



# safeguards

HELPING INSURERS PROTECT THEIR CLIENTS

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## Court Decides Insurer Waives Attorney-Client and Work-Product Privilege Following the Filing of a Declaratory Action

By Jennifer L. Smith

In a 2-1 decision, the Fourth District Appellate Court of Illinois held that an insurer puts its good faith at issue by filing a declaratory action judgment asserting no duty to indemnify or defend, and therefore waives its attorney-client and work product privileges. *Western States Insurance Company v. O'Hara*, 2005 Ill. App. LEXIS 451 (May 10, 2005).

Richard and Mary Ann O'Hara had an automobile liability policy with Western States Insurance Company ("Western States") with a \$500,000 limit for all claims. During the policy period, their daughter Jessica, who was insured under the policy, was involved in a serious car accident. Her vehicle collided with a vehicle driven by Robert Hilgenbrinck, seriously injuring individuals in both cars. Robert and Mary Hilgenbrinck and their grandson Andrew had numerous injuries, and Megan Lovelace, who had been in Jessica's vehicle, suffered a spinal fracture that left her paralyzed from the waist down.

After the accident, OneBeacon Insurance Company, an affiliate of Western States, hired the law firm of Tressler, Soderstrom, Maloney & Pries ("Tressler firm") to represent Western States in regard to its obligation to the O'Haras. The Tressler firm provided no legal advice to the O'Haras regarding the accident. Western paid \$10,101 to settle property damage to Robert Hilgenbrinck's vehicle, \$480 to settle a claim for property damage to a tree at the site of the accident, and \$489,419 to settle the claim based on Lovelace's injuries. This purportedly exhausted the \$500,000 policy limit.

Before settling Lovelace's claim, Western States contacted counsel for the O'Haras by telephone and letter. According to Western States, this attorney was hired by them to represent Jessica in the criminal proceedings following the accident. These communications solicited input from the O'Haras' attorney and confirmed his agreement to settle the Lovelace claim.

On July 15, 2003, the Hilgenbrincks filed a lawsuit against Jessica, seeking damages for injuries allegedly sustained in the accident. Upon notification of the suit, Western States retained counsel to defend Jessica under a reservation of rights. On October 20, 2003, Western States filed suit, seeking a declaratory judgment that it had no obligation to defend Jessica in the Hilgenbrinck action because the policy limits had been exhausted by the prior settlement of the Lovelace claim. The O'Haras filed a counterclaim asserting breach of contract and bad-faith refusal to settle. After discovery

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In this insured-oriented decision, the Illinois Appellate Court strips away key insurer rights in declaratory judgment actions. Not only are what would otherwise be considered privileged documents fair game to the insured, but they are also potentially discoverable by third-party defendants as well.

Although it is unknown whether this issue will ever be addressed by the Illinois Supreme Court, insurers should recognize that communications must be thoughtful and considered, as hitherto protected exchanges with counsel may be discoverable.

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began and interrogatories were served, Western States asserted the attorney-client and work-product privileges as to certain claims materials. Specifically, Western States refused to produce documents relevant to its consideration of claims against the O'Haras and documents related to the settlement of the Lovelace claim. The O'Haras asserted that Western States had waived any protection of the privilege and work product by placing at issue whether the settlement with Lovelace was reached in good faith. They also asserted the privilege did not protect discovery by them under the common-interest doctrine. The Hilgenbrincks moved to compel production of these documents and the trial court issued two orders pertaining to the production of certain documents as to both the O'Haras and the Hilgenbrincks. Western States refused to comply with these orders, and the court then issued what it termed a "friendly contempt order" finding Western States was in civil contempt for its failure to comply. An appeal followed.

In its analysis, the appellate court looked to a 1991 Illinois Supreme Court decision finding that an insurer could not rely on the attorney-client privilege when the insurer and insured were previously involved in a lawsuit in which they held a common interest. *Waste Management, Inc. v. International Surplus Lines Insurance Company*, 144 Ill. 2d 178 (1991). Generally, what has been termed as the "common-interest doctrine" applies when an attorney acts for two different parties who each have a common interest, whereby communications by either party to the attorney are not necessarily privileged in subsequent controversies between them. Western States argued that Jessica had been represented by separate counsel and therefore her interests were not "common." Even so, the court found that the common-interest doctrine applied because Western States and the O'Haras shared a common interest in settling or defeating the Lovelace claim, regardless of whether the Tressler law firm represented the O'Haras or not. The court reasoned that, "both the insured and the insurer do not have to be privy to or involved in the communications with counsel for counsel to be acting in the interests of both." The court also held that the work-product doctrine did not apply to the disputed documents based upon the *Waste Management* decision. The materials were, in the first instance, prepared for the mutual benefit of the insurers and insureds against a third-party adversary.

Although the common-interest doctrine did not apply to the Hilgenbrincks, the court found that the Hilgenbrincks were still entitled to the production of documents. First, the court found that the Hilgenbrincks had standing to challenge the proposed declaratory judgment since "the act of seeking a declaration, coupled with naming the third party as a defendant, gave the injured the right to challenge the insurer's good faith in the declaratory-judgment action." Second, the court found that "good faith" is an issue of the declaratory judgment, being that a settlement amount is "deductible from the limits of liability specified in the policy" only when a settlement is made in good faith. Thirdly, by contending that the settlements exhausted the policy limits in the declaratory judgment, Western States placed "good faith" at issue. By asking the court to find it exhausted the policy limits, Western States asks the court to find "good faith." This can only be fairly determined looking at the reasons and motives underlying that decision. Accordingly, the court held that neither the attorney-client nor work-product privileges afforded Western States protection from the discovery of certain documents. The court went on to uphold the trial court's civil-contempt order.

In his dissent, Justice Robert Cook argued that Western States should have been allowed to employ an attorney to prepare for the declaratory judgment action immediately after the accident as long as that attorney was not the attorney retained by it to represent the insureds as well. As this was not a combined-representation case, the discovery of a separate counsel's file should not be the first option, absent further justification or a showing of bad faith.

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