D&O Insurance: The Tension Between Cooperating with the Insurance Company and Protecting Privileged Information from Third Party Plaintiffs

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I. INTRODUCTION

At the beginning of the twenty-first century, Congress responded to a trend of corporate scandals¹ by passing the Sarbanes-Oxley Act of 2002, which allowed investors more access to corporate information and significantly increased executive liability.² Subsequently, many corporate directors and officers became concerned that worst-case scenarios might jeopardize their personal assets.³ In addition, investors continued to be wary about misleading or dishonest corporate accounting practices.⁴

Directors’ & Officers’ Liability (D&O) insurance, which can be described as corporate malpractice insurance,⁵ is designed to address some of these concerns because it protects both the corporate assets of investors⁶ and the personal assets of directors and officers.⁷ Most often, D&O

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3. See Jeremy Kahn, Desperately Seeking Suit Protection, FORTUNE, Apr. 1, 2002, at 38 (discussing concerns that board members should have regarding scope of D&O insurance coverage after Enron).

4. See Ben White, Enron – Related Fears Take Toll on Other Firms’ Stocks, WASH. POST, Feb. 13, 2002, at E01.


6. Id. § 12:2.
insurance covers derivative suits against board members and securities litigation against the corporation and its executives. However, because it applies mostly to complex and volatile litigation, adjustments are often made in order to avoid unintended results. For example, after experiencing catastrophic losses in 2001 and 2002, D&O insurers narrowed coverage terms and drastically increased premiums. When clarifying the intent of coverage, the D&O insurance community primarily focuses on coverage terms and price. However, the D&O insurance community should also focus on the relationship between the insurer and the insured, so it can prevent the unintended consequence of waiving the attorney-client privilege or the work product doctrine.

When D&O insurance covers ongoing litigation, D&O insurers often request or require that the insureds share relevant information both with the adjuster who monitors the claim and with the underwriter who evaluates the insureds’ risk when the D&O insurance policy is up for renewal. For example, during the renewal process, most underwriters request information on pending litigation before deciding whether the insurer should change the coverage terms, change the coverage price, or even stop providing coverage. The insured or defense counsel may be asked to provide information about potential future legal concerns that could either increase defense costs or potentially increase the insureds—and thus, the insurer’s—liability. Underwriters may also request information about the defense attorney’s settlement strategy or any other legal theories that will keep the insureds—and insurer’s—liability low. An insured that fails to provide the requested information risks jeopardizing

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7. D&O insurance arose on a wide basis to protect the personal assets of directors and officers in the 1960s after two influential decisions held directors and officers personally liable, even when they had not personally profited. See Roberta Romano, What Went Wrong with Directors’ and Officers’ Liability Insurance, 14 DEL. J. CORP. L. 1, 21 & nn.74–77 (1989).


12. Id.

13. Under the terms of the policy, the insured is obligated to provide any material information to the insurer relevant to the risk. Various repercussions are possible if material information relating to the litigation is omitted. Because the consequences of failing to share requested information with the underwriter is outside the scope of this article, the reader should assume that the insurer and the insured openly share information regarding litigation when the insurer is paying for the defense costs.
favorable coverage terms and straining the relationship with the insurance company that is funding defense costs.

During discovery, the plaintiff's counsel may request the files from the insured business or insurance company that contain information used by the insurance company underwriters when they evaluated the insurance risk. This information often includes documents provided by the insured to the insurer and notes taken by the underwriters. In making this discovery request, the plaintiff's counsel will assert that privilege no longer protects the information because the insured has voluntarily waived the privilege by sharing the information with a third party.

In response, both the insured and the insurer will claim that any privileged information is protected and that the privilege has not been waived. The insured wants the protection because sharing summaries or notes with the plaintiff's counsel might have devastating effects on the outcome of litigation, possibly increasing the amount of any future settlement or judgment. Similarly, the insurance company wants the protection because if a settlement or judgment amount increases, then the insurer's financial liability might also increase. Because this issue arises at the discovery stage of the trial, the insured has the right to appeal any order to produce documents. However, most securities litigation and derivative suits settle out of court, and this right to appeal often has very little effect. Once privileged information is disclosed, the damage often cannot be repaired.

Jurisdictions should protect privileged communications that are voluntarily shared between insureds and insurers. They should recognize this protection to prevent unwanted and unintended disclosure to third parties while continuing to encourage honest communication between insurance companies and their insureds. To achieve this result, jurisdictions need to adopt an approach that views the insurance company as the insured's ally, rather than adversary, even when the insured is defending a lawsuit that the insurer might later exclude from coverage.

Part II of this Comment describes how and why D&O policies differ from general liability policies, which also involve litigation concerning privileged information. Because D&O insurance contracts are unique, applying rules tailored towards general liability insurance contracts creates unreasonable results when applied to D&O liability insurance contracts. Part III describes the attorney-client privilege and work product doctrine. Part IV describes how privilege applies between an insured and insurer when the insurer has failed to confirm coverage.

Specifically, this Part reviews the minority approach of encouraging honest communication between insurance companies and insureds by allowing privilege to extend to communication between the two. Part IV also discusses the majority’s approach of protecting the insured from being forced to disclose information to the insurer and the outcome of applying the majority approach when third party plaintiffs request the shared information. Part V describes a middle ground between the majority and minority approaches and concludes that courts should adopt an approach that protects the insured from any forced disclosure but still encourages open communication between the insured and insurer.

II. THE DIFFERENCES BETWEEN AND SIMILARITIES OF D&O INSURANCE POLICIES AND GENERAL LIABILITY INSURANCE POLICIES

Because litigation involving general liability insurance occurs more often than litigation involving D&O insurance, courts facing issues of first impression involving D&O insurance often turn to the approach used in the general liability insurance context. The scope of privilege offered to insurance companies is most often determined by examining the insurer’s duty to defend, its coverage position, its relationship to defense counsel, and the insured’s duty to cooperate. This Part describes how these factors differ between general liability and D&O insurance. Specifically, this Part explains, compares, and contrasts the following characteristics under each coverage: (A) the insurer’s obligation to defend litigation, (B) the coverage position taken by the insurer, (C) the process of appointing defense counsel, and (D) the insured’s obligation to cooperate.

A. The Insurer’s Obligation to Defend Litigation

Typically, general liability policies provide that the insurer bears the duty to defend the litigation. In contrast, D&O insurance policies provide that the insurer merely has the duty to indemnify the insured for defending the litigation. Under the typical general liability duty to de-

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15. Michael Sean Quinn & Andrea D. Levin, Directors’ and Officers’ Liability Insurance: Probable Directions in Texas Law, 20 REV. LITIG. 381, 385 (2001) (explaining that there are far fewer cases about D&O insurance throughout the country partly because D&O insurance is less comprehensive and arbitration clauses often prevent trials and published opinions).
16. See id.
17. 22 JOHN ALAN APPELМАN & GORDON L. OHLSSON, APPELМАN ON INSURANCE LAW AND PRACTICE § 136.1 (2d ed. 2008) [hereinafter APPELМАN].
18. Many D&O policies differentiate between the duty to advance defense costs and the duty to reimburse defense costs to the insured at some point during or after the final disposition of litigation. D&O LIABILITY, supra note 5, § 12:25. This Comment focuses on fact that most D&O insurers do
fend provision, the insured submits a claim to the insurer and the insurer's attorney takes control of the defense.\textsuperscript{19} The insurer appoints counsel, monitors the defense, and makes decisions regarding settlement on behalf of the insured.\textsuperscript{20} This process creates an intertwined relationship among the insured, the insurer, and the defense attorney.\textsuperscript{21}

