



In South Carolina, Insurer's Denial of Liability Does Not Waive Attorney-Client Privilege for Bad Faith Claim

Determining the scope of discovery can be challenging, particularly when an insurance bad faith claim is involved. Courts often face the difficult decision of weighing the importance of preserving attorney-client privilege with the public policy rationale of protecting an insured against their insurer's bad faith behavior. The Supreme Court of South Carolina recently recognized this dilemma by rejecting a hardline approach to bad faith discovery disputes and adopting a case-by-case analysis.

The case, *In re Mt. Hawley Ins. Co.*,¹ arose out of a construction defect claim. ContraVest Construction Company ("ContraVest") constructed a development in South Carolina and was later sued for alleged defective construction. ContraVest sought coverage for the lawsuit from its insurers, including Mount Hawley Insurance Company ("Mount Hawley"), which had provided excess commercial liability insurance to ContraVest during the relevant timeframe. Mount Hawley denied the claim, which prompted ContraVest to sue it for bad faith, breach of contract, and unjust enrichment.

As part of its bad faith claim, ContraVest sought to discover the reasons for Mount Hawley's denial of the claim. ContraVest requested Mount Hawley's file not only for this claim, but also for all of ContraVest's other claims under the relevant policies. Mount Hawley claimed attorney-client privilege and produced redacted versions of the files accompanied by privilege logs. ContraVest moved to compel full production, and the magistrate judge granted the motion and ordered Mount Hawley to produce the full files for in camera review, on the basis that Mount Hawley put the files "at issue" by denying any liability for bad faith. Under South Carolina law, a defendant who injects an issue into a case waives the attorney-client privilege on that issue. Here, the trial court found that ContraVest had established a prima facie case of bad faith for failure to insure, and by denying bad faith liability in its answer, Mount Hawley waived its right to claim attorney-client privilege as to any relevant communications in its internal files.

A certified question was posed to the Supreme Court of South Carolina to determine the appropriate scope of the attorney-client privilege in bad faith cases. Like many states, South Carolina permits insureds to recover consequential damages for an insurer's refusal to pay benefits or for failing to properly process a claim, which equates to a common-law tort if the denial is made unreasonably and in bad faith. Punitive damages may also be recovered if the insured can demonstrate that the insurer's actions were willful or in reckless disregard of the insured's rights. Thus, in cases where the insurer's bad faith is at issue, courts must balance the preservation of the attorney-client privilege with the importance of holding insurers accountable for their bad acts.

The court began its analysis by recognizing three different approaches to this balancing act. First, a minority of jurisdictions apply a broad crime-fraud exception, finding that attorney-client privilege does not apply to communications in furtherance of any crime, fraud, or tort, including the tort of bad faith. These jurisdictions typically find that an insurer's entire pre-denial claim file is discoverable. Second, at the other end of the spectrum, some jurisdictions strictly enforce the attorney-client privilege absent a direct, express reliance on a privileged communication. Third, the middle-ground approach, requires a case-by-case analysis of the facts to determine whether privilege applies.

¹No. 2018-001170, 2019 WL 2441119 (S.C. June 12, 2019).

The Supreme Court of South Carolina adopted the middle-ground approach for determining whether a file is protected under attorney-client privilege, or if it is discoverable. For instruction, the court turned to an Arizona case involving bad faith discovery, *State Farm Mutual Automobile Insurance Co. v. Lee*.² *State Farm* was a class action brought by various insureds alleging a pattern of rejecting underinsured and uninsured motorist claims. The insurer resisted discovery of its files and documents, arguing that it had relied on the advice of counsel as to whether to pay or reject the insurance claims. However, the insurer's position implied that it demonstrated good faith by relying on the advice of counsel; thus putting these communications at issue, which impliedly waived the attorney-client privilege. Essentially, the court found that an insurer cannot both defend itself on the basis that it acted reasonably by educating itself about the law via its counsel, but then also claim attorney-client privilege to bar the insured from discovering what the insurer actually learned and knew about the claim.

Ultimately, the Supreme Court of South Carolina recognized that the attorney-client privilege is not necessarily waived simply because litigation involves a claim or defense of bad faith. A case-by-case review of the facts and claims at issue is required to determine the appropriate scope of discovery. The court further opted to impose a requirement that the party seeking production of privileged documents must make a prima facie showing of bad faith.

The scope of discovery can be difficult to determine, especially where bad faith is involved. Insurers will often try to use the attorney-client privilege as both a sword and a shield, asserting that it relied on the advice of counsel to support its denial but then refusing to disclose those communications based on privilege. As your coverage counsel, SDV is ready to help you navigate these issues and determine the best strategy for resolving discovery disputes and moving forward with bad faith litigation.

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²199 Ariz. 52, 13 P.3d 1169 (2000) (en banc).