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How to Avoid the Implied Waiver of the Attorney-Client Privilege In Arizona Insurance Bad Faith Cases

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In *State Farm v. Lee*, 199 Ariz. 52, 13 P.3d 1169 (2000) (En Banc), the Arizona Supreme Court first held that an Insurer can impliedly waive the attorney-client privilege (the "Privilege") in a bad faith case, despite not explicitly asserting an advice-of-counsel defense. Ever since, plaintiffs in bad faith cases have either threatened to obtain or attempted to obtain attorney-client communications between an Insurer and its counsel.[1] This article examines *Lee* and its progeny, notes guidelines that will assist an Insurer's analysis of whether a court will find a waiver of the Privilege, and offers tips for how an Insurer can avoid the implied waiver of the Privilege.

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State Farm v. Lee

State Farm v. Lee was a bad faith class action in which the Insureds alleged that, before the Arizona Supreme Court decided otherwise,[2] the Insurer unreasonably concluded that language in its policy language complied with ARS § 20-259.01 and prevented Insureds from "stacking" certain UM and UIM coverages in separate policies.[3] The Insureds sought the Insurer's communications with fifteen law firms. *Lee* held the Insurer "implicitly asserted the advice of counsel as a defense when it made its claim of good-faith conduct turn on [its] legal research and the resulting subjective legal knowledge of its claims managers at issue in the case and when that knowledge necessarily included the advice of counsel as part of the decision-making process."[4] In so holding, *Lee* relied on three primary points.

First, the Arizona Supreme Court noted the Insurer defended the case by asserting its actions were both objectively reasonable *and* subjectively reasonable based, in part, on "its

[1] In a single case, an Insured unsuccessfully argued the Insurer impliedly waived the Privilege at least three times. *See Safety Dynamics, Inc. v. Gen. Star Indem. Co.*, 2013 WL 11299209 at *3, 4 (D. Ariz. Aug. 8, 2013) (Order) (Insurer did not impliedly waive the Privilege); *Safety Dynamics Inc. v. Gen. Star Indem. Co.*, 2014 WL 268653 at *3 (D. Ariz. Jan. 24, 2014) (Order) (overruled objections to above Order); *Safety Dynamics Inc. v. Gen. Star Indem. Co.*, 2014 WL 11281283 *4 (D. Ariz. Apr. 3, 2014) ("This is not Plaintiff's first attempt to argue implied waiver and, again, it fails.").

[2] *See State Farm Mut. Ins. Co. v. Lindsey*, 182 Ariz. 329, 332, 897 P.2d 631, 634 (1995).

[3] *See Lee*, 199 Ariz. at 54-55, 13 P.3d at 1171-1172.

[4] *Id.* at 67, 13 P.3d at 1184.

agents evaluat[ion] of the law—policy provisions, statutes, and cases" and "part of that evaluation [was] informed by counsel."[5]

Second, *Lee* adopted a three-part test for the implied waiver of the Privilege based primarily on a sword and shield analysis. In Arizona, a litigant impliedly waives the Privilege if:

1. Assertion of the privilege was a result of some affirmative act, such as filing suit or raising an affirmative defense, by the asserting party;

2. Through this affirmative act, the asserting party put the protected information at issue by making it relevant to the case; and

3. Application of the privilege would have denied the opposing party access to information vital to his defense.[6]

The Arizona Supreme Court observed that Arizona has "found reliance on a privilege unfair when used as both sword and shield."[7] If "a litigant seeks to establish its mental state by asserting that it acted after investigating the law and reaching a well-founded belief that the law permitted the action it took, then the extent of its investigation and the basis for its subjective evaluation are called into question…"[8] "A litigant cannot assert a defense based on the contention that it acted reasonably because of what it did to educate itself about the law, when its investigation of and knowledge about the law included information it obtained from its lawyer, and then use the privilege to preclude the other party from ascertaining what it actually learned and knew."[9] In other words, "a waiver can be implied when a party injects a matter that, in the context of the case, creates such a need for the opponent to obtain the information allegedly protected by the privilege that it would be unfair to allow that party to assert the privilege."[10]

Third, *Lee* concluded that the Insurer's "affirmative act" that "put the protected information at issue" was the "affirmative assertion that its actions were reasonable because of its evaluation of the law, based on its interpretation of the policies, statutes, and case law, and because of what its personnel actually knew and did."[11] In *Lee,* the Insurer admitted that it "consult[ed] with counsel and obtain[ed] counsel's views of the meaning of the policies, statutes, and case law. Having asserted that its actions were reasonable because of what it knew about the applicable law, [the Insurer] put in issue the information it obtained from counsel."[12] "By asserting the subjective evaluation and understanding of its personnel about the state of the law on stacking, [the Insurer] affirmatively injected the legal knowledge of its claims managers into the litigation and put the extent, and thus the sources, of this legal knowledge at issue."[13] Under

[5] *Id.* at 57, 13 P.3d at 1174.
[6] *Id.* at 56, 13 P.3d at 1173 (citing *Hearn v. Rhay,* 68 F.R.D. 574, 581 (E.D.Wash.1975)).
[7] *Lee,* 199 Ariz. at 58, 11 P.3d at 1175.
[8] *Lee,* 199 Ariz. at 60, 13 P.3d at 1177.
[9] *Id.*
[10] *Id.* at 61, 13 P.3d at 1178.
[11] *Id.* at 63, 13 P.3d at 1180.
[12] *Id.* at 64, 13 P.3d at 1181. In *Lee,* the Insurer admitted it consulted with fifteen separate law firms and the purported privileged material filled five privilege logs. *Id.* at 55, 13 P.3d at 1172.
[13] *Id.* at 65, 13 P.3d at 1182.

the sword and shield analysis, the Insurer's "claims managers cannot testify that they investigated the state of the law and concluded and believed they were acting within the law but deny [the Insureds] the ability to explore the basis for this belief and to determine whether it might have known its actions did not conform to the law."[14]

The Arizona Supreme Court, however, was also careful to state what conduct does *not* impliedly waive the Privilege:

- We assume client and counsel will confer in every case, trading information for advice. This does not waive the privilege.

- We assume most if not all actions taken will be based on counsel's advice. This does not waive the privilege.