The duty to defend under a general liability policy can create unwanted complications. If the insurer has this duty, it can be difficult to determine whether the insurer or the insured is the ultimate client.\textsuperscript{22} An attorney might receive a large amount of work from the insurance company and only represent a specific insured on occasions where the insurance company is paying for the defense.\textsuperscript{23} This relationship can create the impression that the attorney is loyal to the insurer, rather than to the insured who the attorney is actually defending.\textsuperscript{24} During litigation, the insurer might also employ the attorney to review whether the insurer is legally obligated to provide coverage under the policy terms.\textsuperscript{25} This creates a conflict of interest where the insured business might share information with the attorney that is later used against it.\textsuperscript{26} In response to concerns about conflict, some jurisdictions hold that an insurer, with a duty to defend, owes an enhanced obligation to the insured even if it is unclear whether coverage exists.\textsuperscript{27} To fulfill this obligation, the insurer must thoroughly investigate the insured’s claim and retain competent defense counsel for the insured.\textsuperscript{28} Both the insurer and counsel must understand that the counsel’s only client is the insured, not the insurer.\textsuperscript{29}

Another unwanted complication arising from a duty to defend policy is that the insurer often absorbs uncovered liabilities.\textsuperscript{30} For instance, a complaint may seek damages both for actions covered by the insured’s policy and for actions not covered by the policy.\textsuperscript{31} Even though the in-
surer might be liable only for portions of the ultimate settlement or award, the insurer must cover the costs to defend each allegation of the complaint, not just those allegations that the policy potentially covers.\textsuperscript{32} In addition, if the insurer declines to defend a complaint and is later determined to be liable, the insurer must pay the entire amount arising out of the complaint, even those amounts that the insurer is not liable for under the policy provisions.\textsuperscript{33}

The concerns created by a duty to defend policy are mitigated when the insurance company only has an obligation to reimburse defense costs under a D&O policy. If an insurer reimburses defense costs and is not responsible for defending the litigation itself, it can allocate defense costs and only reimburse the insured for those portions attributable to the covered portions of the complaint.\textsuperscript{34} In addition, if the insurer merely has the duty to reimburse defense costs and does not have direct control over the defense, fewer conflicts exist among the insurer, the insured, and defense counsel.

The duty to defend provision included in most general liability policies creates a potential conflict of interest among defense counsel, insurance companies, and insureds.\textsuperscript{35} The duty to defend also requires the insurer to defend both covered and uncovered claims.\textsuperscript{36} These complications are avoided under a D&O policy because the insurer only pays defense costs attributable to allegations covered under the insurance, and it is not responsible for costs associated with defending the entire complaint.\textsuperscript{37}

\textbf{B. The Coverage Position Taken by the Insurer}

Under duty to defend provisions of general liability insurance, the insurance company has three primary approaches to determine whether or not a claim is covered under the insured’s policy.\textsuperscript{38} First, the insurance company can deny the claim.\textsuperscript{39} Second, the insurance company can accept the claim.\textsuperscript{40} Third, the insurance company can begin to defend the complaint, but simultaneously issue a reservation of rights letter to the

\textsuperscript{32} Trizec Prop., Inc. v. Biltmore Constr. Co., 767 F.2d 810, 811 (11th Cir. 1985).
\textsuperscript{33} APPLEMAN, supra note 17, § 136.8[B][1].
\textsuperscript{34} D&O LIABILITY, supra note 5, § 12.26.
\textsuperscript{35} APPLEMAN, supra note 17, § 136.9[C][2].
\textsuperscript{36} Id. § 136.2[D].
\textsuperscript{37} D&O LIABILITY, supra note 5, § 12.26.
\textsuperscript{38} APPLEMAN, supra note 17, § 136.7[A].
\textsuperscript{39} Id.
\textsuperscript{40} Id.
insured. In contrast, under a D&O policy, the insurance company typically takes only the third approach of issuing a reservation of rights.

A reservation of rights letter informs the insured that the insurance company is going to begin defending the claim but will reserve its rights under the policy to cease defending and seek reimbursement later. The insurer will stop defending and seek reimbursement if facts show that a complaint is either precluded or excluded from coverage. For example, if a jury determines that the general liability insured intentionally, rather than unintentionally, caused bodily injury, the general liability insurer might seek reimbursement under its previously issued reservation of rights. General liability insurers do not issue reservation of rights letters on a regular basis because the majority of claims submitted include allegations of negligence that are covered under the policy.

Unlike general liability insurers, most D&O insurers typically issue reservation of rights letters. D&O insurers rely on reservation of rights letters because coverage for submitted claims often depends on the plaintiff alleging certain allegations. For example, all D&O insurance policies contain personal conduct exclusions, such as exclusions for loss arising out of fraudulent wrongful acts. An insured is not likely to admit fraud willingly and jeopardize insurance coverage at the onset of litigation. Therefore, the question of whether the insured committed a fraud will probably be answered during trial or after a settlement is reached. Because fraud allegations are common in D&O claims, a D&O insurer cannot be confident about coverage until the litigation has developed. To avoid bad faith claims, most D&O insurers agree to indemnify defense costs while the litigation is developing, but usually reserve their right to deny coverage later down the road.

41. Id. § 136.7[B][1].
42. Id.
43. Id.
44. See id.
45. INDEMNIFICATION AND INSURANCE, supra note 8, § III.
46. Id.
47. D&O LIABILITY, supra note 5, § 12:12.
48. Id. Although most D&O policies contain a fraud exclusion, policies vary on the scope of the exclusion. Some policies provide that the exclusion will only apply when fraud has been proven "in fact," while others provide that coverage will be excluded only after fraud has been proven by a final adjudication. It logically follows that under the final adjudication approach, coverage cannot be fully determined until a final judgment has been provided if allegations of fraud are at issue.
C. The Process of Appointing Defense Counsel

Many insured businesses become concerned that a conflict of interest exists when a general liability insurer has the duty to defend but has also reserved its right to later deny coverage.\(^51\) Under the duty to defend provisions of a general liability policy, the insurer is responsible for appointing counsel and defending the claim. The appointed counsel might consider both the insurance company and the insured as clients. The appointed counsel might also be inclined to hold the insurance company’s interests above the insured’s interests.\(^52\) Most often, an insurance company selects counsel with which it has prior experience. In turn, the defense counsel is often very loyal to the insurance company because it provides most of the defense counsel’s business.

