties' common interest. Meanwhile, there are a host of adverse interests stemming from the policyholder's desire to maintain coverage, and the insurance company's goal of avoiding or limiting coverage. A confidentiality agreement should identify those adverse interests and make clear that the policyholder has no obligation to share any information that could further the insurance company's adverse interest — that is, not a "common" interest. Finally, a confidentiality agreement should specify that by sharing information within the bounds of the agreement, the policyholder is in compliance with the policy's cooperation clause.

Disclosure of privileged defense information to insurance companies presents a risk of waiver of the privilege such that the plaintiff in the underlying action might also be able to obtain that information. Meanwhile, absolute nondisclosure risks a loss of insurance coverage due to violation of the policy's cooperation clause. The "common interest privilege" may not be available in all states and circumstances. Even when it is available to provide general protection to a policyholder, a written agreement that details the understanding of the parties will provide enhanced protection to the policyholder, and be available to refute assertions of failing to cooperate. A carefully drafted common interest and confidentiality agreement can protect the policyholder from loss of coverage and from greater liability in the underlying action. ▲

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