- Based on counsel's advice, the client will always have subjective evaluations of its claims and defenses. This does not waive the privilege.[15]

The Arizona Supreme Court noted that *Lee* had one additional factor—the Insurer "claim[ed] its actions were the result of its reasonable and good-faith belief that its conduct was permitted by law ***and*** its subjective belief based on its claims agents' investigation into and evaluation of the law. It turns out that the investigation and evaluation included information and advice received from a number of lawyers. It is the last element, combined with the others, that impliedly waives the privilege."[16]

Twin City Fire Ins. Co. v. Burke

In *Twin City Fire Ins. Co. v. Burke*, 204 Ariz. 251, 63 P.3d 282 (2003) (En Banc), only three years later, the Arizona Supreme Court accepted Special Action jurisdiction[17] to address the implied waiver of the Privilege again. *Burke* arose from a wrongful death claim in which an Excess Insurer alleged a Primary Insurer breached the duty to give equal consideration to settlement offers within policy limits. The Primary Insurer sought communications between the Excess Insurer and its attorneys regarding the Excess Insurer attorneys' evaluations and monitoring of the Primary Insurer's defense of the underlying case.[18] The Arizona Supreme Court held the Excess Insurer did not impliedly waive the Privilege because: (a) the mental state

[14] *Id.* In other words, the Insurer "advance[d] the argument that its conduct was reasonable and in good faith because of its investigation of the law and the resultant subjective belief of its claims people. That investigation and knowledge included the opinions it received from its lawyers. Under well-established Arizona precedent, [the Insurer] cannot, on the one hand, claim that what it discovered and what it knew following that legal investigation led it to a reasonable, good-faith conclusion that it could and should deny the claims of its insured and, on the other hand, prevent the court and jury from learning what it discovered and what it knew." *Id.* at 66, 13 P.3d at 1183.

[15] *Id.* at 66, 13 P.3d at 1183.

[16] *Id.* (emphasis in original).

[17] A "special action" is an Arizona procedure for obtaining extraordinary appellate relief, replacing the traditional writs of certiorari, mandamus, and prohibition. Generally, special action relief is not permitted "where there is an equally plain, speedy, and adequate remedy by appeal." ARP Special Action 1; Nelson, "The Rules of Procedure for Special Actions: Long Awaited Reform of Extraordinary Writ Practice in Arizona," 11 Ariz. L. Rev. 413 (1969).

[17] *See Burke*, 204 Ariz. at 253, 63 P.3d at 284.

[18] *See Burke*, 204 Ariz. at 253, 63 P.3d at 284.

and conduct of the Excess Insurer's agents and counsel were not at issue, and (b) the Excess Insurer did not inject privileged attorney-client communication into the litigation.[19]

In so holding, *Burke* clarified at least four points about *Lee* and the implied waiver of the Privilege in Arizona. First, the Arizona Supreme Court noted that *Lee* "established the standard for deciding whether the Privilege has been waived in cases in which *the mental state of a litigant is at issue*."[20] Second, *Burke* reinforced *Lee's* rejection of "the notion that the mere filing of a bad faith action, the denial of bad faith, or the affirmative claim of good faith may be found to constitute an implied waiver of the privilege."[21] Third, questions that determine whether an Insurer impliedly waived the Privilege include: (a) "Would the application of the privilege deny [the Primary Insurer] access to information vital to its defense?"; and (b) "Would recognizing the privilege make it impossible for the factfinder to fairly determine the very issue raised by [the Primary Insurer]?"[22] Fourth, neither the relevance nor pragmatic importance of the privileged communications alone supports an implied waiver of the attorney client privilege.[23]

Ultimately, the Arizona Supreme Court explained that *Burke* presented the "flip side" of *Lee*.[24] The Excess Insurer's good faith conduct was not the issue—the good faith conduct of the Primary Insurer was the issue. *Id.* "The subjective views and evaluations of [the Excess Insurer's] claims agents do not shed light on the question of [the Primary Insurer's] good faith. Confidential communications between [the Excess Insurer] and its counsel therefore do not tell us whether [the Primary Insurer] refused, in good faith, to settle the wrongful death claims within its policy limit."[25] Accordingly, the Excess Insurer did not waive the privilege.

Mendoza v. McDonald's Corp

Mendoza v. McDonald's Corp., 222 Ariz. 139, 213 P.3d 288 (App. 2009), was the first Arizona Court of Appeals decision to address the implied waiver of the Privilege. *Mendoza*, which arose from the denial of a worker's compensation claim because the Insurer concluded the injury was not work related, held an Insurer impliedly waived the Privilege regarding communications with attorneys who represented the Insurer at Industrial Commission of Arizona ("ICA") hearings. In so holding, the Court of Appeals reasoned as follows.

[19] *Id.* at 255, 63 P.3d at 286.

[20] *Id.* at 254, 63 P.3d at 285 (emphasis added) (citing *Lee*, 199 Ariz. at 54, 13P.3d at 1171).

[21] *Burke*, 204 Ariz. at 255, 63 P.3d at 286 (citing *Lee*, 199 Ariz. at 62, 13 P.3d at 1179). Rather, the implied waiver of the Privilege occurs only if "the party claiming the privilege has interjected the issue of advice of counsel into the litigation to the extent that recognition of the privilege would deny the opposing party access to proof without which it would be impossible for the factfinder to fairly determine the very issue raised by that party." *Burke*, 204 Ariz. at 255, 63 P.3d at 286 (citing *Lee*, 199 Ariz. at 62, 13 P.3d at 1179).

[22] *Burke*, 204 Ariz. at 255, 63 P.3d at 286.

[23] *Id.* at 256, 63 P.3d at 287. As *Lee* noted, "there is more than relevance and materiality needed to find a waiver, for communications with counsel are almost always very relevant and material." *Lee*, 199 Ariz. at 58, 13 P.3d at 1175; *see also Empire West Title Agency, L.L.C. v. Talamante ex rel. Cty. of Maricopa*, 234 Ariz. 497, 499, 323 P.3d 1148, 1150 (2014) ("neither the relevance nor pragmatic importance alone of the information sought will support a finding that the attorney-client privilege has been waived.") (internal cites omitted)).

[24] *See Burke*, 204 Ariz. at 256, 63 P.3d at 287.