In the past, it was not uncommon for an insurer to employ the same counsel to represent both the insured and the insurance company when there was a coverage dispute with the insured.\(^53\) This made sense because the counsel was often the most familiar with the details of the litigation and was in the best position to argue the facts.\(^54\) Because of this trend, insureds and courts became concerned that, although the counsel was representing the insured in litigation, the focus of the counsel was to determine coverage for the insurer.\(^55\)

Most jurisdictions solve this conflict by permitting the insured to appoint independent counsel, at the expense of the insurer, when the insurer has issued a reservation of rights letter.\(^56\) This counsel is referred to as Cumis counsel, after the leading case establishing the insurer’s obligation to pay for independent counsel.\(^57\) In Cumis, the court acknowledged that “[i]n actions in which . . . the insurer and insured have conflicting interests, the insurer may not compel the insured to surrender control of the litigation.”\(^58\) The court relied, in part, on standards of ethical care expressed in the ABA Code of Ethics that outline requirements for undiluted loyalty to clients.\(^59\) The court found that the insurer still

\(^{52}\) Id.
\(^{53}\) Id.
\(^{54}\) Id.
\(^{55}\) Id.
\(^{58}\) Id. at 501 (quoting Tomerlin v. Canadian Indem. Co., 61 Cal. 2d 638, 648 (1964)).
\(^{59}\) Id. at 499–500 (quoting Model Code of Prof’l Responsibility EC 5-1 (“The professional judgment of a lawyer should be exercised, within the bounds of the new law, solely for the benefit of his client and free of compromising influences and loyalties. Neither his personal inter-
must pay for these defenses when the insured has appointed independent
counsel because the insurer had the duty to pay for the defense under the
duty to defend.60

Unlike a general liability insurance policy, an insured under a D&O
policy has the responsibility of selecting and appointing counsel from the
onset of the claim.61 Counsel must be approved, however, by the D&O
insurance company.62 In addition, many D&O insurance policies provide
that the insurer will advance defense costs, either as the costs are in-
curred or on an interim basis, rather than at the conclusion of the litiga-
tion.63 Insurance companies recognize that it is in the insurer’s best in-
terest to advance defense costs because if an insured could not afford a
competent defense, then the insurance company’s ultimate liability might
increase.64

Appointing Cumis counsel under a general liability policy and ap-
pointing counsel under a D&O policy are similar. In each instance, the
insured, not the insurer, has the direct relationship with counsel.

D. The Insured’s Obligation to Cooperate

Most liability insurance policies, including D&O and general liabil-
ity insurance policies, have a “cooperation clause.”65 This clause re-
quires the insured to fully cooperate with the insurer in the event of a
claim.66 A typical cooperation clause reads:

The Insurer shall have the right to effectively associate with each
and every [insured] in the defense and prosecution of any Claim that
involves, or appears reasonably likely to involve, the Insurer, in-
cluding, but not limited to, negotiating a settlement. Each and every
[insured] shall give the Insurer full cooperation and such informa-
tion as it may reasonably require.67

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60. Id. at 501.
62. Id. In determining whether to approve counsel, the D&O insurer considers whether possi-
bile conflicts exist between that counsel and other insureds, whether duplication of representation
exists, the counsel’s expertise in handling such claims, and the policies and procedures the counsel
has in place to monitor and allocate costs.
63. Id. § 12:25.
64. Id.
65. COUCH, supra note 56, § 199:3.
66. Id. § 199:4.
   .html (last visited Aug. 18, 2008).
Cooperation clauses not only help ensure that the insured is cooperating with the insurer in good faith but also help prevent fraud and collusion between the insured and a third party claimant.\textsuperscript{68} Insurance companies require insureds' cooperation to monitor defense costs and settlement amounts because the companies usually have a financial interest in the outcome.\textsuperscript{69} Additionally, the insured also benefits from cooperating with the insurance company because, for instance, the insurer has seen many different D&O claims and can share insight and experience with the insured and the insured's counsel.\textsuperscript{70}

If the insurer can show that the insured has not cooperated, then the insured's coverage will be in jeopardy.\textsuperscript{71} Non-cooperation with the insurance company can also slow the reimbursement of costs of a claim.\textsuperscript{72} Although many businesses can absorb these costs on a short-term basis, individual directors and individual officers are often unable or unwilling to absorb steep defense costs, even on a short-term basis.\textsuperscript{73} Therefore, the insured often has a pragmatic incentive to maintain a working relationship and fully cooperate with the insurer.

III. BASIC POLICIES ASSOCIATED WITH THE ATTORNEY-CLIENT PRIVILEGE AND WORK PRODUCT DOCTRINE

Because they must cooperate with their D&O insurance company, insureds often question the potential ramifications of sharing information. This Part reviews (A) privileges and voluntary waiver of privileges and (B) exceptions to voluntary waiver principles.

A. Privileges and Voluntary Waiver of Privileges

The attorney-client privilege and work product doctrine protect parties from having to disclose certain information to outside parties.\textsuperscript{74} First, the attorney-client privilege protects communications between attorneys and their clients in the course of obtaining or rendering legal advice.\textsuperscript{75} To be protected, this information must be communicated in con-

\begin{itemize}
  \item \textsuperscript{68} 14 COUCH, supra note 56, § 199:4.
  \item \textsuperscript{69} D&O LIABILITY, supra note 5, § 12:24.
  \item \textsuperscript{70} Id.
  \item \textsuperscript{72} See D&O LIABILITY, supra note 5, § 12:24 (discussing the importance of a dialogue between the insurer and insured in the beginning of the litigation in order to establish a defense strategy).
  \item \textsuperscript{73} Cf. id. § 12:25.
  \item \textsuperscript{74} EDNA SELAN EPSTEIN, THE ATTORNEY-CLIENT PRIVILEGE AND THE WORK-PRODUCT DOCTRINE 3 (5th ed. 2007) [hereinafter PRIVILEGE DOCTRINE].
  \item \textsuperscript{75} Id. Attorneys also have an ethical obligation to protect information communicated confidentially with clients. MODEL CODE OF PROF'L RESPONSIBILITY DR 4-101(B).
\end{itemize}
fidence, between privileged persons, and for the purpose of obtaining or rendering legal assistance.\textsuperscript{76} Second, the work product doctrine protects certain materials that are prepared by or for an attorney in anticipation of litigation.\textsuperscript{77} Materials protected by the work product doctrine include an attorney’s mental impressions, conclusions, opinions, and legal theories.\textsuperscript{78}

Courts protect the work product privilege more than they protect the attorney-client privilege because the work product privilege reinforces the adversarial nature of the legal system.\textsuperscript{79} In contrast, courts will only recognize the attorney-client privilege if the party asserting the privilege has taken some “affirmative action to preserve confidentiality.”\textsuperscript{80} Consequently, the attorney-client privilege is waived if privileged information is voluntarily disclosed to a non-privileged party while the work product privilege is waived only if information is voluntarily disclosed to an adversarial party.\textsuperscript{81} A non-privileged party is broader than an adversarial party because it includes any party that is not the client, the client’s attorney, or certain agents of either the client or the attorney.\textsuperscript{82}

The attorney-client and work product privileges can be unintentionally waived\textsuperscript{83} through client conduct.\textsuperscript{84} Disclosing communication to a non-privileged or adversarial party waives not only the privilege of that particular communication but possibly also the privilege of all communications regarding the same subject.\textsuperscript{85}

\textit{B. Exceptions to Voluntary Waiver Principles}

In certain situations, interested parties might want to share privileged information with an outsider without waiving the attorney-client privilege or the work product privilege. Two doctrines that can protect privileged information from voluntary waiver are the joint-defense doctrine and the common interest doctrine.\textsuperscript{86}

