wiley

NEWSLETTER

Independent Counsel's Settlement Report Inadmissible in Subsequent Litigation Under Different Policy

May 2014

Applying California law, a federal court in California has held that an insurer that issued two primary policies to a policyholder may not use a confidential settlement memorandum prepared by independent counsel retained under one policy in subsequent coverage litigation related to the other policy. *Fidelity Nat'l Financial, Inc. v. Nat'l Union Fire Ins. Co.,* 2014 WL 1393743 (S.D. Cal. Apr. 9, 2014).

An insurer issued two primary policies to a financial institution: an E&O policy with a duty to defend and a financial institution bond (FIB) policy that applied to first-party loss but provided no duty to defend. When the institution faced multiple lawsuits arising out of an alleged Ponzi scheme, the insurer accepted its tender of the claims for a defense under the E&O policy subject to a reservation of rights, and it reserved its right to contest coverage under the FIB policy. Because it reserved its rights under the E&O policy, the insurer retained independent counsel to defend the matter. The institution asked the insurer to erect a "firewall" between the E&O and FIB claims departments, but the insurer declined to do so, promising only to make its "best efforts" in that regard.

During the pendency of the underlying lawsuits and at the behest of the insurer, the independent counsel provided his assessment of the settlement value of the case in a detailed memorandum to the E&O claims department. The insurer eventually contributed to a settlement under the E&O policy but refused to indemnify the insured under the FIB policy. The institution sued the insurer, and it questioned some of the insurer's executives about the E&O file in the course of discovery. However, in doing so, it did not use the independent counsel's memorandum. Nonetheless, the insurer provided the memorandum to its expert witness and otherwise relied on it as a basis for denying coverage under the FIB policy.

The court concluded that there was no enforceable firewall agreement, but nonetheless held that the insurer could not use the confidential memorandum prepared for the E&O file in the subsequent FIB dispute. The court determined that the insured's disclosure of the memorandum was not a waiver of the attorney-client privilege because California law expressly required the policyholder to cooperate with its insurer by providing all information relevant to the defense of the action. Because an evaluation of whether to settle was directly relevant to the defense of the action and was unrelated to the coverage issues, the court concluded that its

disclosure in connection with the E&O claim was compelled by law and did not waive the policyholder's rights. The court also rejected the insurer's argument that, because the California statute provides that the disclosure of defense information to the insurer "is not a waiver of the privilege as to any other party," and because the insurer was the same corporate entity under both policies, it could rely on confidential information gleaned under one policy to deny coverage under the other policy. The court held that, for all practical purposes, the FIB department should be treated as a different entity from the E&O department so as not to disadvantage policyholders with multiple policies issued by the same insurer.