[25] *Id.* at 256, 63 P.3d at 287.

First, despite *Lee's* repeated references to a subjective evaluation of the law,[26] *Mendoza* asserted "there is nothing in *Lee* to suggest an insurer will *only* be deemed to impliedly waive the privilege when it argues its actions were reasonable based on its subjective evaluation of the law."[27]

Second, despite *Lee's* statement that neither "actions taken…based on counsel's advice" nor "counsel's advice [shaping] subjective evaluations of claims and defenses" "waive the privilege,"[28] *Mendoza* contended "the heart of *Lee* is the recognition that, in the bad faith context, when an insurer raises a defense based on factual assertions that, either explicitly or implicitly, incorporate the advice or judgment of its counsel, it cannot deny an opposing party the opportunity to discover the foundation for those assertions in order to contest them."[29]

Third, *Mendoza* rejected the Insurer's argument that it defended on objective reasonableness alone.[30] The Court of Appeals found the Insurer "affirmatively asserted its actions in investigating, evaluating, and paying [the Insured's] claim were subjectively reasonable and taken in good faith"[31] because both the Insurer's adjusters and expert testified regarding the Insurer's subjective belief in the reasonable bases for their actions.[32] *Mendoza* noted that, by "electing to defend this case based on the subjective, not just objective, reasonableness of its adjusters' actions, [the Insurer] placed in issue [its] subjective beliefs and directly implicated the advice and judgment they had received from [the Insurer's] counsel

[26] *Lee* referred to a subjective evaluation of the law no fewer than ten times. *See generally Lee,* 199 Ariz. 52, 13 P.3d 1169.

[27] *Mendoza,* 222 Ariz. at 153, 213 P.3d at 302 (emphasis in original); *but see Nguyen v. Am. Commerce Ins. Co.*, 2014 WL 1381384 *5 (Ariz.App. Apr. 8, 2014) (Memorandum Decision). In *Nguyen*, the Court of Appeals held, only five years after *Mendoza* and in a bad faith case which arose from an Insurer's denial of a claim for the theft of an $80,000 diamond ring, that an Insurer did not impliedly waive the Privilege. Although the Insurer consulted counsel to evaluate the objective reasonableness of its position, it did not "put the advice it received from counsel at issue" and the Insurer never took the position that "its subjective view of the law was reasonable ([much less that its] subjective view necessarily incorporated advice from its counsel)." *Id.* Furthermore, the Court of Appeals stated, "for implied waiver, a party must claim its actions 'were the result of its reasonable and good-faith belief that its conduct was permitted by law *and* its subjective belief based on its claims agents' investigation into and evaluation of the law.'" *Nguyen,* 2014 WL 1381384 at *6 (citing *Lee,* 199 Ariz. at 62, 13 P.3d at 1179). *Nguyen* also stated that "*Lee* makes clear that evaluating an insurance company's reasonableness 'under the statutes, the case law, and the policy language' does not 'put counsel's advice to the claims managers at issue.'" *Nguyen,* 2014 WL 1381384 at *7 (citing *Lee,* 199 at 60, 13 P.3d at 1177). Thus, *Nguyen* seemed to emphasize that a "subjective belief" of good faith based on "claims agents' investigation and evaluation of the law" was, in fact, necessary for an implied waiver.

[28] *Lee,* 199 Ariz. at 66, 13 P.3d at 1183.

[29] *Mendoza,* 222 Ariz. at 153, 213 P.3d at 302 (citing *Lee,* 199 Ariz. at 61, 13 P.3d at 1178).

[30] *Mendoza,* 222 Ariz. at 153, 213 P.3d at 302.

[31] *Id.*

[32] *Id.* at 153–54, 213 P.3d at 302–03. Specifically, the Insurer's expert testified that the Insurer sent the Insured to numerous IMEs to give the insured the benefit of the doubt and to determine what was really wrong with the Insured, rather than to delay and make the Insured jump through needless adversarial hoops. *Id.* The Insured's adjuster similarly testified that he never tried to delay the Insured's claim in an effort to get the Insured to "give up or go away"; rather, the adjuster testified she thought an IME report provided a reasonable basis for a denial of a surgery request." *Mendoza* concluded that, "[t]hrough this and other evidence, [the Insurer] depicted its claims adjusters as attempting to act in [the Insured's] best interest, using information from the independent medical examinations to determine what treatment would be best for her, and encouraging her to receive the best care available after a full consideration of all of her options. In representing its conduct this way, [the Insurer] affirmatively placed in issue the subjective motives of its adjusters in administering [the Insured's] claim. It thus defended this case based on the subjective reasonableness of its conduct."

incorporated in those actions. [The Insurer] thus rendered the advice and judgment its adjusters received from its ICA counsel relevant to the case."[33]

Fourth, the Insurer improperly attempted to use the privilege as both a sword and a shield. The Insurer "sought to shield from [the Insured] the very evidence she would need to challenge [the Insurer's] representations that its adjusters subjectively believed their actions were reasonable and taken in good faith."[34]

Mendoza, however, should arguably be viewed as an outlier—or at the very least unique—because the Insurer did much more than confer and trade information for advice, take actions based on counsel's advice, and form subjective evaluations of its claims and defenses—all actions *Lee* stated do "not waive the privilege."[35] Rather, substantial evidence in *Mendoza* indicated the ICA attorneys *directed* the Insurer to act in bad faith. The Court of Appeals noted evidence which indicated that, "based on advice from and judgments made by its…counsel," the Insurer: (a) forced the Insured to jump through needless adversarial hoops (numerous IMEs with "good doctors"); (b) took positions without a reasonable basis (the Insurer asserted the Insured's injury was not work-related at a hearing, despite the adjuster's belief the injury *was* work-related and it would be bad faith to assert otherwise); and (c) delayed the claim ("relied on counsel's advice in delaying surgical authorization through the end of her involvement with the claim…").[36]

Empire West Title Agency v. Talamante

Empire West Title Agency, L.L.C. v. Talamante ex rel. Cty. of Maricopa, 234 Ariz. 497, 323 P.3d 1148 (2014), although not a bad faith case, is significant because it was the first Arizona Supreme Court decision to address the implied waiver of the Privilege after *Mendoza* and signaled Arizona's retreat from some of the broader statements in *Mendoza*. In *Empire West*, the Supreme Court accepted Special Action jurisdiction, considered a Purchaser's breach of contract action against a Title Agent for failing to confirm that the legal description of a property included an easement, and held the Purchaser did not impliedly waive the Privilege, despite the Purchaser alleging that it "reasonably believed" the property description included the easement.