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{76} \textit{Restatement (Third) of Law Governing Lawyers} § 68 (2008).
\item \textsuperscript{77} United States v. Nobles, 422 U.S. 225, 238 n.11 (1975).
\item \textsuperscript{78} Id.
\item \textsuperscript{79} Westinghouse Elec. Corp. v. Republic of Phil., 951 F.2d 1414, 1428–29 (3d Cir. 1991) (“Protecting attorneys’ work product promotes the adversary system by enabling attorneys to prepare cases without fear that their work product will be used against their clients.”).
\item \textsuperscript{80} \textit{In re Horowitz}, 482 F.2d 72, 82 (2d Cir. 1973).
\item \textsuperscript{81} \textit{Westinghouse Elec. Corp.}, 951 F.2d at 1428–29.
\item \textsuperscript{82} \textit{See Privilege Doctrine, supra} note 74, at 134.
\item \textsuperscript{83} \textit{See Powers v. Chi. Transit Auth.}, 890 F.2d 1355, 1359 (7th Cir. 1989).
\item \textsuperscript{84} \textit{See 2 Paul R. Rice, Attorney-Client Privilege in the U.S.} § 9:23 (2d ed. 2008).
\item \textsuperscript{85} \textit{See id.} § 9:80.
\item \textsuperscript{86} \textit{David M. Greenwald et al., Testimonial Privileges} §§ 1:78–79 (3d ed. 2008) [hereinafter \textit{Testimonial Privileges}].
\end{enumerate}
\end{footnotesize}
The joint-defense doctrine is an exception to voluntary waiver of the attorney-client or work product privileges.\textsuperscript{87} This doctrine applies when the same counsel represents parties in the same litigation.\textsuperscript{88} The Restatement of the Law Governing Lawyers describes the joint-defense doctrine exception as occurring when "two or more persons are jointly represented by the same lawyer in a matter, [in which case] a communication of either co-client . . . is privileged as against third persons."\textsuperscript{89}

From the joint-defense doctrine grew the common interest doctrine.\textsuperscript{90} The common interest doctrine applies when separate counsel represents parties with a common interest.\textsuperscript{91} The Restatement of the Law Governing Lawyers describes the common interest exception as occurring "[i]f two or more clients with a common interest in litigated or non-litigated matter are represented by separate lawyers . . . [in which case a communication of either client] that relates to the common interest is privileged as against third persons."\textsuperscript{92}

To claim the common interest exception, some courts require that the common goal or interest be a legal one, not merely a business one.\textsuperscript{93} Some jurisdictions, however, have held that a mere financial interest is sufficient.\textsuperscript{94} This approach recognizes that many parties seek out legal counsel when substantial financial amounts are at risk. If sharing information waives the associated privileges, parties will hesitate to engage in a transparent exchange of information and, thus, may not obtain effective legal advice. In addition, even though parties such as insurance companies and creditors do not have a per se legal interest in the outcome of litigation, they have a significant financial one.

\textsuperscript{87} Haines v. Ligget Group Inc., 975 F.2d 81, 94 (3d Cir. 1992) (holding that the joint-defense doctrine permits counsel for clients facing a common litigation opponent to exchange privileged communications and attorney work product in order to adequately prepare a defense without waiving either privilege.).

\textsuperscript{88} RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 75 (2008).

\textsuperscript{89} Id.

\textsuperscript{90} TESTIMONIAL PRIVILEGES, supra note 86, § 1:80 (discussing courts' willingness to "expand the rationale of the joint-defense doctrine to include situations in which the clients are pursuing a common interest but do not share the same attorney").

\textsuperscript{91} Id.

\textsuperscript{92} RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS §76 (2008).


\textsuperscript{94} Cf. Waste Mgmt., Inc. v. Int'l Surplus Lines Ins. Co., 579 N.E.2d 322, 328 (Ill. 1991) (finding that a common interest existed between the insurance company and insured because the insurance company had a financial interest in the ultimate outcome of the litigation).
Some courts have also held that a common interest does not exist when parties are adversaries. This interpretation means that the work-product privilege is waived when privileged information is shared with an adversarial party. Therefore, if a court finds that two parties have adversarial interests with respect to a specific issue, then their entire relationship might also be considered adversarial. If so, the common interest exception will fail to protect work product regarding a different, non-adversarial matter.

Parties use exceptions to voluntary waiver of privilege in two ways. The first way is to use the doctrine as a sword, by forcing information exchange between parties that are members of the common interest group or parties that share the same counsel. The second way is to use the information as a shield, by protecting the information from third parties that are not members of the common interest group or co-parties in litigation.

The common interest exception is used as a sword when an insured and insurer engage in coverage litigation. In this situation, the insurer argues that the insured must disclose privileged information to the insurer because the insurer and the insured have a common interest in defending the suit. Although the insurer is seeking to deny coverage, the insurer is still potentially liable under the policy and arguably has a shared interest with the insured to minimize defense and settlement costs. In response, the insured argues that the insurer does not share a common interest with the insured because the insurer is seeking to deny the claim.

The common interest is used as a shield to protect information that an insured shares with an insurer. In this situation, a third party plaintiff argues that the insured has voluntarily waived privileged information because the insured shared the information with the insurer, a non-privileged party. The insurer and the insured argue that the common interest exception shields the information, and that the privilege still applies because the insurer and insured have a common interest to defeat

95. United States v. Lopez, 777 F.2d 543, 553 (10th Cir. 1985).
98. Id.
99. Id.
100. Id.
102. Fischer, supra note 97, at 638.
103. Id.
104. See id.
the litigation. If the insurer has the duty to defend under general liability insurance, the insurer and the insured will also argue that the joint-defense doctrine shields the information because the insured and insurer share attorneys.

If the court finds that the common interest serves as a sword, it will also probably find that the common interest serves as a shield against other third parties. To serve as a sword, the court must find that the insurer and the insured share a common interest and can, or even should, freely exchange information. When the insured and insurer share a common interest, sharing privileged information does not voluntarily waive the privilege with respect to third parties. Therefore, the common interest is available to serve as a shield. However, the opposite also applies. If the court finds that a common interest does not exist and the insured is not required to share information with the insurer, the court will also probably find that a common interest does not exist to provide a shield against third party plaintiffs. If the insured is not required to share information with the insurer, voluntarily doing so will waive the privilege.

Privileged information voluntarily shared with a D&O insurance company will continue to be protected if the court finds that the D&O insurer and the insured have a common interest in the litigation. Therefore, it is necessary to review whether jurisdictions are willing to apply a broad definition of common interest when an insurer is obligated to reimburse defense costs but does not have a legal responsibility to provide or hire defense counsel.

IV. THE "COMMON INTEREST" BETWEEN AN INSURED AND INSURER WHEN THE INSURER IS NOT DIRECTLY DEFENDING THE LITIGATION

If an insurance company controls the defense of a claim on a duty to defend basis under general liability insurance, the joint-defense doctrine can protect privileged information voluntarily shared between the insurer and the insured. If an insurance company is reimbursing defense costs, as it would under D&O insurance, the joint-defense doctrine will not apply because the insured and the insurer do not share the same counsel. Some jurisdictions might protect privileged information by applying the common interest doctrine, but many jurisdictions will not. This inconsistency results from courts differing as to whether a common interest exists between the insurer and insured when the two parties share

105. See id.
106. Id. at 640.
107. The joint-defense doctrine applies when an insurer has a duty to defend because the insurer and the insured are sharing the same counsel.
only a financial interest in the litigation, rather than a direct legal interest in the defense.\footnote{108}

Most frequently, courts are asked whether a common interest exists when a general liability insurer is demanding privileged information from the insured that relates to a disputed coverage issue.\footnote{109} Jurisdictions answering this question are split. The minority holds that a common interest does exist and that the insured must share privileged information relating to potentially covered claims with its insurer.\footnote{110} In contrast, the majority holds that a common interest does not exist and the insured is not required to share privileged information with its insurer, even if the insurance company might have financial responsibly for the outcome of the claim.\footnote{111}

One jurisdiction has applied the majority approach to the issue presented in this article: whether information voluntarily shared by an insured with its D&O insurer remains privileged against third parties. The court held that the information does not remain privileged because a common interest does not exist between a D&O insurer and its insured.\footnote{112} Therefore, the insured was forced to share information with the third party plaintiff despite protests from both the insured and the D&O insurance company.\footnote{113}

The remainder of this Part describes the reasoning behind (A) the minority approach of finding a common interest and (B) the majority approach of finding no common interest between an insured and an insurer that is reimbursing defense costs under either a general liability or a D&O insurance policy.