In so holding, the Supreme Court emphasized three limits which it originally placed on the implied waiver of the Privilege fourteen years earlier and suggested a fourth limit. First, contrary to the Court of Appeals statement in *Mendoza*, the Supreme Court noted a necessary component of implied waiver is a "subjective evaluation or understanding that incorporates the advice of counsel:"[37] Under Arizona's three-part test, when a litigant [a] advances a subjective and allegedly reasonable evaluation of the law that [b] necessarily incorporates the advice of counsel, confidential attorney-client communications relevant to that evaluation are discoverable."[38] Second, the Supreme Court noted it "emphasized in *Lee*…that merely filing an

[33] *Mendoza*, 222 Ariz. at 154, 213 P.3d at 303 (citing *Lee*, 199 Ariz. at 61, 13 P.3d at 1178).
[34] *Mendoza*, 222 Ariz. at 155, 213 P.3d at 304.
[35] *See Lee*, 199 Ariz. at 66, 13 P.3d at 1183.
[36] *Id.* at 153-54, 213 P.3d at 303-04.
[37] *Empire West*, 234 Ariz. at 498, 323 P.3d at 1149.
[38] *Id.* at 499, 323 P.3d at 1150 (citing *Lee*, 199 Ariz. at 62, 13 P.3d at 1179). The Supreme Court mentioned a

action or denying an allegation does not waive the privilege."[39] Third, the Supreme Court observed "*Lee* was an 'unusual case' involving waiver of the Privilege when 'the mental state of a litigant was at issue.'"[40] Fourth, the Supreme Court noted an implied waiver should not be found unless the party seeking the attorney-client communications demonstrates that denial of the waiver would "undermine its defense" and there are not "other means of obtaining information about what [a litigant] knew or should have known…"[41]

The Supreme Court explained that, in *Empire West*, the Purchaser did not impliedly waive the Privilege for several reasons. First, the Purchaser's breach of contract action did not depend on the Purchaser's state of mind or the Purchaser's subjective knowledge.[42] Second, the Purchaser's allegation in the complaint that it "reasonably believed" the legal description of the property included the easement did not alter the Supreme Court's analysis.[43] This allegation was "not essential," "superfluous," and merely reflected the Purchaser's understanding "rather than a subjective and allegedly reasonable evaluation of the law that necessarily incorporates knowledge or advice obtained from counsel and that formed a basis" for a claim or defense."[44] Third, even if the Purchaser's state of mind was at issue, the Title Agent did not "demonstrate that denying it access to the requested communications would undermine its defense" because it had "other means of obtaining information about what [the Purchaser] knew or should have known regarding the easement's purported abandonment."[45] Fourth, the sword and shield policy concern was not present, because the Purchaser did not "thrust its lack of knowledge into the litigation as a basis for its claim, while at the same time asserting the privilege so as to frustrate discovery of what it actually knew."[46]

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subjective evaluation of the law no fewer than four times in *Empire West. See generally Empire West*, 234 Ariz. 497, 323 P.3d 1148. Furthermore, regarding the necessary subjective evaluation of the law and affirmative injection of a litigant's mental state, the Supreme Court explained that, in *Lee*, "by asserting 'the subjective evaluation and understanding of its personnel about the state of the law' as a defense, [the Insurer] 'affirmatively injected' those issues into the litigation and thereby invited scrutiny of the bases of that legal knowledge, including any relevant communications with counsel. [The Insurer's] defense of its employees' 'subjective belief,' which in turn was directly based on 'information and advice received from a number of lawyers,' was crucial to [a] finding an implied waiver in *Lee." Empire West*, 234 Ariz. at 499, 323 P.3d at 1150 (citing *Lee*, 199 Ariz. at 65, 66, 13 P.3d at 1182, 1183.

[39] *Empire West*, 234 Ariz. at 499, 323 at 1150.

[40] *Id.* at 500, 323 P.3d at 1151 (citing *Lee*, 199 Ariz. at 54, 13 P.3d at 1174.

[41] *Empire West*, 234 Ariz. at 500, 323 P.3d at 1151 (citing *Burke*, 204 Ariz. at 256-57, 63 P.3d at 287-88).

[42] *See Empire West*, 234 Ariz. at 500, 323 P.3d at 1151.

[43] *Id.*

[44] *Id.* Furthermore, the Supreme Court stated, "We will not find a waiver based merely on imprecise or superfluous pleading." *Id.*

[45] *Id.* (citing *Burke*, 204 Ariz. at 256-57, 63 P.3d at 287-88).

[46] *Empire West*, 234 Ariz. at 500, 323 P.3d at 1151 (citing *Lee*, 199 Ariz. at 58-59, 13 P.3d at 1175-76). *But see Miller v. York Risk Servs. Grp.*, 2014 WL 4354833 at *1, 2 (D. Ariz. Sept. 3, 2014) (Order and Opinion). In *Miller*, a bad faith case arising from workers' compensation claims, the District of Arizona held an Insurer impliedly waived the Privilege regarding its adjusters' notes of communications with attorneys that represented the Insurer at ICA hearings, by: (a) relying on *Mendoza*, (b) noting "the analytical principle behind *Lee* and *Mendoza* is not *how* the defendant's good faith becomes an issue, but the fact that it is an issue"; (c) observing the Insurer's adjusters testified they acted in good faith by relying on all information available to them, (d) noting it "appeared" the adjusters' decisions routinely took into account and relied on communications with lawyers; and (e) stating it "makes no sense to say that *how the issue of a defendant's good faith arises* separates cases like *Lee* from cases like the one at bar." (emphasis added). *Miller* appears to incorrectly ignore the first two elements of Arizona's implied waiver test, because they make it clear that "how the issue of a defendant's good faith arises" is critical: "1. Assertion of the privilege was *a result of some affirmative act.*…by the asserting party… 2. Through this affirmative

Everest Indemnity v. Rea

In *Everest Indem. Ins. Co. v. Rea*, 236 Ariz. 503, 504, 342 P.3d 417, 418 (App. 2015), the first Court of Appeals decision to address the implied waiver of the Privilege after the Supreme Court revisited the issue in *Empire West*, the Court of Appels considered a case arising from the allegation that an Insurer entered a settlement agreement which exhausted the liability limits to the detriment of the Insured, accepted Special Action jurisdiction, and held the Insurer did not impliedly waive the Privilege despite asserting its actions were subjectively reasonable and admitting it consulted with counsel regarding the settlement agreement.