\textit{A. The Minority Approach Holds that a Common Interest Always Exists Between an Insured and Insurer}

In the leading case in support of the minority approach, \textit{Waste Management, Inc. v. International Surplus Lines Insurance Co.}, the Illinois Supreme Court found that the cooperation clause in the insurance

\footnotesize
\begin{itemize}
  \item \footnote{108} See Fischer, supra note 97, at 653–54.
  \item \footnote{109} See id. at 637.
  \item \footnote{112} Imperial Corp. of Am. v. Shields, 167 F.R.D. 447, 453 (S.D. Cal. 1995).
  \item \footnote{113} id.
\end{itemize}
policy created a common interest between the insurer and the insured.\textsuperscript{114} Because the court found that a common interest existed, it required the insured to share privileged information with the insurer.\textsuperscript{115} The plaintiffs in \textit{Waste Management} were insurance companies that had sold \textit{Waste Management} multiple environmental liability insurance policies.\textsuperscript{116} Under the provisions of the policies, the insurers had the duty to reimburse \textit{Waste Management} but did not have the duty to defend.\textsuperscript{117} In addition, the policies contained a standard cooperation clause requiring \textit{Waste Management} to “give all such information and assistance as the insurers may reasonably require” in the event of a claim.\textsuperscript{118}

When \textit{Waste Management} initially submitted its claim to the insurers, the insurers reserved their right to later deny coverage.\textsuperscript{119} In addition to the initial reported claim, the insured was also involved in related litigation that was not covered under the policy.\textsuperscript{120} The insurance companies denied coverage when the insured requested reimbursement due in part to \textit{Waste Management}’s failure to disclose the additional litigation.\textsuperscript{121} During subsequent coverage litigation, the insurer requested that \textit{Waste Management} produce privileged files in connection with both the submitted claim and the unreported litigation.\textsuperscript{122} The circuit court compelled \textit{Waste Management} to produce the documentation.\textsuperscript{123} \textit{Waste Management} appealed to the Illinois Supreme Court seeking to overturn the lower court’s order.\textsuperscript{124}

In this case, the insurers used the common interest doctrine as a sword by arguing that \textit{Waste Management} should be compelled to share privileged information with the insurer because a common interest existed.\textsuperscript{125} \textit{Waste Management} urged the court to recognize that the insurance company did not participate in the defense and, therefore, did not have a common interest.\textsuperscript{126} The court ultimately compelled \textit{Waste Management} to share the information because (1) \textit{Waste Management} could not have expected to keep information confidential after accepting the

\begin{itemize}
  \item \textsuperscript{114} 579 N.E.2d 322, 328–30 (Ill. 1991).
  \item \textsuperscript{115} \textit{Id.} at 331–32.
  \item \textsuperscript{116} \textit{Id.} at 324–25.
  \item \textsuperscript{117} \textit{Id.} at 325.
  \item \textsuperscript{118} \textit{Id.} at 327–28.
  \item \textsuperscript{119} \textit{Id.} at 325. Although the court did not call the insurer’s response a “reservation of rights,” the court did accept that the insurer was not accepting or denying coverage at that time.
  \item \textsuperscript{120} \textit{Id.}
  \item \textsuperscript{121} \textit{Id.}
  \item \textsuperscript{122} \textit{Id.}
  \item \textsuperscript{123} \textit{Id.}
  \item \textsuperscript{124} \textit{Id.}
  \item \textsuperscript{125} \textit{Id.} at 328.
  \item \textsuperscript{126} \textit{Id.}
\end{itemize}
cooperation clause in the insurance policy and (2) Waste Management had a common interest with the insurance company. ¹²⁷

First, the court held that the element of confidentiality to establish the attorney-client privilege was missing. ¹²⁸ Specifically, after Waste Management accepted the cooperation clause, it could no longer expect to have a choice in whether or not it disclosed information to the insurers about a claim in which the insurers had an ultimate duty to pay. ¹²⁹ Without the element of confidentiality, Waste Management failed to establish the attorney-client privilege.

Second, the court held that the insured and the insurer had a common interest, and therefore, the attorney-client privilege and work product doctrine did not protect the information from being shared with the insurer. ¹³⁰ The court recognized that courts will generally find a common interest in cases where the insurer has participated in the defense. ¹³¹ However, the court held that a common interest existed between Waste Management and insurers even though the insurers did not participate in the defense and did not have a duty to defend. ¹³² To achieve this outcome, the court concluded that a common interest existed when the insurer might be ultimately liable for payment to the insured. ¹³³ The court was further motivated by the possibility that denying discovery “would be to disregard considerations of public policy which require encouragement of full disclosure by an insured to his insurer.” ¹³⁴ Although Waste Management argued that the work product doctrine applied because the insurer was an adverse party, the court found that the information was produced for the common interest of both parties before they became adversarial. ¹³⁵

In its conclusion, the court clarified that privilege was waived only with respect to the insurance company and was not waived with respect to other third parties. ¹³⁶ This conclusion makes sense given that the court held the insured had a common interest with the insurer. By sharing information with the insurer, the insured would not waive its privilege in a traditional sense. Under this reasoning, information subject to a common

¹²⁷ Id. at 328–30.
¹²⁸ Id. at 328.
¹²⁹ Id.
¹³⁰ Id. at 329.
¹³¹ Id. at 328.
¹³² Id.
¹³³ Id. at 329.
¹³⁴ Id.
¹³⁵ Id. at 332.
¹³⁶ Id.
interest would likely be protected from a discovery request made by a third party plaintiff.\footnote{137}{However, this approach does leave the door open to consider if the attorney-client privilege exists at all because the court finds that the cooperation clause in the policy establishes an expectation that confidentiality will not be maintained. Without the confidentiality element established, it is possible that a third party plaintiff would argue that the attorney-client privilege does not protect the information in the first place.}

Adopting the minority position, the court in \textit{Waste Management} held that when an insurer is reimbursing defense costs and has reserved its right to later deny coverage, a common interest still exists between the insured and the insurer.\footnote{138}{See cases cited supra note 111.} Because a common interest exists in this situation, sharing information between an insured and an insurer does not waive any associated privilege and the information is still protected from other non-privileged and adversarial parties.