Everest also noted three limitations on the implied waiver of the attorney-client privilege in Arizona. First, echoing the Supreme Court in *Empire West*, the Privilege "may be deemed waived [only] when application of the privilege would deny an opposing party access to necessary information to counter a claim or defense asserted by the other party."[47] Second, it "is not sufficient that the information sought is relevant or important to a claim or defense…"[48] Third, the Privilege "is impliedly waived only when the litigant asserts a claim or defense that is *dependent* upon the advice or consultation of counsel."[49]

Everest also explicitly rejected the argument that a defense of subjective reasonableness coupled with consultation with counsel automatically waives the Privilege. The Court of Appeals noted this argument "over reads *Mendoza* and is inconsistent with *Lee*. Indeed, *Lee* expressly held that the assertion of a subjective good faith defense coupled with consultation with counsel did not, without more, waive the attorney-client privilege."[50]

The critical take-aways from *Everest* are the continued retreat from *Mendoza* and the Court of Appeals' statement that an Insurer does not impliedly waive the Privilege unless its subjective belief and actions were "based on," "depended on," and/or were "inextricably intertwined with" counsel's advice.[51]

Ingram v. Great American Insurance Company

Ingram v. Great Am. Ins. Co., 112 F. Supp. 3d 934 (D. Ariz. 2015), is the only published District of Arizona case to address the implied waiver, considered a bad faith case arising from a denial of workers' compensation claims which involved a subjective legal evaluation like *Lee*, and unsurprisingly held that an Insurer impliedly waived the Privilege.[52] In so holding, *Ingram* relied on three primary points. First, like the denials in *Lee*, the Insurer's denials in *Ingram* were based on a subjective evaluation of the law, because the Insurer denied the claim after it analyzed the law and concluded the claims were not compensable based on its conclusion that the Insureds

act, the asserting party *put the protected information at issue by making it relevant to the* case…" *Lee*, 199 Ariz. at 56, 13 P.3d at 173 (emphases added).

[47] *Everest Indemnity*, 236 Ariz. 503, 342 P.3d at 419 (citing *Lee*, 199 Ariz. at 62, 13 P.3d at 1179).

[48] *Id.*

[49] *Id.* (emphasis in original).

[50] *Id.* (citing *Lee*, 199 Ariz. at 66, 13 P.3d at 1183).

[51] *See Everest Indemnity*, 236 Ariz. 503, 342 P.3d at 419-20.

[52] "In diversity jurisdiction cases…state law governs the issue of attorney-client privilege." *Ingram*, 112 F. Supp. 3d at 937.

were not in the course and scope of employment at the time of the accident.[53] Second, the Insurer affirmatively injected the privileged communications into the litigation by asserting its "decisions denying [the Insureds'] claims were made in good faith based on the investigation, evaluation and recommendation by its [TPA] as well as its own consideration of the facts and law."[54] Third, under the sword and shield analysis, the Insurer's adjusters could not "testify that they investigated the state of the law and concluded and believed they were acting within the law but deny [the Insureds] the ability to explore the basis for this belief and to determine whether it might have known its actions did not conform to the law."[55] Thus, *Ingram* was a proper application of *Lee* or, at the very least, an example of an Insured framing the issue so the case seemed very similar to *Lee.*

Guidelines to Assist an Insurer's Analysis of Whether a Court Will Find an Implied Waiver of the Attorney Client Privilege in Arizona Bad Faith Cases

Because Arizona cases touching on this issue are copious, confusing, and complex, we note the following guidelines—though sometimes conflicting—have emerged from *Lee* and its progeny and will assist an Insurer's analysis of whether a court will find an implied waiver of the Privilege:

1. **The mental state of an Insurer must be an issue to impliedly waive the Privilege.**[56]

    a. An Insurer cannot impliedly waive the Privilege if it defends a bad faith claim solely on objective reasonableness.[57]

    b. A court, however, may reject an Insurer's claim it is defending a bad faith based solely on objective reasonableness.[58]

2. **An Insurer must affirmatively inject the relevance of attorney-client communications into the litigation to impliedly waive the Privilege.**[59]

[53] *Id.* at 938.

[54] *Id.* at 939.

[55] *Id.* (quoting *Lee*, 199 Ariz. at 65, 13 P.3d at 1182).

[56] *See Burke*, 204 Ariz. 251, 63 P.3d 282 (Excess Insurer did not waive the privilege, in part, because the mental state and conduct of the Excess Insurer's agents and counsel were not at issue); *Empire West*, 234 Ariz. 497, 323 P.3d 1148 (Purchaser did not waive privilege, in part, because the Purchaser's state of mind was not an issue).

[57] *See Nguyen*, 2014 WL 1381384 *5 (Insurer did not impliedly waive the Privilege, in part, because the Insurer defended solely on objective reasonableness).