\textbf{B. The Majority Approach Holds that a Common Interest Never Exists Between an Insured and Insurer that is Not Directly Defending the Claim}

A number of other courts have taken the opportunity to review the \textit{Waste Management} decision and most have declined to follow it.\footnote{139}{Rockwell Int’l Corp. v. Superior Court, 32 Cal. Rptr. 2d 153, 156 (Cal. Ct. App. 1994).} The majority of courts that oppose the \textit{Waste Management} decision adamantly rejected the conclusion that a cooperation clause waives confidentiality and also rejected the conclusion that a common interest inherently exists between insurers and insureds.\footnote{140}{Bituminous Cas. Corp. v. Tonka Corp., 140 F.R.D. 381, 386 (D. Minn. 1992).} One federal court went so far as to describe the reasoning in \textit{Waste Management} as “fundamentally unsound.”\footnote{141}{Rockwell Int’l Corp., 32 Cal. Rptr. 2d at 156.}

The majority approach of finding no common interest is most clearly established in the context of an insurer attempting to use the common interest as sword by demanding information from an insured during coverage litigation.\footnote{142}{Imperial Corp. of Am. v. Shields, 167 F.R.D. 447, 456 (S.D. Cal. 1995).} However, one court did have the opportunity to apply the majority approach in the context of a third party plaintiff demanding information that the insured shared with its D&O insurer.\footnote{143}{Rockwell Int’l Corp., 32 Cal. Rptr. 2d at 156.}

1. The Majority Approach: When a General Liability Insurer Demands Privileged Information from the Insured

\textit{Rockwell International Corp. v. Superior Court} is the leading case that rejects the \textit{Waste Management} approach in the context of an insured
versus insurer dispute.\footnote{144} Rockwell International Corporation (Rockwell) was named as a defendant in a number of environmental liability lawsuits.\footnote{145} The company reported the claim to its various general liability insurers and requested defense according to the provisions of the policies outlining the insurers’ duty to defend.\footnote{146} A number of insurers denied the claim outright, while a number of other insurers agreed to defend under a reservation of rights.\footnote{147} Rockwell later sued its insurers for declaratory relief and breach of contract.\footnote{148} During discovery, Rockwell withheld certain documents from the insurers and claimed protection under the attorney-client privilege and work product doctrine.\footnote{149}

The insurers urged the court to follow \textit{Waste Management}, which would require Rockwell to provide the documentation.\footnote{150} However, the California Court of Appeals rejected \textit{Waste Management} and held that (1) a cooperation clause does not act as a waiver of confidentiality and (2) a common interest does not exist between an insured and an insurer that has issued a reservation of rights.\footnote{151}

In holding that a cooperation clause does not waive an expectation of confidentiality, which is an element required to establish privilege, the court conducted a three-part analysis.\footnote{152} First, the court looked at the plain language of the cooperation clause and held that there was no basis to infer that the insured expected to waive the confidentiality of its attorney’s advice to satisfy the conditions of the policy.\footnote{153} The plain language merely addressed the insurer’s right to attend hearings and trials and made no reference to providing privileged or confidential information.\footnote{154}

Second, the court concluded that the intent of the cooperation clause was to prevent the insured and a potential plaintiff from colluding against the insurer, not to compel the production of privileged information.\footnote{155} The insurers even conceded that they did not consider obtaining, nor did they intend to obtain, privileged information when they drafted the policy provision.\footnote{156}

\begin{footnotes}
144. \textit{Rockwell Int’l Corp.}, 32 Cal. Rptr. 2d at 156.
145. \textit{Id.} at 155.
146. \textit{Id.}
147. \textit{Id.}
148. \textit{Id.}
149. \textit{Id.} at 156.
150. \textit{Id.}
151. \textit{Id.} at 160.
152. \textit{Id.} at 156–58.
154. \textit{Id.}
155. See \textit{id.} at 158.
156. \textit{Id.}
\end{footnotes}
Third, the court held that the *Waste Management* approach was in conflict with California legislation that prevented the insurer from obtaining privileged information for use in a coverage dispute. Addressing the situation where an insurer with the duty to defend had issued a reservation of rights letter, Section 2860 of the California Civil Code provides the following:

> it shall be the duty of that counsel and the insured to disclose to the insurer all information concerning the action except privileged materials relevant to coverage disputes. . . . Any claim of privilege asserted is subject to in camera review in the . . . superior court. Any information disclosed by the insured or by independent counsel is not a waiver of the privilege as to any other party.  

The court determined that the legislature intended to protect the attorney-client privilege for the insured to have an attorney relationship “free from the fear of disclosure of privileged communications.” The court believed that the policy of transparent communication between attorneys and clients trumps the policy of transparent communication between insureds and insurers.

With respect to its second holding, the court concluded that a common interest did not exist between Rockwell and its insurers because the common interest doctrine requires that two parties retain or consult the same counsel regarding a common interest. However, this reasoning is flawed because the common interest doctrine and joint-defense doctrine are distinct exceptions and must be considered separately. Unlike the court in *Waste Management*, which focused on the common interest between the insurer and the insured, the California Court of Appeals focused on whether the insured and the insurer retained the same counsel. Therefore, the California Court of Appeals side-stepped the issue of common interest. It only addressed the exclusion applicable to joint-defense, which was not applicable under the circumstances because the insurer and the insured were not co-parties in the litigation.

Applying the majority position, the *Rockwell* court held that when an insurer is reimbursing defense costs and has reserved its right to later deny coverage, a common interest does not exist between the insured and

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157. *Id.*
158. *Id.* (citing CAL. CIV. CODE § 2860(d) (italics in original)).
159. *Id.* at 158.
160. *Id.* at 160.
161. See *supra* Part III.B (explaining that the joint-defense doctrine applies when parties share the same counsel, while the common interest doctrine applies when parties share a "common interest" in a matter but retain different counsel).
162. *Rockwell Int’l Corp.*, 32 Cal. Rptr. 2d at 160.
the insurer. Although the Rockwell court concluded that a common interest does not exist, it focused its analysis on whether the insured should be forced to share information with its insurer. The court failed to consider the implications of its decision as relating to a situation in which the interests of the insurer and the insured are aligned. Under the Rockwell approach, anytime an insured voluntarily shares privileged information with an insurer that has issued a reservation of rights, a common interest does not exist and the privilege is waived with respect to all other parties.

2. The Majority Approach Applied to Privileged Information that an Insured Shares with its D&O Insurer

The Southern District of California had the opportunity to apply the Rockwell majority approach to a third party discovery request within the specific context of D&O insurance. Yet, because the Rockwell approach failed to address the common interest of the parties and applied its holding only to the situation of a general liability insurer-insured dispute, an inappropriate outcome resulted.

In Imperial Corp. of America v. Shields, the Southern District of California was asked to determine the exact question of whether privileged information shared with a D&O insurer was discoverable by a third party plaintiff. The court firmly rejected the insured’s argument that the insurer had a common interest with the insured because both parties opposed the plaintiffs. The court held that the communications were not protected by privilege. In reaching its conclusion, the court conceded that there was no federal case directly controlling this issue with respect to D&O insurance. In addition, the court expressly rejected the holding of Waste Management on the grounds that it was not binding and had been rejected by a majority of courts. Instead, the court relied on federal cases that support the majority approach and concluded there was no common interest when the insured and the insurer are in a coverage dispute.