[58] *See Mendoza*, 222 Ariz. at 153-54, 213 P.3d at 302-03; notes 30-33 *supra.*

[59] *See Lee*, 199 Ariz. at 56, 13 P.3d at 1173 (stating the first and second criteria of the implied waiver test, i.e. a litigant impliedly waives the Privilege if, "(1) assertion of the privilege was a result of some affirmative act, such as filing suit or raising an affirmative defense, by the asserting party; (2) through this affirmative act, the asserting party put the protected information at issue by making it relevant to the case."); *see also Mt. Hawley Ins. Co. v. Slayton ex rel. Cty. of Coconino*, 2013 WL 708535 (Ariz.App. Feb. 26, 2013) (Memorandum Decision) (in case which arose from a General Contractor ("GC") Insurer suing a Subcontractor ("Sub") Insurer to recover defense and indemnity costs, Court of Appeals held that the GC Insurer did not impliedly waive the Privilege, in part, because the GC Insurer did not inject attorney-client communications into the lawsuit by attempting to rely on attorney-client communications to prove its defense and settlement of the underlying case was reasonable).

a. These acts *do* affirmatively inject the relevance of attorney-client communications into litigation:

i. An Insurer asserts its actions were subjectively reasonable based, in part, on its agents' evaluation of the law and part of that evaluation is informed by counsel.[60]

ii. An Insurer's adjusters testify that they considered *and relied upon* the legal opinions or legal investigation of in-house counsel to deny a claim.[61]

iii. Counsel directs an Insurer to act in bad faith, i.e. counsel directs an Insurer to: make an Insured jump through needless adversarial hoops, take actions without a reasonable basis, or delay a claim.[62]

iv. An Insurer asserts a defense dependent upon the advice or consultation of counsel.[63]

v. An Insurer asserts its settlement offers were subjectively reasonable, in part, because it determined it had a strong probability of prevailing on coverage.[64]

vi. An *Insured* testifying he did not seek policy benefits because, based on prior counsel's advice, he did not think benefits were available and consequently did not seek benefits earlier.[65]

[60] *See Lee*, 199 Ariz. at 57, 13 P.3d at 1174; *Nguyen*, 2014 WL 1381384 *5 (Insurer did not impliedly waive the Privilege, in part, because the Insurer never took the position that "its subjective view of the law was reasonable ([much less that its] subjective view necessarily incorporated advice from its counsel."); *Ingram*, 112 F. Supp. 3d 934, 939 (Insurer impliedly waived privilege where it denied workers compensation claim after a subjective evaluation of the law).

[61] *Roehrs v. Minnesota Life Ins. Co.*, 228 F.R.D. 642, 646-647 (D. Ariz. 2005) (Order) (an Insurer impliedly waived the Privilege because the adjusters affirmatively injected attorney-client communications into the litigation by testifying at their depositions that "they each considered *and relied upon*, among other things, the legal opinions or legal investigation [of in-house counsel] in denying" the claims) (emphasis added); *but see Safety Dynamics*, 2014 WL 268653 at *1 (*Roehrs* is not precedent, distinguished *Roehrs*, and declined to follow *Roehrs*).

[62] *See Mendoza*, 222 Ariz. at 153054, 213 P.3d at 303-04.

[63] *Everest Indemnity*, 236 Ariz.503, 342 P.3d at 419.

[64] In *Cosgrove v. Nat'l Fire & Marine Ins. Co.*, 2016 WL 4578139 (D. Ariz. Sept. 2, 2016), a bad faith case arising from an alleged breach of the duty to give settlement offers within policy limits equal consideration, the District of Arizona held that an Insurer impliedly waived the Privilege with coverage counsel because the Insurer asserted its settlement decisions were subjectively reasonable, in part, because: it determined there was an 80 percent chance the claims were not covered, this "determination involved[d] an evaluation of the law"; "it [was] highly likely [the Insurer's] determination was informed by counsel's advice"; and it was "more probable than not that [the Insurer] not only consulted with [coverage counsel] but necessarily relied on the information and advice [it] received." *Cosgrove*, 2016 WL 4578139 *5.

[65] *Barten v. State Farm Mut. Auto. Ins. Co.*, 2015 WL 11111310 (D. Ariz. June 19, 2015) (Order) (in bad faith case arising from a car accident, District of Arizona held that an *Insured* would impliedly-waive the Privilege regarding his decision not to seek attendant care benefits if he affirmatively injected the issue by testifying that he did not think attendant care benefits were available and consequently did not seek such benefits earlier based on his previous counsel's advice).

b. These acts *do not* affirmatively inject the relevance of attorney-client communications into litigation:

i. An Insurer and counsel simply conferring and/or trading information for advice.[66]

ii. An Insurer taking actions based on counsel's advice.[67]

iii. An Insurer forming subjective evaluations of its claims and defenses based on counsel's advice.[68]

iv. An Insured (or an Insurer) filing a bad faith action.[69]

v. An Insurer's mere denial of bad faith or affirmative claim of good faith.[70]

vi. An Excess Insurer suing a Primary Insurer for bad faith based upon a breach of the duty to give equal consideration to settlement offers within policy limits.[71]

vii. An Insurer relying on advice of counsel to issue a denial letter.[72]

viii. An Insurer consulting with counsel to evaluate the objective reasonableness of its position.[73]

[66] *See Lee*, 199 Ariz. at 66, 13 P.3d at 1183 ("We assume client and counsel will confer in every case, trading information for advice. This does not waive the privilege."); *Safety Dynamics*, 2013 WL 11299209 at *3, 4 (Insurer did not impliedly waive the Privilege, despite an adjuster's testimony that he relied on advice of counsel to issue a denial letter, in part, because *Lee* noted that "client and counsel confer[ing]" does not waive the privilege, so the deposition testimony was "insufficient by itself to waive the privilege").

[67] *See Lee*, 199 Ariz. at 66, 13 P.3d at 1183 ("We assume most if not all actions taken will be based on counsel's advice. This does not waive the privilege."); *Safety Dynamics*, 2013 WL 11299209 at *3, 4 (Magistrate ordered that an Insurer did not impliedly waive the Privilege, despite an adjuster's testimony that he relied on advice of counsel to issue a denial letter, in part, because *Lee* noted that "action taken…based on counsel's advice" does not waive the privilege, so the deposition testimony was "insufficient by itself to waive the privilege").

[68] *See Lee*, 199 Ariz. at 66, 13 P.3d at 1183 ("Based on counsel's advice, the client will always have a subjective evaluations of its claims and defenses. This does not waive the privilege."); *Nguyen*, 2014 WL 1381384 *5 (Insurer did not impliedly waive the Privilege, in part, because the Insurer merely consulted counsel to evaluate the objective reasonableness of its position).

[69] *See Lee*, 199 Ariz. at 62, 13 P.3d at 1179; *Burke* 204 Ariz. at 255, 63 P.3d at 286; *Empire West*, 234 Ariz. 499, 323 P.3d 1150; *Slayton*, 2013 WL 708535 (GC Insurer did not impliedly waive the Privilege, in part, by simply filing the lawsuit).