163. Id.
164. Id.
166. Id.
167. Id. at 451.
168. Id.
169. Id.
170. Id. at 452.
The counsel, chosen by the defendant directors and officers, provided letters to the defendant’s D&O insurer pursuant to the cooperation clause of the policy.\textsuperscript{172} The letters contained detailed explanations of counsel’s investigation, analysis of the risk exposure, and descriptions of a settlement demand.\textsuperscript{173} During the time the letters were being forwarded, counsel also entered into an agreement with the D&O insurer that specifically provided that the “purpose of the agreement [was] to share confidential information to facilitate defense of the claims in the underlying action.”\textsuperscript{174}

Even though the insured and the insurer agreed to share confidential information only for the benefit of their mutual interest, the court held that the attorney-client privilege was waived because the insurer did not select the counsel, did not directly pay the counsel, did not seek legal advice, and did not obtain the same counsel.\textsuperscript{175} The court placed much of its emphasis on the fact that counsel and insured were aware that their interests did not fully align with the insurer’s interest because the insurer had issued a reservation of rights letter.\textsuperscript{176}

Although the court did not specifically mention the common interest doctrine with respect to the attorney-client privilege, it did expressly review the doctrine with respect to the work product privilege.\textsuperscript{177} Incorrectly referring to the common interest doctrine as the “joint defense privilege,” the court distinguished between normal business communications and common defense strategies.\textsuperscript{178} It found that the letters were normal business communications because the letters were the method that the insured and the attorneys used to comply with the provisions of the policy, specifically the cooperation clause.\textsuperscript{179}

The court expressed concern that if the common interest rule did apply to communications between an insurer with no defense obligations and an insured, then it would also apply to any other entity with which the insured was in a contractual relationship.\textsuperscript{180} Because the insurer and the insured did not have a common interest and the insurer was a potential adversary of the insured, the court held that the work product doc-

\textsuperscript{172} Id. at 450.
\textsuperscript{173} Id.
\textsuperscript{174} Id.
\textsuperscript{175} Id. at 452–53.
\textsuperscript{176} Id. at 455–56.
\textsuperscript{177} Id. at 455.
\textsuperscript{178} Id. at 455–56.
\textsuperscript{179} Id. at 455.
\textsuperscript{180} Id. at 456.
trine did not protect the communications between the insured’s counsel and the insurer.181

The result in Imperial is inappropriate because it rejects the policies behind both the majority and minority approaches to the common interest doctrine. Although the majority approach attempts to protect the insured from being forced to share information, the insured in Imperial was forced to share information with a third party plaintiff. In addition, the insured in Imperial was discouraged from providing information to the insurer, which directly conflicts with the policy of transparent communication between insureds and insurers.

However, the minority approach is also not appropriate because it forces the insured to share information with its insurer even when their interests are not aligned. To achieve a more practical result, a third approach is necessary. This approach should recognize a limited common interest in which the insured and the insurer have a common interest with respect to the underlying litigation, but not with respect to coverage dispute issues.

V. A LIMITED COMMON INTEREST EXISTS BETWEEN AN INSURED AND AN INSURER THAT IS NOT DIRECTLY DEFENDING THE CLAIM

Courts should find that a limited common interest exists between a D&O insurer and insured because finding that no common interest exists fails to recognize that the insurer’s and the insured’s interests in the outcome of the litigation are aligned. The Eastern District of California found a limited common interest between an insured and a general liability insurer that was paying for Cumis counsel because it had the duty to defend, but had issued a reservation of rights letter.182 This Part first describes the decision of the Eastern District of California and then explains why a limited common interest should also apply to a situation involving a D&O insurer that has the duty to reimburse defense costs.

A. A Limited Common Interest Exists Between an Insured and an Insurer Paying for Cumis Counsel

In Lectrolarm Custom Systems, Inc. v. Pelco Sales, Inc., the Eastern District of California examined whether a third party plaintiff was entitled to information protected by privilege that was shared with the defendant’s general liability insurer.183 The court found that the privilege was

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181. Id.
183. Id at 568.
not waived when the insured voluntarily provided information to its insurer that was paying for Cumis counsel.

In Lectrolarm, Pelco, the insured, was being sued by the plaintiff, Lectrolarm, for unfair competition and trademark infringement.\textsuperscript{184} Pelco's insurer issued a reservation of rights letter, but was paying for Cumis counsel because it had a duty to defend under the insurance policy.\textsuperscript{185} Lectrolarm submitted a broad discovery request to Pelco and Pelco's liability insurer.\textsuperscript{186} The discovery request demanded that all documentation be exchanged between the two parties.\textsuperscript{187}

The court held that Pelco could not be compelled to disclose the privileged information to Lectrolarm because the discovery request was too broad.\textsuperscript{188} Specifically, the court stated that the discovery request was unreasonable and "propounded for the improper purpose of harassment."\textsuperscript{189} The court also found that even if the discovery request had been reasonable, Pelco had not waived any privilege by sharing information with its insurer because Pelco and the insurer had a common interest.\textsuperscript{190}

In holding that the insured and insurer had a common interest, the court analyzed whether a "common legal enterprise" existed when the insurer was paying for Cumis counsel rather than defending the litigation directly.\textsuperscript{191} The court recognized that an inherent tension existed between the insured's interest and the insurer's interest because the insurer had reserved its right to later deny coverage.\textsuperscript{192} As such, the insured and insurer would not have a common interest if they began to litigate against one another to determine coverage.\textsuperscript{193} However, the court found that the insured and the insurer did share a common legal enterprise with respect to communications relating to the claims and defenses in the underlying lawsuit.\textsuperscript{194}

\textsuperscript{184} Id.
\textsuperscript{185} Id. at 570. The opinion did not expressly state that Pelco's insurer had the duty to defend. However, the opinion does state that Pelco is entitled to Cumis counsel, which only applies when the insurer has the duty to defend. See San Diego Navy Fed. Credit Union v. Cumis Ins. Soc'y, Inc., 208 Cal. Rptr. 494, 498 (Cal. Ct. App. 1984).
\textsuperscript{186} Lectrolarm Custom Sys., Inc., 212 F.R.D. at 568-69.
\textsuperscript{187} Id.
\textsuperscript{188} Id. at 570.
\textsuperscript{189} Id.
\textsuperscript{190} Id. at 572.
\textsuperscript{191} Id.
\textsuperscript{192} Id. at 571.
\textsuperscript{193} Id. at 572.
\textsuperscript{194} Id.
The court in Lectrolarm placed significant weight on Section 2860 of the California Civil Code.\textsuperscript{195} Section 2860 states that "[a]ny information disclosed [to the insurer] \ldots by independent counsel is not a waiver of the privilege as to any other party."\textsuperscript{196} However, Section 2860 was not controlling because federal law, rather than state law, applied.\textsuperscript{197} Nevertheless, the court applied Section 2860 because the insured relied on it when deciding to share information with its insurer.\textsuperscript{198}

Although the court in Lectrolarm denied the discovery request because it was too broad, the court still decided to address the issue of whether a common interest existed because it was confident that such an issue would arise again.\textsuperscript{199} Unlike the courts in Rockwell or Imperial, this court concluded that a limited common interest did exist.\textsuperscript{200} Although the Lectrolarm decision was based upon the context of a general liability insurer that did have the duty to defend, it is also applicable to a D&O insurer that does not have the duty to defend.

\textit{B. A Limited Common Interest Should Also Exist Between an Insured and a D&O Insurer}

Although the insurer had the duty to defend in Lectrolarm, the court's reasoning should also extend to circumstances when an insurer, such as a D&O insurer, has the duty to reimburse defense costs rather than the duty to defend. The insured in Lectrolarm appointed a Cumis counsel because the insurer had issued a reservation of rights letter.\textsuperscript{201} Therefore, similar to D&O insurance, the insured in Lectrolam, not the insurer, had control of the defense. There are few, if any, differences between the relationship and interest that an insurer has with Cumis counsel and the relationship the insurer has with counsel appointed by the insured under a D&O policy.