[70] *See Lee*, 199 Ariz. at 62, 13 P.3d at 1179.

[71] *See Burke*, 204 Ariz. 251, 63 P.3d 282

[72] *Safety Dynamics*, 2013 WL 11299209 at *3, 4 (Insurer did not impliedly waive the Privilege, despite an adjuster's testimony that he relied on advice of counsel to issue a denial letter, in part, because *Lee* noted that "client and counsel confer[ing]" does not waive the privilege, so the deposition testimony was "insufficient by itself to waive the privilege").

[73] *See Nguyen*, 2014 WL 1381384 *5 (Insurer did not impliedly waive the Privilege, in part, because the Insurer merely consulted counsel to evaluate the objective reasonableness of its position).

ix. An Insurer asserting its actions were subjectively reasonable *and* admitting it consulted with counsel regarding the subjectively reasonable actions.[74]

3. An Insurer does not waive the Privilege unless application of the Privilege would deny the Insured access to information vital to the Insured's claim, i.e. the Insurer cannot use the Privilege as both a sword and a shield.[75]

a. Neither the relevance nor importance *alone* of attorney-client communications is sufficient to impliedly waive the Privilege.[76]

b. A court probably will not find an implied waiver of the Privilege if the Insured has other evidence of bad faith available.[77]

4. **Even if an Insurer impliedly-waives the Privilege, the waiver is limited to content actually communicated to the Insurer.[78] The implied waiver does not extend to counsel's file.**[79]

[74] *See Everest,* 236 Ariz. 503, 504, 342 P.3d 417, 418 (Insurer did not impliedly waive the Privilege despite asserting its actions were subjectively reasonable and admitting it consulted with counsel regarding the subject settlement agreement) ("*Lee* expressly held that the assertion of a subjective good faith defense coupled with consultation with counsel did not, without more, waive the attorney-client privilege.").

[75] *See Lee,* 199 Ariz. at 56, 13 P.3d at 1173 (stating the third criteria of Arizona's implied waiver test, i.e. a litigant impliedly waives the Privilege if, "(3) application of the privilege would have denied the opposing party access to information vital to his defense."); *Id.* at 65, 13 P.3d at 1182 (Under the sword and shield analysis, the Insurer's "claims managers cannot testify that they investigated the state of the law and concluded and believed they were acting within the law but deny [the Insureds] the ability to explore the basis for this belief and to determine whether it might have known its actions did not conform to the law."); *Burke,* 204 Ariz. at 255, 63 P.3d at 286 (questions that determine whether an Insurer implied waived the Privilege include: (a) "Would the application of the privilege deny [Insurer] access to information vital to its defense?"; and (b) "Would recognizing the privilege make it impossible for the factfinder to fairly determine the very issue raised by [Insurer]?"); *Mendoza,* 222 Ariz. at 155, 213 P.3d at 304 (The Insurer "sought to shield from [the Insured] the very evidence she would need to challenge [the Insurer's] representations that its adjusters subjectively believed their actions were reasonable and taken in good faith."); *Everest,* 236 Ariz. 503, 342 P.3d at 418 (the Privilege "may be deemed waived [only] when application of the privilege would deny an opposing party access to necessary information to counter a claim or defense asserted by the other party."); *Ingram,* 112 F. Supp. at 939 (Insurer's adjusters could not "testify that they investigated the state of the law and concluded and believed they were acting within the law but deny [the Insureds] the ability to explore the basis for this belief and to determine whether it might have known its actions did not conform to the law.").

[76] *See Burke,* 204 Ariz. at 256, 63 P.3d at 287 (as *Lee* noted, "there is more than relevance and materiality needed to find a waiver, for communications with counsel are almost always very relevant and material."); *Lee,* 199 Ariz. at 58, 13 P.3d at 1175; *Empire West,* 234 Ariz. at 499, 323 P.3d at 1150 ("neither the relevance nor pragmatic importance alone of the information sought will support a finding that the attorney-client privilege has been waived." (internal cites omitted); *Everest,* 236 Ariz. 503, 342 P.3d at 419 (it "is not sufficient that the information sought is relevant or important to a claim or defense…").

[77] *See Lee,* 199 Ariz. at 56, 13 P.3d at 1173 (again, stating the third criteria of the implied waiver test, i.e. a litigant impliedly waives the Privilege if, "(3) application of the privilege would have denied the opposing party access to information vital to his defense."); *Empire West,* 234 Ariz. at 500, 323 P.3d at 1151 (an implied waiver should not be found unless the party seeking the attorney-client communications demonstrates that denial of the waiver would "undermine its defense" and there are not "other means of obtaining information about what [a litigant] knew or should have known…") (even if the Purchaser's state of mind was at issue, the Title Agent did not "demonstrate that denying it access to the requested communications would undermine its defense" because it had "other means of obtaining information about what [the Purchaser] knew or should have known regarding the easement's purported abandonment."); *Slayton,* 2013 WL 708535 (GC Insurer did not impliedly waive the Privilege, in part, because the Sub Insurer had reasonable alternatives to seeking privileged communications to prove its case, such as retaining an expert to testify the GC Insurer did not act reasonably in defending and settling the underlying action).

[78] *See Cosgrove,* 2016 WL 4578139 (limited implied waiver to "communication with [coverage counsel] to the

Tips For Avoiding the Implied Waiver Of the Attorney-Client Privilege in Arizona Bad Faith Cases

Although Arizona law regarding the implied waiver of the Privilege is far from certain, an Insurer *may* avoid a waiver by following these tips:

1. An Insurer should consider whether to defend a bad faith claim solely on objective reasonableness.[80]

2. An Insurer should avoid, if possible, asserting its actions were subjectively reasonable based on its adjuster's evaluation of the law, especially when the evaluation was informed by counsel.[81]

3. An Insurer should not allow counsel to direct claim handling.[82]

4. An Insurer should instruct its adjusters that counsel's advice is simply a consideration and that the Insurer's ultimate positions—whether a coverage determination, settlement offer, etc.—are not *dependent* on, *reliant* upon, or inextricably intertwined with counsel's advice.[83]