The limited common interest rule illustrated by the court in Lectrolarm should also be applied to the context of an insured sharing information with its D&O insurer because the limited common interest (1) correctly rejects the application of the cooperation clause taken by the court in Waste Management; (2) recognizes the distinction between the joint-defense doctrine and the common interest doctrine; and (3) draws a

\textsuperscript{195} Id. at 571.
\textsuperscript{196} CAL. CIV. CODE § 2860(d).
\textsuperscript{197} Lectrolarm Custom Sys., Inc., 212 F.R.D. at 570.
\textsuperscript{198} Id. at 570–71.
\textsuperscript{199} Id. at 571.
\textsuperscript{200} Id. at 572.
\textsuperscript{201} Id. at 570.
distinction between interests in which the insured and the insurer are aligned and those interests in which the parties are adversaries.

First, even though the court in *Lectrolarm* did not expressly reject *Waste Management*, the court did recognize that the insured expected its communications with its insurer to remain confidential with respect to third parties. 202 The court was not willing to hold that cooperating with the insurer waived an expectation of confidentiality because to do so would put the insured in the position of choosing between sharing confidential information with the insurer and obtaining reimbursement for defense. 203 Either of these choices would be detrimental to the insured's legal defense. The court was also in line with the majority of other jurisdictions that have failed to adopt the court's approach in *Waste Management* waiving confidentiality under the cooperation clause.

Second, a number of jurisdictions that have rejected the court's finding in *Waste Management* of a per se common interest between the insurer and the insured have done so by incorrectly interpreting the common interest doctrine. 204 In these cases, the courts have considered only whether the same counsel represents the insurer and insured, rather than whether the insurer and the insured have an actual common interest. By adopting a common interest doctrine that applies only when parties share the same counsel, the attorney-client privilege would not be protected in many situations when the parties have a common interest. 205 For example, under a shareholder derivative action, many directors or officers might want to retain independent counsel to avoid any conflicting defense. However, if the common interest doctrine is limited only to parties sharing counsel, the counsel representing the different defendant directors would not be able to transparently communicate. Not permitting the common interest doctrine to apply when parties have separate counsel, but do have a common interest, would greatly impede the efficiency of the legal process and possibly impact the outcome of the litigation, despite the underlying merits of the case. Therefore, the court in *Lectrolarm* appropriately analyzed the interest of the parties rather than the procedural structure of their defense.

Third, instead of making a bright line determination that an insurer is an adversary of an insured or that an insurer is completely aligned with an insured, the court in *Lectrolarm* determined the interest based upon

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202. *Id.* at 570-71.
203. *Id.* at 571.
205. See Fischer, *supra* note 97, at 657.
the underlying situation. In *Imperial*, the court relied on prior case law, holding that a common interest only applies when there is no dispute about coverage. However, under this reasoning, a D&O insurer and an insured would never have a common interest in the litigation until after settlement or final adjudication by the court because the status of coverage often turns on the adjudicated issues. In *Lectrolarm*, the court correctly concluded that the insured and insurer have a common interest in the underlying litigation, but might not have a common interest in other matters.

This holding also makes sense under a pragmatic approach for two reasons. First, most relationships are not the same under every situation. It is quite possible for parties to be co-litigants in one action and be opposing parties in a subsequent action involving similar subject matter. For instance, a third party might be suing a corporation and one of its agents for breach of contract while the corporation is suing its agent for negligence, each involving the same set of facts but different legal theories. If a bright line approach was adopted, an absurd result would occur. Either the corporation and the agent could not share privileged information about the contractual liability claim or the corporation and the agent would be forced to share privileged information regarding the negligence claim. However, under the *Lectrolarm* approach, the corporation and agent can freely communicate with respect to the contractual claim, but their distinct legal strategies and communications pertaining to the negligence claim remain protected. The middle ground approach promotes efficient litigation when the insured’s and the insurer’s interests are aligned, and it simultaneously protects their adversarial position when their interests are opposed.

VI. CONCLUSION

Insureds are familiar with general liability insurance because they utilize it in a variety of situations. Most insureds are not as familiar with D&O insurance because it is tailored to apply to limited instances of corporate malpractice. Furthermore, many insureds wrongly assume that D&O insurance and general liability insurance work in the same way. However, a D&O insurance policy is much more complex than the tradi-

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207. *Imperial Corp. of Am. v. Shields*, 167 F.R.D. 447, 452 (S.D. Cal. 1995) (quoting Vermont Gas Sys. v. U.S. Fid. & Guar. Co., 151 F.R.D. 268, 277 (D. Vt. 1993) ("The 'common interest' doctrine does not apply where there is an adversarial relationship between the insured and insurer as to whether coverage exists.") and NL Indus., Inc. v. Commercial Union Ins. Co., 144 F.R.D. 225, 231 (D.N.J. 1992) ("The common interest doctrine is applicable only when it has been determined that the . . . insurer is obligated to defend the underlying action brought against the insured.").

tional general liability insurance policy. As such, severe consequences occur when the unique aspects of D&O insurance policies are not fully considered or understood.

An insured might believe that it can share privileged information with its D&O insurer without waiving the privilege because it can usually do so with its general liability insurer. However, an insured that does share privileged information with its D&O insurer jeopardizes the protection offered under the attorney-client privilege and the work product doctrine. Although privileged information shared with a general liability insurer is usually protected under the joint-defense or common interest doctrine, most jurisdictions will likely hold that information shared with a D&O insurer is not.

D&O insurers and their insureds are not protected under the joint-defense doctrine because they do not share the same counsel. The majority of jurisdictions will also hold that D&O insurers and insureds are not protected under the common interest doctrine because the insurers do not have the duty to defend and have issued a reservation of rights letter. With no duty to defend, the insurer does not have a legal interest in the outcome of the litigation. The majority of jurisdictions currently hold that only a legal interest creates a common interest; a mere financial interest, no matter how significant, is not enough. In addition, because the insurer has issued a reservation of rights letter, the two parties might be adversaries in future coverage litigation.

It is inappropriate for the majority to hold that a common interest does not exist between an insured and insurer when the insurer does not have a duty to defend and has issued a reservation of rights letter. Instead, a limited common interest does exist between the two parties. A common interest applies only to information about the litigation in which the insurer is advancing defense costs and does not apply to coverage disputes.

A limited common interest would encourage the insured to continue to openly communicate with its D&O insurer. Open communication is important because it prevents possible fraud and prevents possible future litigation by fostering a cooperative relationship between a D&O insurer and its insureds. Although the D&O insurer’s interest is financial and not legal, it is directly related to the outcome of the litigation. However, a limited common interest also recognizes that the insured and D&O in-

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209. An insured can share information with its general liability insurer without jeopardizing privilege, so long as the insurer has accepted coverage for the claim. A general liability insurer accepts coverage for claims more than it issues reservation of rights letters. It is also unlikely that an insured would voluntarily share privileged information with an insurer that has expressly denied coverage (doing so would waive any associated privilege).
surer might be future adversaries. Therefore, if the insured chooses not to share information with its D&O insurer, it will not be forced to do so in future litigation.