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extent those communication addressed the coverage issues in the underlying case on which [the Insurer] based its settlement decisions."); *Ingram*, 112 F. Supp. 3d at 940 (limited the implied waiver to "only those communications pertaining to the law and information that was part of what [the Insurer] knew in reaching its evaluation of the law" and the Insurers were "not entitled to discovery of all of counsel's communications."); *City of Glendale v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 2013 WL 1797308 at *6, 7 (D. Ariz. Apr. 29, 2013) (Order) (a case which arose from an Insurer's refusal to defend and indemnify and considered an Insurer's assertion of an advice-of-counsel defense and consequent *explicit* waiver of the Privilege rather than an *implied* waiver of the Privilege, held the Insurer's waiver extended only to "counsel's advice that was contained in the adjuster's notes in the claims file" and *did not* extend to "documents in [counsel's] files that [were] not communicated to the Insurer."); *Roehrs*, 228 F.R.D. at 647 (Magistrate concluded an Insurer impliedly waived the Privilege, but limited the waiver to communication with certain adjusters on certain issues).

[79] *Id.*

[80] *See Nguyen*, 2014 WL 1381384 *5 (Insurer did not impliedly waive the Privilege, in part, because the Insurer defended solely on objective reasonableness).

[81] *See Lee*, 199 Ariz. at 57, 13 P.3d at 1174; *Nguyen*, 2014 WL 1381384 *5 (Insurer did not impliedly waive the Privilege, in part, because the Insurer never took the position that "its subjective view of the law was reasonable ([much less that its] subjective view necessarily incorporated advice from its counsel."); *Ingram*, 112 F. Supp. 3d 934, 939 (Insurer impliedly waived privilege where it denied workers compensation claim after Insurer's subjective evaluation of the law).

[82] *See Mendoza*, 222 Ariz. at 153054, 213 P.3d at 303-04 (Insurer impliedly waived the privilege, in part, because substantial evidence indicated the Insurer's attorneys *directed* the Insurer's adjusters to: (a) force the Insured to jump through needless adversarial hoops (numerous IMEs with "good doctors"); (b) take positions without a reasonable basis (the Insurer asserted the Insured's injury was not work-related at a hearing, despite the adjuster's belief the injury *was* work-related and it would be bad faith to assert otherwise); and (c) delayed the claim ("relied on counsel's advice in delaying surgical authorization through the end of her involvement with the claim…").

[83] *See Lee*, 199 Ariz. at 66, 13 P.3d at 1183 ("We assume client and counsel will confer in every case, trading information for advice. This does not waive the privilege.") ("We assume most if not all actions taken will be based on counsel's advice. This does not waive the privilege."); *Safety Dynamics*, 2013 WL 11299209 at *3, 4 (Insurer did not impliedly waive the Privilege, despite an adjuster's testimony that he relied on advice of counsel to issue a denial letter, in part, because *Lee* noted that "client and counsel confer[ing]" does not waive the privilege, so the deposition testimony was "insufficient by itself to waive the privilege"); *Roehrs v. Minnesota Life Ins. Co.*, 228 F.R.D. 642, 646-647 (D. Ariz. 2005) (Order) (Insurer impliedly waived the Privilege because the adjusters affirmatively injected attorney-client communications into the litigation by testifying at their depositions that "they each considered *and relied upon*, among other things, the legal opinions or legal investigation [of in-house counsel]

5. If an Insurer wants counsel to analyze the subjective or objective reasonableness of its actions, then an Insurer should perform its own analysis and reach its own conclusions first, and then obtain counsel's analysis.[84]

6. An Insurer should argue, if possible, that an Insured has alternative avenues of attempting to prove the alleged bad faith.[85]

7. If an Insurer believes that whether it impliedly waived the Privilege is a close call, then it should litigate in state court rather than federal court.[86]

8. If an Insurer believes implied waiver of the Privilege may be an issue, then it should communicate with its counsel on the phone rather than in writing.[87]

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in denying" the claims) (emphasis added); *but see Safety Dynamics*, 2014 WL 268653 at *1 (*Roehrs* is not precedent, distinguished *Roehrs*, and declined to follow *Roehrs*);

[84] *See Nguyen*, 2014 WL 1381384 *5 (Insurer did not impliedly waive the Privilege, in part, because the Insurer merely consulted counsel to evaluate the objective reasonableness of its position)*; Everest,* 236 Ariz. 503, 504, 342 P.3d 417, 418 (Insurer did not impliedly waive the Privilege despite asserting its actions were subjectively reasonable and admitting it consulted with counsel regarding the subject settlement agreement) ("*Lee* expressly held that the assertion of a subjective good faith defense coupled with consultation with counsel did not, without more, waive the attorney-client privilege."); *Safety Dynamics*, 2013 WL 11299209 at *3, 4 ("Based on counsel's advice, the client will always have a subjective evaluations of its claims and defenses. This does not waive the privilege.").

[85] *See Lee*, 199 Ariz. at 56, 13 P.3d at 1173 (stating the third criteria of the implied waiver test, i.e. a litigant impliedly waives the Privilege if, "(3) application of the privilege would have denied the opposing party access to information vital to his defense."); *Empire West*, 234 Ariz. at 500, 323 P.3d at 1151 (an implied waiver should not be found unless the party seeking the attorney-client communications demonstrates there are not "other means of obtaining information about what [a litigant] knew or should have known…") (even if the Purchaser's state of mind was at issue, the Title Agent did not "demonstrate that denying it access to the requested communications would undermine its defense" because it had "other means of obtaining information about what [the Purchaser] knew or should have known regarding the easement's purported abandonment."); *Slayton*, 2013 WL 708535 (held GC Insurer did not impliedly waive the Privilege, in part, because the Sub Insurer had reasonable alternatives to seeking privileged communications to prove its case, such as retaining an expert to testify the GC Insurer did not act reasonably in defending and settling the underlying action).

[86] Of the thirteen cases—both published and unpublished—considered for this article, only two of the seven Arizona state court cases found an implied-waiver of the Privilege, but five of the six Arizona federal cases found an implied waiver.

[87] *See City of Glendale v. Nat'l Union Fire*, 2013 WL 1797308 at *6, 7(Insurer's waiver extended only to "counsel's advice that was contained in the adjuster's notes in the claims file").